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TAXATION

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Another comptroller, another legislative session, another set of new rules, and another round of litigation. To differing extents, each of these impacted Texas tax law during the Survey period. The cumulative effect was significant in many respects. Comptroller Glenn Hegar's team, including both long-standing comptroller staff and new appointees, brought a welcome willingness to work cooperatively with taxpayers (though several contentious court cases reflect the (unsurprising) ongoing role of litigation in interpreting tax statutes). Indeed, many of the franchise tax and sales tax cases decided during the Survey period focused specifically on statutory interpretation. Legislative changes

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continued the trend of not only reacting to judicial interpretations, but also trying to find balance on multiple fronts: between raising tax revenue and encouraging business growth, between taxing authorities' needs and taxpayers' rights, and between aggressively pushing ahead on state-level tax and administrative reforms and giving the new comptroller time to find his footing.¹

I. SALES TAX

A. REPORTED CASES

Statutory construction cases again dominated the sales tax world during the Survey period, as courts focused not only on the precise meaning of statutory language but also on the appropriate weight of disputed comptroller interpretations. Taxpayers saw several significant victories as courts appropriately chose statutory language over conflicting or inconsistent comptroller policies or interpretations.

In *Allstate Insurance Company v. Hegar*, the Austin Court of Appeals addressed the meaning of “temporary employment service” in Tax Code § 151.057.² In connection with certain weather events requiring the services of additional claims adjusters, Allstate Insurance Company employed Pilot Catastrophe Services, Inc. Operating under an umbrella agreement, Pilot provided claims adjusters to Allstate on an as-needed, temporary basis and billed Allstate on a per-claims-handled and per-adjuster-day basis.³

In seeking a refund of taxes paid with respect to Pilot's bills for its services, Allstate argued the services are nontaxable under Tax Code § 151.057, which provides that services falling within the following parameters are not subject to sales tax:

[A] service performed by an employee of a temporary employment service as defined by Section 93.001, Labor Code, for an employer to supplement the employer's existing work force on a temporary basis, when the service is normally performed by the employer's own employees, the employer provides all supplies and equipment necessary, and the help is under the direct or general supervision of the employer to whom the help is furnished.⁴

The trial court concluded that Allstate had failed to meet any of the requirements of § 151.057(2) and was therefore not entitled to a refund.⁵ The court of appeals partially agreed with the trial court's conclusion,

1. This Survey period covers selected developments from February 2014 to February 2016 and—instead of describing every case, rule, and legislative change during the period—comments on the ones most likely to change significantly the legal landscape or reflect an important trend.

2. *Allstate Ins. Co. v. Hegar*, 484 S.W.3d 611, 614 (Tex. App.—Austin 2016, pet. filed); see TEX. TAX CODE ANN. § 151.057 (West 2015).

3. *Allstate*, 484 S.W.3d at 619.

4. TEX. TAX CODE ANN. § 151.057(2).

5. *Allstate*, 484 S.W.3d at 615.

though on much narrower grounds.⁶ The court of appeals focused on what it viewed as the “economic realities” of the transaction between Allstate and Pilot.⁷ Relying in part on the long-standing rule of statutory construction that an ambiguous taxing statute must be interpreted strictly against the taxing authority, the court of appeals concluded that the umbrella agreement, which required Pilot to guarantee a minimum number of adjusters, was not “fatal to Allstate’s claims.”⁸ The court of appeals noted that the sales tax is a “tax on the *transaction*,” and therefore the relevant analysis should focus on “each sale of a taxable item,” and not—as the comptroller urged—on the broader business relationship.⁹ Focusing on Allstate’s discrete purchases of services, rather than on the theoretical potential effect of the continuing business relationship between Allstate and Pilot, the court of appeals therefore held that Pilot was supplementing Allstate’s existing work force on a temporary basis.¹⁰ This holding should make it much easier for taxpayers who have similar “umbrella” arrangements with service providers to prevail on this issue.

With respect to the requirement under § 151.057 that the “employer provide[] all supplies and equipment necessary,” however, the court of appeals concluded that Allstate’s interpretation was erroneous.¹¹ Allstate argued that “necessary” under this subsection should be interpreted in the “absolute-impossibility sense,” thereby distinguishing supplies and equipment that are essential to the performance of a service from those that are merely a convenience.¹² Under Allstate’s interpretation, equipment such as cell phones and laptops, which Allstate generally did not provide to Pilot claims adjusters, was merely a convenience for claims adjusters.¹³ The court of appeals, however, concluded that the contracts between Allstate and Pilot required the adjusting services to be provided through cell phones, laptops, and other technological equipment, thereby

6. *Id.* at 634–35.

7. *Id.* at 617.

8. *Id.* at 629; *see also* Combs v. Roark Amusement & Vending, L.P., 422 S.W.3d 632, 637 & n.14 (Tex. 2013) (“We believe that in the area of tax law, like other areas of economic regulation, a plain-meaning determination should not disregard the economic realities underlying the transactions in issue.”); Cynthia M. Ohlenforst et al., *Taxation*, 1 SMU ANN. TEX. SURV. 101, 102–03 (2015) (discussing *Roark Amusement & Vending, L.P.*, 422 S.W.3d 632).

9. *Allstate*, 484 S.W.3d at 623 (emphasis added).

10. For substantially the same reasons, the court of appeals also concluded that Pilot met the definition of a “temporary employment service” under § 93.001 of the Texas Labor Code. *Id.* at 626. The court of appeals viewed the transactions with Pilot separately and declined to follow the comptroller’s urging to view Allstate and Pilot’s contractual relationship “holistically.” *Id.* In reviewing the facts, the court of appeals also concluded that the services at issue were normally performed by Allstate’s own employees who typically handle claims adjustments and that Pilot’s adjusters were under the direct or general supervision of Allstate, either singularly or jointly with Pilot. *Id.* at 628.

11. *Id.* at 618, 625.

12. *Id.* at 632–33.

13. *Id.* at 633.

making them necessary.¹⁴ Ultimately, the court of appeals found that, at least with respect to some claims adjusters, the phones, laptops, and other technological equipment were required to be used by the claims adjusters under the contract, so these adjusters' services were taxable.¹⁵

Southwest Royalties, Inc. v. Combs continued to confound and confuse during the Survey period.¹⁶ Those who have been following the tortured path of this case will remember that the trial court judge originally ruled from the bench that certain taxpayer equipment used in the extraction of oil and natural gas qualified for the manufacturing exemption, but then, after a subsequent rehearing, entered a contrary ruling.¹⁷ The Austin Court of Appeals has since had its turn to address the hotly contested issue of whether certain equipment used in oil and gas extraction qualifies under the manufacturing exemption.¹⁸

In this statutory construction case, Southwest Royalties claimed exemptions for its "casing, tubing, pumps, and related parts" used to extract oil and natural gas from the ground, asserting that the equipment met the requirements of three manufacturing exemption provisions: a general manufacturing exemption,¹⁹ a pollution control exemption,²⁰ and a public health exemption.²¹ All three exemptions require that the equipment for which the exemption is sought be used or consumed in "the actual manu-

14. *Id.* at 634. The comptroller's interpretation of "necessary" in this case is at odds with the position taken by some comptroller auditors who, in the context of the manufacturing exemption, assert that necessary means impossible to do without.

15. The court of appeals agreed with Allstate that it was entitled to a refund for services performed by certain Pilot claims adjusters who worked inside Allstate's facilities and for whom Allstate did provide all of the required equipment. *Id.* at 634–35.

16. *See Sw. Royalties, Inc. v. Combs*, No. 03-12-00511-CV, 2014 WL 4058950 (Tex. App.—Austin Aug. 13, 2014) (mem. op.), *aff'd*, *Sw. Royalties, Inc. v. Hegar*, 59 Tex. Sup. Ct. J. 1316 (Tex. June 17, 2016).

17. *See Cynthia M. Ohlenforst et al., Taxation*, 66 SMU L. REV. 1181, 1188–89 (2013).

18. *See generally Sw. Royalties*, 2014 WL 4058950, at *6.

19. This general manufacturing provision exempts:

[T]angible personal property directly used or consumed in or during the actual manufacturing, processing, or fabrication of tangible personal property for ultimate sale if the use or consumption of the property is necessary or essential to the manufacturing, processing, or fabrication operation and directly makes or causes a chemical or physical change to:

(A) the product being manufactured, processed, or fabricated for ultimate sale; or

(B) any intermediate or preliminary product that will become an ingredient or component part of the product being manufactured, processed or fabricated for ultimate sale.

TEX. TAX CODE ANN. § 151.318(a)(2) (West 2015).

20. The pollution control exemption exempts: "tangible personal property used or consumed in the actual manufacturing, processing, or fabrication of tangible personal property for ultimate sale if the use or consumption of the property is necessary and essential to a pollution control process." *Id.* § 151.318(a)(5).

21. The public health exemption exempts: "tangible personal property used or consumed in the actual manufacturing, processing, or fabrication of tangible personal property for ultimate sale if the use or consumption of the property is necessary and essential to comply with federal, state, or local laws or rules that establish requirements related to public health." *Id.* § 151.318(a)(10).

facturing, processing, or fabrication of tangible personal property.”²²

The court of appeals upheld the trial court’s judgment in favor of the comptroller, albeit on grounds different from those on which the trial court relied.²³ In addressing the statutory language, the court of appeals noted that the text was unclear whether oil and gas extraction is included in “manufacturing, processing, or fabrication.”²⁴ The court of appeals nevertheless opined that the legislature may not have intended to include extraction activities.²⁵ The court of appeals noted that in other contexts, manufacturing and extraction were treated separately, and that dictionaries often distinguished between manufacturing and extraction.²⁶ Having found the statute unclear, the court of appeals deferred to the comptroller’s interpretation, finding the equipment failed to qualify for exemption.²⁷ Briefs to the Texas Supreme Court emphasized the legal significance of this case, while at the same time comptroller and media reports called attention to the financial impact of the case.²⁸ The supreme court granted Southwest Royalties’s Petition for Review and affirmed the court of appeals decision.²⁹

In *Cirrus Exploration Company v. Combs*, the Austin Court of Appeals again focused on the meaning of a disputed statutory provision.³⁰ Tax Code § 151.328 exempts certain airplane purchases by a “certificated or licensed carrier of persons or property.”³¹ Cirrus Exploration had purchased a helicopter to hire out to the public for aerial tours, photography,

22. *Sw. Royalties*, 2014 WL 4058950, at *1–2 (quoting TEX. TAX CODE ANN. § 151.318(a)(2), (5), (10)).

23. In addressing TEX. TAX CODE § 151.318(a)(2), the trial court concluded that Southwest Royalties’ equipment did not directly make or cause a chemical or physical change to the oil and natural gas because, although the extracted petroleum separates into oil and gas as it travels through Southwest Royalties’ equipment, this change is effected by the change in pressure and temperature as the petroleum rises to the surface and not directly by the equipment bringing the petroleum to the surface. *Sw. Royalties, Inc. v. Combs*, No. D-1-GN-09-004284, 2012 WL 7748950, at *1 (353d Dist. Ct. Apr. 30, 2012). The trial court did not decide Southwest Royalties’ alternative arguments under TEX. TAX CODE §§ 151.318(a)(5) and (10). *Id.*

24. *Sw. Royalties, Inc.*, 2014 WL 4058950, at *5.

25. *Id.* at *4. Query whether this belated legislative analysis is consistent with the comptroller’s earlier interpretations and hearings recognizing the exemption applies to extraction activities and that such activities are “processing” within the meaning of § 151.318.

26. *Id.*

27. *Id.* at *5–6. The court of appeals also noted that because ambiguities in exemption statutes are generally resolved in favor of taxation, the statute’s “ambiguity alone might suffice to defeat Southwest Royalties’ claims.” *Id.* at *6.

28. See, e.g., Jim Malewitz, *Oil Driller’s Lawsuit Could Cost Texas Billions in Tax Refunds*, THE TEX. TRIB. (Jan. 30, 2016), <http://www.texastribune.org/2016/01/30/drillers-law-suit-could-cost-state-billions-tax-ref/> [<https://perma.cc/AS54-29NB>]; see generally *Sw. Royalties, Inc.*, 2014 WL 4058950. In the absence of legislative history or a fiscal note evidencing a legislative plan to interpret the exemption so narrowly, the financial repercussions of this statutory construction case should be irrelevant to the interpretation of the statutory words.

29. *Sw. Royalties, Inc. v. Hegar*, 59 Tex. Sup. Ct. J. 1316 (Tex. June 17, 2016).

30. See generally *Cirrus Expl. Co. v. Combs*, 427 S.W.3d 464 (Tex. App.—Austin 2014, pet. denied).

31. TEX. TAX CODE ANN. § 151.328(a)(1) (West 2015). For a discussion of legislation impacting aircraft transactions, see *infra* Article I. Sales Tax, Section B. Legislation.

surveys, and inspections.³² Because Cirrus limited its operations and use of the helicopter to only certain flights for hire, Federal Aviation Administration (FAA) regulations required Cirrus to have only an FAA Letter of Authorization, which authorized Cirrus to operate the helicopter under Part 91 of the FAA regulations.³³ The comptroller argued that “long-standing policy” required a determination that a Letter of Authorization by itself is insufficient to meet the requirements for exemption under § 151.328.³⁴

However, the comptroller’s own long-standing rule on this exemption, Rule 3.297, did not support the comptroller’s argument.³⁵ The rule defines “licensed and certificated carrier” as a “person authorized by the appropriate state agency within the United States to operate an aircraft . . . as a common or contract carrier transporting persons or property for hire in the regular course of business.”³⁶ The dispute focused on the meaning of “authorized.”³⁷ The comptroller argued that Cirrus must be authorized under FAA regulations in addition to Part 91 in order to qualify for exemption, while Cirrus asserted that the term requires only that it hold whatever FAA authorization is required for its specific operations.³⁸

In finding Rule 3.297 unambiguous, the court of appeals not only refused to give deference to the comptroller’s alleged “long-standing policy” but also found the comptroller’s interpretation “squarely contrary to the unambiguous language” of the rule.³⁹ The court of appeals stated that the term “[a]uthorize’ . . . merely denotes the conveyance or recognition of legal authority or permission, and it is not limited to the conveyance of legal authority or permission through the issuance of a certificate or license, or of any particular kind of certificate or license.”⁴⁰ Therefore, finding that Cirrus was authorized by the FAA to operate its helicopter as a common carrier transporting persons or property for hire in the regular course of business, the court concluded that Cirrus was entitled to an exemption on its helicopter purchase.⁴¹

In a constitutional challenge to Tax Code § 151.307, the taxpayer in *H.K. Global Trading, Ltd. v. Combs* argued that a twenty-four-hour waiting period for refunds of sales tax paid on certain purchases of items exported outside the United States violated the U.S. Constitution’s Import-

32. *Cirrus Expl.*, 427 S.W.3d at 466.

33. *Id.*

34. *Id.*

35. *See* 34 TEX. ADMIN. CODE § 3.297(a)(1) (2016).

36. *Id.*

37. *Cirrus Expl.*, 427 S.W.3d at 468–69.

38. *Id.* at 469. The court of appeals opined that the comptroller’s position appeared to be founded on the structure of the FAA regulations, under which many air carriers, including commercial airlines, would have to qualify not only under Part 91—the part under which Cirrus was authorized to conduct its limited activities—but would also have to qualify under additional parts of the regulations. *Id.* at 469–70.

39. *Id.* at 470–71.

40. *Id.* at 471.

41. *Id.*

Export Clause.⁴² H.K. Global owned several stores located in counties that bordered Mexico.⁴³ Its customer had purchased goods and paid sales tax on the purchases. Then, upon presentation of a U.S. Customs Broker Export Certificate evidencing that the goods were being exported outside the United States, H.K. Global refunded the sales tax to the customer, but it did so before the expiration of the twenty-four-hour waiting period required by Tax Code § 151.307(d)(1).⁴⁴ To support its argument that the twenty-four-hour waiting period is unconstitutional on its face, H.K. Global was required to show that the waiting period *always* operates in an unconstitutional manner.⁴⁵

The Austin Court of Appeals determined that the twenty-four-hour waiting period was not constitutional.⁴⁶ The Import-Export Clause provides, “No State shall, without the consent of Congress, lay any Imposts or Duties on Imports or Exports, except what may be absolutely necessary for executing its inspection Laws.”⁴⁷ The court of appeals distinguished tax-imposition provisions from procedural provisions and concluded that the waiting period was merely a procedural provision and did not impose a tax in violation of the Import-Export Clause:⁴⁸

The waiting period is analogous to other procedural requirements in section 151.307, such as the requirement in subsection (b) that the customer present “proof of export” to a retailer in order to obtain a refund of sales tax. H.K. Global has not cited, and we have not found, any authority in which a court invalidated a statute imposing an analogous procedural requirement based on the Import-Export Clause.⁴⁹

The court of appeals also noted that § 151.307 provides alternatives to the twenty-four-hour waiting period, such as claiming an exemption from sales tax by providing a bill of lading to the seller at the time of purchase.⁵⁰ The court of appeals concluded that H.K. Global had failed

42. *H.K. Global Trading, Ltd. v. Combs*, 429 S.W.3d 132 (Tex. App.—Austin 2014, pet. denied); see TEX. TAX CODE ANN. § 151.307(d)(1) (West 2015) (“A retailer who receives documentation . . . relating to the purchase of tangible personal property exported beyond the limits of the United States may not refund the tax paid under this chapter on that purchase before . . . the 24th hour after the hour stated as the time of export of the documentation, if the retailer is located in a county that borders the United Mexican States.”); *id.* § 151.307(e) (“A retailer who makes a refund before the time prescribed by subsection (d) or makes a refund that is undocumented or improperly documented is liable for the amount of the tax refunded with interest.”). For a discussion of a procedural issue decided in *H.K. Global Trading*, see *infra* text accompanying notes 265–70.

43. *H.K. Glob. Trading*, 429 S.W.3d at 134.

44. *Id.*

45. *Id.* at 138.

46. *Id.* at 139.

47. U.S. CONST. art. I, § 10, cl. 2.

48. *H.K. Glob. Trading*, 429 S.W.3d at 139.

49. *Id.* (internal citation omitted).

50. *Id.* at 140; see also TEX. TAX CODE ANN. § 151.307(b)(1) (West 2015) (providing that “a bill of lading issued by a licensed and certificated carrier of persons or property showing the seller as consignor, the buyer as consignee, and a delivery point outside the territorial limits of the United States” is proof of export for claiming an exemption).

to show that § 151.307 always violates the Import-Export Clause.⁵¹

B. LEGISLATION

Though the 84th Texas legislature did not see many sales tax proposals, a handful of successful bills resolved long-pending issues that have distracted—and often pained—taxpayers and the comptroller’s office alike.⁵² Most significantly, Senate Bill 1396 created new Tax Code Chapter 163 to address the sales and use tax treatment of specified aircraft purchases and lease transactions.⁵³ Chapter 163, which does not itself impose a tax, clarifies—and in some respects modifies—the application of Texas’s general sales and use tax under Chapter 151 to certain transactions involving aircraft.⁵⁴ Among other clarifications and modifications, the bill’s new tax chapter (1) incorporates Federal Aviation Regulations definitions for purposes of determining when a transfer occurs in a resale scenario;⁵⁵ (2) permits application of the resale exemption to aircraft lease transactions without subsequent liability for divergent use, so long as any divergent use does not represent more than 50% of departures in a year;⁵⁶ (3) carves out certain activities that will not give rise to taxable use or a presumption of taxable use in Texas;⁵⁷ (4) specifies that use by certain entities or persons related to a purchaser is not subject to tax if the purchaser paid tax on its purchase of the aircraft or the purchase was otherwise exempt in certain limited circumstances;⁵⁸ and (5) provides that the purchase, sale, or use of an aircraft under certain fractional ownership programs is not subject to sales or use tax.⁵⁹

House Bill 2507 addresses another area of the law that had been the subject of sometimes-conflicting comptroller interpretations by explicitly providing an exemption for digital transmission equipment purchased for use by radio stations.⁶⁰ After the legislature enacted a similar exemption for television stations in 2001,⁶¹ the comptroller stated in a 2002 policy ruling that the exemption also applied to radio stations.⁶² The comptroller, however, later revised this interpretation, resulting in a denial of a radio station’s claim for the exemption in a 2010 administrative refund

51. *H.K. Glob. Trading*, 429 S.W.3d at 140.

52. *See* Tex. S.B. 1396, 84th Leg. R.S. (2015).

53. *See id.*; TEX. TAX CODE ANN. §§ 163.001–163.009.

54. *Id.* § 163.008.

55. *Id.* § 163.002(b).

56. *Id.* § 163.002(c).

57. *Id.* § 163.004.

58. *Id.* § 163.006(b).

59. *Id.* § 163.007.

60. Tex. H.B. 2507, 84th Leg., R.S. (2015).

61. Tex. S.B. 1, 77th Leg., R.S. (Tex. 2001). For a chronological discussion of the development of this legislation, see respectively Cynthia M. Ohlenforst et al., *Taxation*, 53 SMU L. REV. 1297, 1308 (2000); Cynthia M. Ohlenforst et al., *Taxation*, 55 SMU L. REV. 1315, 1321–22 (2002); Cynthia M. Ohlenforst et al., *Taxation*, 56 SMU L. REV. 2027, 2034 (2003).

62. STAR Doc. No. 200212663L, Tex. Comptroller of Pub. Accounts (Dec. 30, 2002), <http://aixtcp.cpa.state.tx.us/opendocs/open28/200212663l.html> [https://perma.cc/CS4Q-XZR8].

hearing.⁶³ House Bill 2507 defines equipment qualifying for the exemption, and radio stations should carefully analyze their purchases to ensure that the exemption applies.⁶⁴

C. COMPTROLLER RULES

The comptroller proposed, adopted, amended, and repealed multiple rules during the Survey period.⁶⁵ Faced with an overwhelming number of rules in need of substantive revisions, the comptroller placed a high priority on making only the most critical changes, such as implementing certain legislative changes, including, in some instances, long-overdue changes relating to amendments from earlier legislative sessions.⁶⁶ Consistent with the focus of this article on key developments, this discussion includes only some of the rule changes from the Survey period.⁶⁷

Substantial debate accompanied the changes addressing nexus in Rule 3.286. According to the preamble, the rule amendments were designed to memorialize comptroller policy and to reflect changes made by legislation from the 2011 and 2013 sessions.⁶⁸ Of note, the amendment adds to the comptroller's list of activities that give rise to nexus but also identifies

63. Hearing No. 103,311, STAR Doc. No. 201009918H, Tex. Comptroller of Pub. Accounts (Sept. 28, 2010), <http://aixtcp.cpa.state.tx.us/opendocs/open32/201009918h.html> [<https://perma.cc/UA4M-93D5>].

64. Tex. H.B. 2507, 84th Leg., R.S. (2015).

65. See *infra* note 67.

66. See *id.*

67. The comptroller repealed several rules and adopted several other rules and amendments to rules not discussed in this Survey, including adopting rules and amendments related to occasional sales, newspapers, customs brokers, criminal offenses and penalties, and local sales and use taxes. See, e.g., 39 Tex. Reg. 2114, 2116 (2014) (codified as an amendment to 34 TEX. ADMIN. CODE § 3.360 (2016) (Tex. Comptroller of Pub. Accounts, Customs Brokers)); 39 Tex. Reg. 9597, 1603 (2014) (codified as an amendment to 34 TEX. ADMIN. CODE § 3.334 (Tex. Comptroller Pub. Accounts, Local Sales and Use Taxes)); 41 Tex. Reg. 260, 261 (2016) (codified as an amendment to 34 TEX. ADMIN. CODE § 3.334 (Tex. Comptroller of Pub. Accounts, Local Sales and Use Taxes)); 40 Tex. Reg. 7096, 7096 (2015) (codified as an amendment to 34 TEX. ADMIN. CODE § 3.299 (Tex. Comptroller of Pub. Accounts, Newspapers, Magazines, Publishers, Exempt Writings)); 40 Tex. Reg. 7242, 7243 (2015) (codified as an amendment to 34 TEX. ADMIN. CODE § 3.316 (Tex. Comptroller of Pub. Accounts, Occasional Sales; Transfers Without Change in Ownership; Sales by Senior Citizens' Organizations; Sales by University and College Student Organizations; Sales by Nonprofit Animal Shelters)). The comptroller also proposed sweeping (and at times overreaching) changes to rules related to aircraft, the sale for resale exemption, and the repair, remodeling, maintenance, and restoration of tangible personal property, which proposed rules were eventually withdrawn. See 39 Tex. Reg. 8503, 8506 (2014) (to be codified at 34 TEX. ADMIN. CODE § 3.280 (withdrawn Apr. 28, 2015) (Tex. Comptroller of Pub. Accounts)); 39 Tex. Reg. 8513, 8517 (2014) (to be codified at 34 TEX. ADMIN. CODE § 3.285 (withdrawn Apr. 28, 2015) (Tex. Comptroller of Pub. Accounts)); 39 Tex. Reg. 8520, 8522 (2014) (to be codified as an amendment to 34 TEX. ADMIN. CODE § 3.292 (withdrawn Apr. 28, 2015) (Tex. Comptroller of Pub. Accounts)); 39 Tex. Reg. 8526, 8527 (2014) (to be codified at 34 TEX. ADMIN. CODE § 3.297 (withdrawn Apr. 28, 2015) (Tex. Comptroller of Pub. Accounts)).

68. 40 Tex. Reg. 3183 (2015) (codified as an amendment to 34 TEX. ADMIN. CODE § 3.286 (Tex. Comptroller of Pub. Accounts, Seller's and Purchaser's Responsibilities, including Nexus, Permits, Returns and Reporting Periods, and Collection and Exemption Rules)).

certain activities falling within a safe harbor.⁶⁹ For instance, the amendment adds the following to the rule's list of activities supporting a determination that a seller is engaged in business in Texas: (1) being formed, organized, or incorporated under, and having internal affairs governed by, Texas law, which according to the rule's preamble, "memorialize[s] current comptroller policy"; and (2) holding a substantial ownership interest in certain entities that maintain a location in Texas.⁷⁰ The rule amendment also expressly implements the safe harbor addressed in *Rylander v. Bandag Licensing Corporation*⁷¹ for a person who has no connection with Texas except the possession of a certificate of authority to do business in Texas and discusses the safe harbor created by Tax Code § 151.108 for a person whose only activity in Texas is as a user of Internet hosting.⁷² The rule amendment also removed the controversial trailing nexus provision, which required an out-of-state seller to continue to collect use tax for twelve months after it had ceased to be engaged in business in Texas.⁷³

The comptroller adopted new Rule 3.340 to implement House Bill 800, which added new Tax Code § 151.3182 and created a sales and use tax exemption and franchise tax credit related to certain research and development activities.⁷⁴ New Rule 3.340 sets out procedures for registering for and claiming the qualified research exemption and specifies—as does Tax Code § 151.3182⁷⁵—that a taxpayer that claims the sales tax exemption may not also claim the franchise tax credit.⁷⁶ Rule 3.340 also provides procedures that enable the comptroller to cancel a taxpayer's registration and eligibility for the sales tax exemption if the taxpayer fails to comply with the exemption's requirements.⁷⁷

The comptroller also adopted new Rule 3.335 to implement Tax Code § 151.359, which provides an exemption from state (but not local) sales tax for certain tangible personal property purchases made in connection

69. *See id.*

70. *See id.*; 34 TEX. ADMIN. CODE § 3.286(a)(3)(H), (I) (Tex. Comptroller of Pub. Accounts, Seller's and Purchaser's Responsibilities, including Nexus, Permits, Returns and Reporting Periods, and Collection and Exemption Rules).

71. 18 S.W.3d 296, 301 (Tex. App.—Austin 2000, pet. denied).

72. *See* 34 TEX. ADMIN. CODE § 3.286(a); *see also* TEX. TAX CODE ANN. § 151.108(b) (West 2015).

73. *See* 40 Tex. Reg. 3183 (2015) (codified as an amendment to 34 TEX. ADMIN. CODE § 3.286 (Tex. Comptroller of Pub. Accounts, Seller's and Purchaser's Responsibilities, including Nexus, Permits, Returns and Reporting Periods, and Collection and Exemption Rules)).

74. *See* 40 Tex. Reg. 8663 (2015) (codified at 34 TEX. ADMIN. CODE § 3.340 (Tex. Comptroller of Pub. Accounts, Qualified Research)); *see also* Ohlenforst et al., *supra* note 8, at 101, 107–08 (discussing House Bill 800 passed by the 83rd Texas legislature).

75. TEX. TAX CODE ANN. § 151.3182 (West 2015).

76. *See* 34 TEX. ADMIN. CODE § 3.340(b)(2) (Tex. Comptroller of Pub. Accounts, Qualified Research); *see also infra* Article II. Franchise Tax (discussing franchise tax credit).

77. *See* 34 TEX. ADMIN. CODE § 3.340(c)(5) (Tex. Comptroller of Pub. Accounts, Qualified Research).

with building or refurbishing data centers located in Texas.⁷⁸ Like several other comptroller rules, in addition to implementing the statute and providing procedures for its administration, Rule 3.335 also appears to include some substantive provisions not found in the statutory language.⁷⁹ For instance, consistent with the comptroller's position regarding other exemptions for electricity, Rule 3.335 requires some data centers to perform a predominant use study to determine taxable and nontaxable uses of electricity for which an exemption is sought.⁸⁰

Furthermore, Rule 3.335 states that in order for an expenditure to be counted toward the capital investment requirement, the expenditure must be invoiced to the qualifying owner, operator, or occupant, and that purchases by entities related to these qualifying entities do not count toward the capital investment requirement.⁸¹ Rule 3.335 also requires applicants to agree to toll the statute of limitations for assessments until the comptroller is able to verify that the applicant has met the capital investment and job creation requirements and states that the comptroller will audit data centers five years after qualifying for the exemption to verify compliance with the requirements.⁸²

Another rule adopted by the comptroller that relates to state—but not local—sales tax is Rule 3.345, which relates to a limited refund for certain property used in cable television, Internet access, and telecommunications services.⁸³ Like Rule 3.335 above, Rule 3.345 also expands on the statutory language in an apparent attempt to limit the activities that qualify for the refund.⁸⁴ For instance, the statute's language describing the “distribution of cable television services” is modified in the rule to add that the services must be distributed “by the sending or relaying of video programming for the fulfillment of cable television services[] to subscribing or paying customers.”⁸⁵

78. See 39 Tex. Reg. 1157 (2014) (codified at 34 TEX. ADMIN. CODE § 3.335 (Tex. Comptroller of Pub. Accounts, Property Used in a Qualifying Data Center; Temporary State Sales Tax Exemption)); see also TEX. TAX CODE ANN. § 151.359; Ohlenforst et al., *supra* note 8, at 101, 107 (discussing TEX. TAX CODE ANN. § 151.359).

79. See, e.g., 34 TEX. ADMIN. CODE § 3.335(b)(1)(A) (Tex. Comptroller of Pub. Accounts, Property Used in a Qualifying Data Center; Temporary State Sales Tax Exemption).

80. *Id.*; see also *id.* § 3.295(e), (f) (requiring a predominant use study for the manufacturing exemption and other nontaxable use).

81. *Id.* § 3.335(d)(2)(B).

82. *Id.* § 3.335(e)(1)(C).

83. 39 Tex. Reg. 6863 (2014) (codified at 34 TEX. ADMIN. CODE § 3.345 (2016) (Tex. Comptroller of Pub. Accounts, Annual Refund Program for Providers of Cable Television, Internet Access, or Telecommunications Services)); see also TEX. TAX CODE ANN. § 151.3186 (West 2015); Ohlenforst et al., *supra* note 8, at 101, 108 (discussing TEX. TAX CODE ANN. § 151.3186); *id.* at 108–09 (discussing the amendments made to Rule 3.313 related to cable television service and bundled cable service).

84. See 34 TEX. ADMIN. CODE § 3.345(a)(7)(B) (Tex. Comptroller of Pub. Accounts, Annual Refund Program for Providers of Cable Television, Internet Access, or Telecommunications Services) (expanding on the statutory descriptions of “the distribution of cable television services,” “the provision of Internet access services,” and “the transmission, conveyance, routing, or reception of telecommunications services”).

85. *Id.* § 3.345(a)(7)(B)(i).

Also, in part because the refund is limited to an aggregate \$50 million (prorated among eligible providers if this limit is exceeded), Rule 3.345 sets out onerous request requirements.⁸⁶ Pursuant to the rule, requests are required to include detailed information regarding the transactions for which a refund is sought, and if a taxpayer does not provide information requested by the comptroller within thirty days of the request, the amount of refund requested may be reduced accordingly.⁸⁷ Furthermore, Rule 3.335 states that interest will not be paid on refunds, which could amount to significant dollars if, for instance, a refund request is disputed and significant time is spent resolving the dispute through administrative and legal channels.⁸⁸ The rule also highlights the importance of making a timely refund request: under the rule, late-filed requests in a year when the aggregate requests exceed the \$50 million limit “will be denied for lack of funds.”⁸⁹

The comptroller adopted amendments to Rule 3.338, which relate to multistate tax credits.⁹⁰ The amendments clarify the order in which multistate tax credits may be applied against state and local taxes and repeal subsections that had provided special rules for certain taxpayers, including contractors and motor vehicle and aircraft repair persons.⁹¹ The amendments also clarify that the credit is not allowed against the Texas Emissions Reduction Plan Surcharge.⁹²

II. FRANCHISE TAX

A. REPORTED CASES

Although it has been almost ten years since enactment of the revised Texas franchise tax, taxpayers and the comptroller still frequently face issues of first impression.⁹³ Resolving these issues often depends on construing statutory language and interpreting concepts that can differ markedly from those underlying other states’ taxing statutes.⁹⁴ Some of the controversial provisions, including some relating to exclusions from gross receipts, are new to Texas and have triggered multiple contests.⁹⁵ Other statutory concepts, including ones relating to apportionment factors, are

86. *See id.* § 3.345(e)(1).

87. *Id.* § 3.345(d)(4)(C)(iv); *see generally id.* § 3.345(d).

88. *Id.* § 3.345(d)(5); *see also id.* § 3.345(e)(4), (5) (providing that final refund payments will not be issued until all refund hearings and judicial proceedings are final).

89. *Id.* § 3.345(f)(2).

90. *See* 39 Tex. Reg. 5427 (2014) (codified at 34 TEX. ADMIN. CODE § 3.338 (Tex. Comptroller of Pub. Accounts, Multistate Tax Credits and Allowance of Credit for Tax Paid to Suppliers)).

91. *See id.*

92. *See* 34 TEX. ADMIN. CODE § 3.338(e) (Tex. Comptroller of Pub. Accounts, Multistate Tax Credits and Allowance of Credit for Tax Paid to Suppliers).

93. *See* Josh Haney & Bruce Wright, *The History of the Texas Franchise Tax*, FISCAL NOTES (Tex. Comptroller of Pub. Accounts), May 2016, at 4–6, <http://comptroller.texas.gov/fiscalnotes/may2015/fn.pdf> [<https://perma.cc/AMX5-2C32>].

94. *See id.* at 5.

95. *See, e.g.,* Titan Transp. LP v. Combs, 433 S.W.3d 625, 627 (Tex. App.—Austin 2014, pet. denied).

carryovers from the “old” franchise tax, but give rise to new questions in a new context.⁹⁶

In *Titan Transportation, LP v. Combs*, the Austin Court of Appeals addressed whether a company that transports aggregate to construction sites was entitled to exclude from its gross receipts payments that it was contractually obligated to make to its subcontractors.⁹⁷ Titan was in the business of transporting and depositing aggregate to construction sites where it was used to make concrete or as a foundation for various real property improvements. At the direction of a general contractor or site foreman, Titan’s subcontractors would deposit the aggregate in specified areas—often the “final resting place” for the aggregate—saving the contractor or site manager time and labor that would otherwise be spent moving the aggregate.⁹⁸ Titan provided these services to its customers, which included quarries and construction companies, but had “written contracts only with its subcontractors.”⁹⁹

The principal issue before the court of appeals was the interpretation of Tax Code § 171.1011(g)(3), which provides an exclusion from total revenue for: “subcontracting payments handled by the taxable entity to provide services, labor, or materials in connection with the actual or proposed design, construction, remodeling, or repair of improvements on real property or the location of the boundaries of real property.”¹⁰⁰ Contrary to the plain language of § 171.1011(g)(3), the comptroller interpreted the section to require that Titan be a “‘construction company’ that provides services, labor, or materials that effect a physical change to the property,” and the comptroller argued that Titan was instead a “transportation company” that did not effect such physical change.¹⁰¹ Furthermore, the comptroller argued that Titan was required to have a tripartite contract among itself, its customers, and its subcontractors.¹⁰²

Reversing the trial court’s judgment against Titan, the court of appeals concluded that the comptroller’s interpretation imposed additional, ex-

96. See, e.g., 34 TEX. ADMIN. CODE 3.591(c) (Tex. Comptroller of Pub. Accounts, Margin: Apportionment).

97. *Titan Transp., LP v. Combs*, 433 S.W.3d 625, 627 (Tex. App.—Austin 2014, pet. denied). Titan also argued in the alternative that its subcontractor payments qualified for inclusion in its COGS deduction calculation. *Id.* at 631. The comptroller has since addressed the court decisions in *Titan* and *Combs v. Newpark Res., Inc.*, 422 S.W.3d 46 (Tex. App.—Austin 2013, no pet.) in a policy memorandum. See STAR Doc. No. 201606856L, Tex. Comptroller of Pub. Accounts (June 30, 2016), <http://aixtcp.cpa.state.tx.us/opendocs/open32/201606856l.html> [<https://perma.cc/A8S2-6JNG>]; see also Ohlenforst et al., *supra* note 8, at 101, 109–11 (discussing *Combs v. Newpark Res., Inc.*).

98. *Titan Transp.*, 433 S.W.3d at 633–34.

99. *Id.* at 633–34, 641.

100. *Id.* at 637 (quoting TEX. TAX CODE ANN. § 171.1011(g)(3) (West 2015)).

101. *Id.* at 632.

102. *Id.* at 641. In a Hail Mary-type argument that defied basic accounting, the comptroller also argued that Titan’s payments could not be “flow-through” payments because Titan did not segregate its revenue for each subcontractor payment and because, based on the accrual method of accounting, Titan would pay its subcontractors prior to actually receiving payment from its customers. See *id.* at 641–42. Unsurprisingly, the court of appeals dismissed these arguments. See *id.* at 642.

tra-statutory requirements on an unambiguous statute.¹⁰³ Dismissing the comptroller's argument that Titan must be a "construction company," the court of appeals focused on the statutory requirement that a taxable entity provide its services "in connection with" construction and deemed the language broad enough to cover Titan's activities but not so broad as to be ambiguous.¹⁰⁴ Furthermore, the court of appeals determined that the comptroller's attempt to limit this language by requiring a physical change to the real property was inconsistent with the statute, which includes reference to the proposed design and construction of real property.¹⁰⁵ The court of appeals stated that § 171.1011(g)(3) requires a nexus "established by evidence that Titan provided services that were logically and reasonably connected with the construction of improvements on real property and, indeed, were directly related to the construction of such improvements."¹⁰⁶ The court of appeals concluded that Titan's activities, which were "necessary and integral to the construction of improvements on real property" and "saved the construction companies time, labor, and money," met this requirement.¹⁰⁷

The court of appeals also concluded that the statute does not require that there be a tripartite agreement.¹⁰⁸ Addressing the statutory language "mandated by contract to be distributed to other entities" and acknowledging that the purpose of this subsection is to prevent double taxation of amounts that are not actually income to Titan, the court of appeals concluded that, although the tripartite arrangement described by the comptroller could meet the statutory requirements, "such an arrangement is not required under a plain reading of the statute."¹⁰⁹ Accordingly, Titan's payments under its subcontractor contracts met the requirements for exclusion.¹¹⁰

In *Hallmark Marketing Company, LLC v. Combs*, the Corpus Christi Court of Appeals addressed the meaning of "net gain from the sale" used to determine gross receipts from a taxpayer's entire business for purposes of apportionment under Tax Code § 171.105(b).¹¹¹ During the tax year at issue, Hallmark incurred substantial losses on sales of investments and capital assets.¹¹² Section 171.105(b) provides that "[i]f a taxable entity sells an investment or capital asset, the taxable entity's gross receipts from its entire business for taxable margin includes only the net gain from

103. *Id.* at 641.

104. *Id.* at 637–38.

105. *Id.* at 638.

106. *Id.* at 639.

107. *Id.*

108. *Id.* at 641.

109. *Id.* at 640–41.

110. *Id.* at 642.

111. *Hallmark Mktg. Co. v. Combs*, No. 13-14-00093-CV, 2014 WL 6090574, at *1 (Tex. App.—Corpus Christi Nov. 13, 2014) (mem. op.), *rev'd by* *Hallmark Mktg. Co. v. Hegar*, 488 S.W.3d 795 (Tex. 2016). A docket equalization order issued by the Texas Supreme Court transferred the appeal to the Corpus Christi Court of Appeals. *Id.* at *1 n.1.

112. *Id.* at *3.

the sale.”¹¹³ The comptroller interprets this section in Rule 3.591: “If the combination of net gains and losses results in a net loss, the taxable entity should net the loss against other receipts, but not below zero.”¹¹⁴

Arguing that § 171.105(b) is unambiguous, Hallmark asserted that it was not required to subtract these losses from other receipts because § 171.105(b) requires “only the net *gain*” be included in gross receipts, and therefore its net *loss* should not be included for apportionment purposes.¹¹⁵ The comptroller disagreed, arguing that Hallmark was required to subtract the net loss from gross receipts because (1) Hallmark was required to report those amounts as income, and therefore the amounts must also be reported in everywhere receipts for apportionment purposes; (2) a 1974 appellate court case interpreted similar statutory language to require that gains and losses be offset to calculate a net figure; and (3) § 171.105(b) is ambiguous, and the comptroller’s interpretation in Rule 3.591 was a reasonable interpretation of § 171.105(b).¹¹⁶

Focusing on the comptroller’s third argument, the court of appeals agreed that § 171.105(b) is ambiguous and that the comptroller’s interpretation in Rule 3.591 is reasonable.¹¹⁷ The court of appeals noted that net gain is subject to two interpretations: (1) it “may refer to the particular gain or loss that results from each individual sale when proceeds are offset by costs”; or (2) it “may instead refer to the taxpayer’s cumulative gain or loss on its various investment and capital asset sales made throughout the year.”¹¹⁸ Relying on *Calvert v. Electro-Science Investors, Inc.*,¹¹⁹ which construed a former Tax Code section similar to § 171.105(b) to require that gains and losses be offset in order to arrive at a net figure, the court of appeals concluded that Rule 3.591 is reasonable and therefore entitled to deference by the court.¹²⁰ The court of appeals therefore upheld the trial court’s judgment in favor of the comptroller’s apportionment calculation.¹²¹ The Texas Supreme Court, however, granted Hallmark’s Petition for Review and reversed the court of appeals’ decision.¹²²

In *American Multi-Cinema, Inc. v. Hegar*, the Austin Court of Appeals addressed whether a movie theater qualifies for the cost of goods sold deduction under the franchise tax (COGS).¹²³ The court of appeals addressed (1) whether American Multi-Cinema’s (AMC) movies were

113. TEX. TAX CODE ANN. § 171.105(b) (West 2015).

114. 34 TEX. ADMIN. CODE § 3.591(e)(2) (2016) (Tex. Comptroller of Pub. Accounts, Margin: Apportionment).

115. *Hallmark Mktg.*, 2014 WL 6090574, at *3.

116. *Id.*

117. *Id.* at *4.

118. *Id.*

119. 509 S.W.2d 700 (Tex. Civ. App.—Austin 1974, no writ.).

120. *Hallmark Mktg.*, 2014 WL 6090574, at *4–5.

121. *Id.* at *5.

122. *Hallmark Mktg. Co. v. Hegar*, 488 S.W.3d 795, 796 (Tex. 2016).

123. *Am. Multi-Cinema, Inc. v. Hegar*, No. 03-14-00397-CV, 2015 WL 1967877, at *1 (Tex. App.—Austin Apr. 30, 2015, no pet.).

“goods” for Texas franchise tax purposes; and (2) assuming AMC qualified for the COGS deduction, which parts of AMC’s auditoriums qualified for deduction.¹²⁴

The comptroller argued that AMC was selling a service or an intangible right to watch a movie and was therefore not entitled to the COGS deduction.¹²⁵ Focusing on the franchise tax definition of “tangible personal property,” however, the court of appeals determined that AMC’s movies are “personal property that can be seen, weighed, measured, felt, or touched or that is perceptible to the senses in any other manner.”¹²⁶ The court of appeals was not persuaded by the comptroller’s argument that AMC’s films were not tangible personal property because AMC’s customers did not take home a copy of the films after viewing them; the court of appeals reasoned that the definition of tangible personal property in § 171.1012 “does not have a take-home requirement.”¹²⁷

With respect to the second issue, AMC argued that most of the square footage in its theater auditoriums qualified for the COGS deduction; however, the trial court accepted the comptroller’s assertion that only the square footage housing speakers and screens qualified.¹²⁸ On appeal, the court of appeals reversed the trial court’s determination and refused to give deference to the comptroller’s interpretations or calculations.¹²⁹ The court of appeals concluded that the term “production,” which is defined to include “creation” and “improvement,” was not ambiguous, and therefore the comptroller was not entitled to deference.¹³⁰ AMC argued that its evidence established that “the sight, sound, and lighting in the auditorium space” were integral to the production of its film product.¹³¹ Applying the plain meaning of “production,” the court of appeals reversed the trial court’s findings and rendered judgment based on AMC’s uncontroverted evidence, holding that costs associated with auditorium space are direct costs of producing AMC’s product.¹³²

After the court of appeals issued its decision, the comptroller issued a warning that the court’s ruling, if upheld on appeal, would result in mas-

124. *Id.* at *4, 7; *see also* Ohlenforst et al., *supra* note 8, at 101, 111 (discussing the trial court’s decision).

125. *Am. Multi-Cinema*, 2015 WL 1967877 at *4; *see also* TEX. TAX CODE ANN. § 171.1012(a)(3)(B) (West 2015) (excluding “intangible property” and “services” from the definition of “tangible personal property”).

126. *Am. Multi-Cinema*, 2015 WL 1967877, at *5–6; *see also* TEX. TAX CODE ANN. § 171.1012(a)(3)(A) (defining “tangible personal property”); *id.* § 171.1012(a)(1) (including “tangible personal property” in definition of “goods”). The court of appeals also noted that the comptroller’s interpretation conflicted with another part of the definition of “tangible personal property,” which includes “films . . . without regard to the means or methods of distribution or the medium in which the property is embodied.” *Am. Multi-Cinema*, 2015 WL 1967877, at *6; TEX. TAX CODE ANN. § 171.1012(a)(3)(A)(ii).

127. *Am. Multi-Cinema*, 2015 WL 1967877, at *5; *see also* TEX. TAX CODE ANN. § 171.1012(t) (enacted in 2013 and permitting movie theaters to subtract COGS).

128. *Am. Multi-Cinema*, 2015 WL 1967877, at *7.

129. *Id.* at *9.

130. *Id.* at *7–8.

131. *Id.* at *8.

132. *Id.* at *9.

sive budget shortfalls.¹³³ In particular, the comptroller asserted that the *American Multi-Cinema* decision could affect revenues to the tune of about \$1.5 billion.¹³⁴ Putting aside the issue of whether it is appropriate to try to use financial results to influence statutory interpretation, the comptroller's dire forecast is surprising on several fronts. Most surprising, perhaps, is the comptroller's explicit acknowledgement that the holding in *American Multi-Cinema* would reach taxpayers and industries far beyond those at issue in the case—particularly given the movie and broadcast-specific statutory language on which the comptroller might have relied in trying to limit the scope of the court's ruling.¹³⁵

The debate over the nature and impact of the revised franchise tax raged on in a Survey period marked by tension between states' desires to expand tax bases—if not tax rates—and some taxpayers' desires for uniformity and predictability in taxation. While states such as California have openly rejected the Multistate Tax Compact in favor of unfettered independence for their various tax regimes,¹³⁶ in Texas, taxpayers and the comptroller—with the help of the courts—have waded ever deeper into analyses of what the 79th Texas legislature wrought in enacting the revised franchise tax.¹³⁷

In *Graphic Packaging Corp. v. Hegar*, the Austin Court of Appeals considered a taxpayer's argument that the Texas franchise tax is an "income tax," as defined in Texas Tax Code Chapter 141¹³⁸ and that the taxpayer should therefore be allowed to choose the Multistate Tax Compact (MTC) three-factor formula for franchise tax apportionment purposes.¹³⁹

Following a trial court decision rejecting Graphic Packaging's claim that it was entitled to use the MTC formula, Graphic Packaging appealed, relying on three primary arguments: (1) Tax Code § 171.106(a), requiring a single-factor formula, did not impliedly repeal Chapter 141's MTC provisions; (2) if the provisions were repealed, such repeal was invalid because the MTC is a binding interstate agreement; and (3) the franchise tax is an income tax as defined by the MTC and therefore subject to the

133. See Glenn Hegar, *A Message from the Comptroller*, FISCAL NOTES (Tex. Comptroller of Pub. Accounts), June–July 2015, at 2, <http://comptroller.texas.gov/fiscalnotes/june-july2015/fn.pdf> [<https://perma.cc/A3V9-3XV4>].

134. See Josh Haney, *Franchise Tax Lawsuit Could Cost Texas \$1.5 Billion a Year*, FISCAL NOTES (Tex. Comptroller of Pub. Accounts), June–July 2015, at 3, <http://comptroller.texas.gov/fiscalnotes/june-july2015/amc-decision.php> [<https://perma.cc/6AZH-K4SN>].

135. See *id.*

136. See *Gillete Co. v. Franchise Tax Bd.*, 363 P.3d 94, 96 (Cal. 2015).

137. See, e.g., *Graphic Packaging Corp. v. Hegar*, 471 S.W.3d 138, 138 (Tex. App.—Austin July 28, 2015, pet. filed).

138. *Id.* The Multi-State Tax Compact (MTC) is codified in Chapter 141 of the Texas Tax Code. See TEX. TAX CODE ANN. § 141.001 (West 2015). It allows taxpayers subject to an income tax (in which income is subject to apportionment and allocation for tax purposes) to choose whether to apportion and allocate income according to the manner provided by state law or the manner provided by the MTC. See *id.* The Texas franchise tax provides for a single-factor test, whereas the MTC provides for a three-factor test. See TEX. TAX CODE ANN. §§ 141.001, 171.106(a).

139. *Graphic Packaging Corp.*, 471 S.W.3d at 139.

MTC election and formula.¹⁴⁰

Finding the third issue dispositive, the court of appeals concluded that Graphic Packaging may not use the MTC's three-factor formula for Texas franchise tax apportionment.¹⁴¹ The MTC defines income tax as "a tax imposed on or measured by net income including any tax imposed on or measured by an amount arrived at by deducting expenses from gross income, one or more forms of which expenses are not specifically and directly related to particular transactions."¹⁴² Using this definition, the court of appeals evaluated the Texas franchise tax and found that it is not "measured by net income."¹⁴³ In coming to this conclusion, the court of appeals declined to conclude that the franchise tax's alternative or limited computations—including the E-Z computation, the \$1 million deduction, the 70% of total revenue calculation, and COGS and compensation deductions—were a measure of net income.¹⁴⁴ The court of appeals also declined to find that the exclusion of bad debts from total revenue meant that total revenue was synonymous with net income.¹⁴⁵ In holding that the Texas franchise tax is not an income tax within the definition of the MTC, the court of appeals affirmed the lower court's conclusion requiring Graphic Packaging to use the single-factor formula under Tax Code Chapter 171 to apportion its margin for franchise tax purposes.¹⁴⁶ The taxpayer filed a Petition for Review with the Texas Supreme Court.¹⁴⁷

In *Rent-A-Center v. Hegar*, the Austin Court of Appeals determined whether a rent-to-own business qualifies for the 0.5% franchise tax rate applicable to retailers.¹⁴⁸ Rent-A-Center, which makes the majority of its revenue from providing merchandise to customers via "rental-purchase" agreements, argued that it was primarily engaged in retail trade for franchise tax purposes.¹⁴⁹ The comptroller, focusing on Rent-A-Center's SEC filings and agreements with customers, argued that Rent-A-Center's revenue was derived primarily from leases, not sales.¹⁵⁰ The trial court ruled in favor of the comptroller and "held Rent-A-Center was not entitled to a refund."¹⁵¹

140. *Id.* at 141.

141. *Id.* at 142, 147.

142. *Id.* at 143 (quoting TEX. TAX CODE ANN. § 141.001, art. II.4).

143. *Id.* at 147.

144. *Id.* at 144.

145. *Id.* at 143–47.

146. *Id.* at 147. Query whether the franchise tax, while not—according to the court—an income tax under the MTC, may be a gross receipts tax for other purposes. *See generally* TEX. TAX CODE ANN. § 171.106.

147. *Graphic Packaging Corp.*, 471 S.W.3d 138 (petition for review filed by December 14, 2015).

148. *Rent-A-Center v. Hegar*, 468 S.W.3d 220, 220 (Tex. App.—Austin June 11, 2015, no pet.). Effective for tax years after the years at issue in this case, the Tax Code was amended to provide that "retail trade" specifically includes certain "rental-purchase agreement activities." *Id.* at 221; *see also* TEX. TAX CODE ANN. § 171.0001(12)(D); Ohlenforst et al., *supra* note 8, at 101, 111–12 (discussing the trial court's decision).

149. *Rent-A-Center*, 468 S.W.3d at 222.

150. *Id.* at 224.

151. *Id.* at 221.

In reversing the trial court, the court of appeals conceded that the rental-purchase transactions are hybrids of rentals and sales, but asked, “Are they *more* like sales or leases?”¹⁵² The court of appeals noted, among other things, that all of Rent-A-Center’s merchandise is offered for sale, 97% of its merchandise is sold in an average of twenty months per item (the remaining 3% is stolen, damaged, or lost), and the amount due under the rental-purchase agreements decreases with each payment.¹⁵³ Because it deemed Rent-A-Center’s activities more like selling than leasing, the court of appeals held that Rent-A-Center is primarily engaged in retail trade and therefore qualifies for the more favorable 0.5% rate for retailers.¹⁵⁴

In *Gulf Chemical and Metallurgical Corporation v. Hegar*, the Austin Court of Appeals addressed whether a taxpayer must amend its federal income tax return to account for an incorrectly reported exclusion from gross receipts.¹⁵⁵ Gulf Chemical performs environmental disposal and recycling services for customers and offers customers a monetary credit for precious metals recovered during the service.¹⁵⁶ In its federal tax returns, Gulf Chemical deducted the credits as cost of goods sold instead of properly excluding them from gross receipts as allowances, affecting Gulf Chemical’s Texas apportionment calculations under Texas’s former franchise tax.¹⁵⁷

Interpreting statutes and regulations applicable to Texas’s former franchise tax, the court of appeals looked to the substance of Gulf Chemical’s transactions with its customers to determine that the credits at issue were properly treated as allowances.¹⁵⁸ The court of appeals rejected the comptroller’s arguments that Gulf Chemical was “bound by the way it characterized the metals credits on its federal tax returns” and that Gulf Chemical was attempting to retroactively change its accounting method; the court of appeals stressed that the characterization of the credits for franchise tax purposes must turn on the substance of the transactions and not on the form they took on Gulf Chemical’s federal tax returns.¹⁵⁹ The court of appeals looked to former Rule 3.557 and found that the determinative issue is whether the credits qualify as allowances; if so, then Gulf Chemical was entitled to adjust its computation of gross receipts to account for these allowances.¹⁶⁰ The term “allowance” in former Rule 3.557

152. *Id.* at 225 (emphasis in original).

153. *Id.* at 224.

154. *Id.* at 225.

155. *Gulf Chem. & Metallurgical Corp. v. Hegar*, 460 S.W.3d 743, 744 (Tex. App.—Austin 2015, no pet.); see also Ohlenforst et al., *supra* note 8, at 101, 112 (discussing the trial court’s decision).

156. *Gulf Chem. & Metallurgical Corp.*, 460 S.W.3d at 744.

157. *Id.* at 745–46.

158. *Id.* at 747–49.

159. *Id.* at 748.

160. *Id.* at 748 (providing that “sales returns and allowances that a seller allows reduce gross sales of the seller in the computation of gross receipts”); 28 Tex. Reg. 1218 (2003) (*repealed by* 38 Tex. Reg. 5109 (2013) (former 34 TEX. ADMIN CODE § 3.557(e)(31) (Comptroller of Pub. Accounts, Earned Surplus: Apportionment))).

had not been further defined by the courts, the Tax Code, or the regulations, so as a matter of first impression, the court of appeals considered its ordinary, common meaning.¹⁶¹ Further, the court of appeals considered both GAAP treatment of sales incentives and persuasive case law from the Tax Court of the United States that instructed courts to “look at the substance of a transaction rather than its form when determining whether an adjustment should be properly considered an allowance.”¹⁶² Because the credits at issue were allowances under former Rules 3.557, the trial court’s judgment was reversed, and the case was remanded to determine the amount of Gulf Chemical’s refund of franchise taxes.¹⁶³

B. LEGISLATION

In the months leading up to the 84th Texas legislative session, practitioners, taxpayers, and lawmakers alike speculated about the many possible tax bills that were likely to come out of the legislature. Following much general discussion about tax relief—and oftentimes heated arguments about what shape such relief would, could, and should take—the 84th Texas legislature did not produce many significant bills, unlike prior sessions in which credits and other tax incentives,¹⁶⁴ or wholesale revisions of the franchise tax regime,¹⁶⁵ played starring roles.

Though there continues to be much perennial noise around repealing—and perhaps replacing—the franchise tax, no serious, viable bills emerged.¹⁶⁶ Owing primarily to differing state-tax philosophies, proponents of relief tended to advocate for one or more of (1) sales tax rate reductions; (2) property tax rate or appraisal caps; and (3) franchise tax rate reductions. In the end, the tax relief package that did pass focused on a significant franchise tax rate reduction¹⁶⁷ and an increase in the amount of the property tax homestead exemption.¹⁶⁸ Several other tax bills of interest did ultimately join this tax relief package, but they tended to be

161. *Gulf Chem. & Metallurgical Corp.*, 460 S.W.3d at 749 (citing BLACK’S LAW DICTIONARY 89 (9th ed. 2009)) The court of appeals defined the term “allowance” to imply a transaction between two parties wherein the seller of goods or services allows the buyer a credit or reduction against an original stated price. *Id.* Because the uncontroverted evidence described the Gulf Chemical transactions as fitting within this definition, the court of appeals held that the credits at issue were substantively allowances. *Id.*

162. *Id.* at 749–50 (citing *Pittsburgh Milk Co. v. Comm’r*, 26 T.C. 707, 708 (1956)).

163. *Id.* at 750–51.

164. See Ohlenforst et al., *supra* note 8, at 101, 113.

165. See *id.* at 114.

166. For bills proposing immediate outright repeal of the franchise tax, see, e.g., Tex. S.B. 105, 84th Leg., R.S. (2015); Tex. S.B. 175, 84th Leg., R.S. (2015). For bills proposing to phase out the franchise tax over time, see, e.g., Tex. S.B. 138, 84th Leg., R.S. (2015); Tex. H.B. 193, 84th Leg., R.S. (2015); Tex. H.B. 250, 84th Leg., R.S. (2015) (proposing to phase out the franchise tax over time).

167. Tex. H.B. 32, 84th Leg., R.S. (2015) (reducing the general one percent rate to 0.75 percent and the 0.5% rate that applied to taxpayers primarily engaged in wholesaling and retailing to be reduced to 0.375% and expanding availability of the “EZ calculation” to businesses whose total revenue does not exceed \$20 million and reducing the rate of those businesses using the EZ computation from 0.575% to 0.331%).

168. Tex. S.B. 1, 84th Leg., R.S. (2015).

of more limited applicability. This Survey highlights those that garnered significant attention and discussion.

House Bill 32 was the most significant of the handful of amendments to the franchise tax.¹⁶⁹ This bill decreased franchise tax rates by 25%, to 0.375% for certain wholesalers and retailers and to 0.75% for other taxable entities.¹⁷⁰ The bill also extended the option to calculate tax due by using the simplified “EZ calculation” to entities with total revenue of not more than \$20 million;¹⁷¹ previously, only entities with not more than \$10 million of total revenue qualified to use this calculation.¹⁷² Entities applying the EZ computation will also enjoy a 40% rate reduction, from 0.575% to 0.331%.¹⁷³

C. COMPTROLLER RULES

During the Survey period, the comptroller adopted several new rules applicable to the franchise tax. These rules, like some of the sales tax rules adopted during the Survey period, implement prior legislation and provide guidance related to several tax incentives enacted by the Texas legislature.

The comptroller adopted new Rule 3.598 related to a tax credit for certified rehabilitation of certified historic structures. The rule implements House Bill 500, Section 14, 83rd Texas legislature, 2013, which added new Subchapter S to Chapter 171 of the Tax Code.¹⁷⁴ The rule—like Subchapter S—provides guidelines and procedures for establishing and claiming the credit, including procedures related to allocation of the credit by a pass-through entity to its partners, members, or shareholders, and procedures for selling or transferring the credit.¹⁷⁵ Among other things, Rule 3.598 also clarifies that the reporting entity of a combined group may claim the credit for each member entity.¹⁷⁶

The comptroller also adopted new Rule 3.599 related to a research and development franchise tax credit. New Rule 3.340 implements House Bill 800, 83rd Texas legislature, 2013, which added Subchapter M to Chapter

169. Also of note, House Bill 2896 clarified that broadcasters' receipts from licensing income shall be apportioned to Texas based on the domiciles of their customers. *See* Tex. H.B. 2896, 84th Leg., R.S. (2015). This construct is known generally as the “location of payor” rule of apportionment. *See id.*

170. Tex. H.B. 32, 84th Leg., R.S. (2015).

171. *Id.*

172. *Id.*, *see also* TEX. TAX CODE ANN. § 171.1016(a) (West 2015).

173. Tex. H.B. 32, 84th Leg., R.S. (2015).

174. *See* 40 Tex. Reg. 4904 (2015) (codified as 34 TEX. ADMIN. CODE § 3.598 (2016) (Tex. Comptroller of Pub. Accounts, Margin: Tax Credit for Certified Rehabilitation of Certified Historic Structure)).

175. *See generally* TEX. TAX CODE ANN. §§ 171.901–171.908; 34 TEX. ADMIN. CODE § 3.598 (Tex. Comptroller of Pub. Accounts, Margin: Tax Credit for Certified Rehabilitation of Certified Historic Structure).

176. 34 TEX. ADMIN. CODE § 3.598(f)(3) (Tex. Comptroller of Pub. Accounts, Margin: Tax Credit for Certified Rehabilitation of Certified Historic Structure).

171 of the Tax Code.¹⁷⁷ The rule specifies—as does Subchapter M—that a taxpayer that claims the research and development credit may not also claim the corresponding sales tax exemption.¹⁷⁸ In addition to the guidelines set forth by statute, Rule 3.340 also clarifies that both upper tier and lower tier entities in a tiered partnership may claim a credit, albeit not for the same qualified research expense.¹⁷⁹ Acknowledging that the rule was enacted after the effective date of the credit, Rule 3.340 also provides guidelines for amending prior franchise tax returns on which a taxpayer would otherwise have been entitled to claim a credit.¹⁸⁰

III. PROPERTY TAX

A. REPORTED CASES

Texas property tax litigation during the Survey period featured many of the perennial procedural issues familiar to taxpayers, practitioners, and loyal readers of this Survey. The Survey period also saw a handful of cases highlighting tensions between taxing jurisdictions' budgetary concerns and constraints, and taxpayers' ability to challenge the manner in which the jurisdictions impose and administer local property taxes. In part as a response to some of these cases, the legislature may in the 2017 session consider wholesale administrative reforms, possibly including constitutional amendments. Of course, much negotiation and arm wrestling will occur before it becomes clear what shape such reforms may take.

Several cases have dealt with the aftermath of amendments to statutes that provide guidelines for classifying heavy equipment. Six cases in three Texas courts of appeals have come to generally consistent conclusions regarding the questions that have arisen.¹⁸¹ The three main issues with respect to new Tax Code §§ 23.1241 and 23.1242 are: (1) whether natural

177. See 40 Tex. Reg. 1858 (2015) (codified as 34 TEX. ADMIN. CODE § 3.599 (Tex. Comptroller of Pub. Accounts, Margin: Research and Development Activities Credit)).

178. See TEX. TAX CODE ANN. § 171.653; 34 TEX. ADMIN. CODE § 3.599(d)(1) (Tex. Comptroller of Pub. Accounts, Margin: Research and Development Activities Credit). For a discussion of the corresponding sales tax exemption, see *supra* Article I. Sales Tax.

179. See 34 TEX. ADMIN. CODE § 3.599(h).

180. See *id.* § 3.599(m).

181. See *EXLP Leasing, LLC v. Ward Cty. Appraisal Dist.*, 476 S.W.3d 752 (Tex. App.—El Paso 2015, pet. filed); *EXLP Leasing, LLP v. Loving Cty. Appraisal Dist.*, 478 S.W.3d 790 (Tex. App.—El Paso 2015, pet. filed) (same holdings as *Ward* court); *Valerus Compression Servs. v. Reeves Cty. Appraisal Dist.*, 478 S.W.3d 20 (Tex. App.—El Paso 2015, pet. filed) (same holdings as *Ward* court); *Midcon Compression, L.L.C. v. Reeves Cty. Appraisal Dist.*, 478 S.W.3d 704 (Tex. App.—El Paso 2015, pet. filed) (same holdings as *Ward* court); *EXLP Leasing, LLC v. Galveston Cent. Appraisal Dist.*, 475 S.W.3d 421 (Tex. App.—El Paso 2015, pet. filed) (coming to the same conclusions as other courts; but not addressing whether compressor packages are or are not heavy equipment); *Valerus Compression Servs. v. Gregg Cty. Appraisal Dist.*, 457 S.W.3d 520 (Tex. App.—Tyler 2015, no pet.) (coming to the same conclusions as other courts with respect to taxable situs but remanding the issues of whether compression packages were heavy equipment and whether the method of calculation was “based on . . . reasonable market value” for further proceedings because there was insufficient information to determine the issues as a matter of law).

gas compressor packages qualify as heavy equipment under the new provisions; (2) whether the new provisions provide language for determining taxable situs that trumps the general situs statute; and (3) whether the provisions are unconstitutional.¹⁸² In 2011, the Texas legislature amended §§ 23.1241 and 23.1242 governing taxation of heavy equipment to change the definitions of “dealer,” “dealer’s heavy equipment inventory,” “sales price,” and “total annual sales,” as well as the formulas for calculating the market value of and tax due on heavy equipment inventory.¹⁸³

Relying on these changes, dealers of heavy equipment inventory “for lease or rent” began to calculate the market value of their inventory in a manner that was previously available only to sellers, resulting in substantially reduced tax liability for many.¹⁸⁴ Moreover, these dealers claimed their taxes were due in the county in which they kept their business address or location, and not the county where the equipment was located.¹⁸⁵ The respective appraisal districts disagreed and added a constitutional challenge for good measure.¹⁸⁶

With respect to the first issue, the courts that have addressed the issue interpreted § 23.1231(a)(6), which defines “heavy equipment” to include gas compressor packages. Compressor packages are equipment that facilitates production and processing of natural gas. When courts have been presented with evidence that compressor packages have internal combustion engines, they have held that compressor packages are self-powered and are therefore heavy equipment as a matter of law.¹⁸⁷

With respect to the second issue, courts agree that § 23.1241(f), which directs the comptroller to adopt a dealer’s heavy equipment inventory declaration form, is not a specific situs provision, and as such, the general situs provision at Tax Code § 21.02(a) applies.¹⁸⁸

Finally, with respect to the third issue, the appraisal districts have been unable to demonstrate that §§ 23.1241 and 23.1242 are unconstitutional as applied. Their first argument in support of this contention is that these sections violate the constitutional requirement that property be taxed in

182. See, e.g., *Ward Cty. Appraisal Dist.*, 476 S.W.3d at 756–58.

183. See, e.g., *id.* at 757.

184. See, e.g., *id.*

185. See, e.g., *id.* at 769.

186. See, e.g., *id.* at 758.

187. See, e.g., *id.* at 762 (basing its decision on the legislative intent and the plain language of the statute). Compare *id.*, with *Valerus Compression Servs. v. Gregg Cty. Appraisal Dist.*, 457 S.W.3d 520, 530–31 (Tex. App.—Tyler 2015, no pet.), in which the Tyler Court of Appeals remanded the case because there was no evidence presented to determine as a matter of law that compressor packages were heavy equipment: “Our review of . . . [the] evidence reveals no evidence proving that either the compressor packages or cooler units have internal combustion engines. In short, Valerus provided no evidence explaining how its equipment functions. It is impossible to know if the equipment is ‘self-powered’ in the absence of such an explanation.” *Gregg Cty. Appraisal Dist.*, 457 S.W.3d at 530–31.

188. See, e.g., *Ward Cty. Appraisal Dist.*, 476 S.W.3d at 769 (citing *Gregg Cty. Appraisal Dist.*, 457 S.W.3d at 526, and holding that reliance on the language of § 23.1241 and Property Tax Form 50-265 for situs purposes is erroneous because nothing in the statute refers to taxable situs and the cited form is “nothing more than a form”).

proportion to its market value. Courts have generally reasoned that the legislature determines the manner in which market value is measured and, to challenge the legislature's prescribed method, appraisal districts are required to prove that the legislature acted arbitrarily or capriciously.¹⁸⁹ In *Ward County Appraisal District*, the El Paso Court of Appeals noted that "it is eminently reasonable to require dealers of inventory held for lease or rent in the ordinary course of business to pay taxes only on inventory actually leased or rented"¹⁹⁰; the appraisal districts in cases that address the issue have failed to prove otherwise. The second argument relating to §§ 23.1241 and 23.1242 is that they are unconstitutional because they violate the constitutional requirement that taxation be equal and uniform. This argument has been summarily dismissed because the valuation method prescribed is applied equally and uniformly to all dealers of heavy equipment inventory.¹⁹¹ Petitions for Review were filed with the Texas Supreme Court for several of these cases.¹⁹²

In *Galveston Central Appraisal District v. Valero Refining - Texas L.P.*, the Fourteenth Houston Court of Appeals addressed an equal and uniform challenge related to Valero's refinery.¹⁹³ At trial, a "jury found that the challenged portions of the Valero refinery had been unequally appraised" and determined the equal and uniform value of the property was equivalent to Valero's experts' figure.¹⁹⁴

Among its arguments on appeal, the appraisal district asserted that Valero's experts' analysis was conclusory because it did not explain why it had excluded certain portions of the refineries from its calculations.¹⁹⁵ On the first day of trial, Valero was granted leave to amend its petition, "dropping its valuation challenge to two of the accounts: pollution control

189. See, e.g., *Ward Cty. Appraisal Dist.*, 476 S.W.3d at 762–63.

190. *Id.* at 765.

191. See, e.g., *id.* at 767 (finding "there is no disparate treatment within the class").

192. See, e.g., *id.* at 752 (petition for review filed by January 27, 2016).

193. *Galveston Cent. Appraisal Dist. v. Valero Ref. - Texas L.P.*, 463 S.W.3d 177, 180 (Tex. App.—Houston [14th Dist.] 2015, pet. filed). As a preliminary matter the court of appeals determined that the trial court had authority to review the taxpayer's appeal from the appraisal review board decision. *Id.* at 186–87. The appraisal district claimed that because taxpayers are prohibited from making piecemeal challenges to a property's value under the Tax Code, the trial court lacked subject matter jurisdiction. *Id.* at 185 (citing *Covert v. Williamson Cent. Appraisal Dist.*, 241 S.W.3d 655, 658–60 (Tex. App.—Austin 2007, pet. denied)). The court of appeals disagreed, finding *Covert* did not address jurisdiction and, in any case, Valero's third amended petition satisfied the prohibition on piecemeal challenges under *Covert* because, even though it specifically mentioned three account numbers, the petition alleged that the *entire property* was unequally appraised. *Id.* at 186. The appraisal district also claimed Valero forfeited its right to judicial review because it did not file a statement under Tax Code § 42.08(b-1) stating the amount of taxes Valero would pay before the delinquency date if it elected to pay the tax amounts not in dispute. The court of appeals correctly dismissed this argument because "Valero paid the current tax liability in full before the delinquency date" and therefore the statement requirement did not apply. *Id.* at 187 (citing TEX. TAX CODE ANN. § 42.08 (West 2015)).

194. *Id.* at 184.

195. *Id.* at 187–90.

equipment and personal property and inventory.”¹⁹⁶ In preparing their equal-and-uniform analyses of the appraised value of the refineries, Valero’s experts included the pollution control equipment in one analysis and excluded it from another. The jury ultimately decided the analysis that excluded the pollution control equipment was the correct measure, resulting in a substantial reduction in value.¹⁹⁷ The court of appeals agreed with the appraisal district’s contention, finding that there was insufficient evidence to support the jury’s verdict; the court of appeals held that “Valero’s experts were required to explain why the value of the pollution control equipment” was excluded from “their equal and uniform analysis.”¹⁹⁸ A Petition for Review was filed with the Texas Supreme Court.¹⁹⁹

In *ETC Marketing, Ltd. v. Harris County Appraisal District*, the First Houston Court of Appeals looked to the Dormant Commerce Clause of the U.S. Constitution to determine whether natural gas stored by ETC in the Bammel reservoir in Harris County for the purpose of selling the gas later at a higher price was immune from local taxation.²⁰⁰ Property is immune from local ad valorem taxation if federal law prohibits such a tax.²⁰¹ The U.S. Constitution forbids states from imposing discriminatory burdens on interstate commerce.²⁰² Relying on *Complete Auto*, the court of appeals determined that even if the property at issue were in interstate commerce, the property tax did not impose discriminatory burdens on interstate commerce and therefore the property is not exempt from ad valorem taxation under the U.S. Constitution.²⁰³

Under the *Complete Auto* test, the taxpayer has the burden to prove that the tax “(1) applies to an activity lacking a substantial nexus to the taxing State; (2) is not fairly apportioned; (3) discriminates against interstate commerce; or (4) is not fairly related to the services provided by the State.”²⁰⁴ ETC Marketing argued the activity (storing natural gas) did not have a substantial nexus despite its physical presence in the state, that the tax is not fairly apportioned because it is impossible to determine which gas is located under Harris County, and that it does not enjoy the benefit of county public services because it owns the stored gas, not the reservoir

196. *Id.* at 191.

197. *Id.*

198. *Id.* at 192–93. The court of appeals rejected Valero’s arguments that the pollution control equipment was properly excluded because each refinery’s equipment is different and the equipment is ultimately exempt from taxation; as such, the experts’ equal and uniform analysis should have focused on the appraised value, and not the final taxable value which would not include exempt property. *Id.*

199. *Id.* at 177 (petition for review filed by July 21, 2015).

200. *ETC Mktg., Ltd. v. Harris Cty. Appraisal Dist.*, 476 S.W.3d 501, 503–04 (Tex. App.—Houston [1st Dist.] 2015, pet. filed). The court of appeals concluded as a preliminary matter that whether or not the gas was in interstate commerce did not matter because even if it were in interstate commerce it could be subject to local taxation. *Id.* at 505.

201. TEX. TAX CODE ANN. § 11.12 (West 2015).

202. *ETC Mktg., Ltd.*, 476 S.W.3d at 507–08 (citing U.S. CONST. art. I, § 8, cl. 3).

203. *Id.* at 523 (citing *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977)).

204. *Id.* at 508 (citing *Barclays Bank PLC v. Franchise Tax Bd. of Cal.*, 512 U.S. 298, 310–11 (1994)).

in which it is stored.²⁰⁵ The court of appeals rejected these arguments, concluding the physical presence of the natural gas in the county was sufficient to establish substantial nexus, and it was uncontested that ETC Marketing owns the natural gas.²⁰⁶ The court of appeals also found the storage of the natural gas was supported by public services provided to the reservoir.²⁰⁷ Having found the property tax acceptable under the *Complete Auto* test, the court of appeals determined that even if the gas were in interstate commerce, the tax imposed was appropriate.²⁰⁸ A Petition for Review was filed with the Texas Supreme Court.²⁰⁹

In *Texas Student Housing Authority v. Brazos County Appraisal District*, the Texas Supreme Court considered as a matter of first impression “whether a dormitory-like facility owned by a ‘higher education facility authority’ forfeits its property tax exemption by providing summer housing to non-college students attending university-sponsored instructional programs.”²¹⁰ The supreme court decided that the statute contained no conditions and therefore, the exemption provision does not contain limitations on how the housing authority may use the property at issue.²¹¹

The housing authority owned property exempt from property taxes under the Higher Education Authority Act. The property, located near Texas A&M University, was used during the summer for various extracurricular camps and activities that the appraisal district alleged violated a requirement that the property be “devoted exclusively to the use and benefit of the students, faculty, and staff members of an accredited institution of higher education.”²¹² The court of appeals reversed the denial of tax-exempt status for 2005 but affirmed for 2006–2008 by distinguishing among the types of extracurricular activities for which the dormitories were being used, and both parties appealed.²¹³ The supreme court looked to the plain language of the statute and rejected the appraisal district’s view that the housing authority forfeited its tax exemption with respect to the dormitories.²¹⁴

Section 53.46 of the Texas Education Code titled “Authority Exempt From Taxation,” reads: “Because the property owned by authority will be held for educational purposes only and will be devoted exclusively to the

205. *Id.* at 508–23.

206. *Id.* at 511–12.

207. *Id.* at 509, 521–22.

208. *Id.* at 523.

209. *Id.* at 501 (petition for review filed by October 14, 2015).

210. *Tex. Student Hous. Auth. v. Brazos Cty. Appraisal Dist.*, 460 S.W.3d 137, 138 (Tex. 2015); *see also* Ohlenforst et al., *supra* note 8, at 101, 115 (discussing the court of appeals’s decision that preceded this decision).

211. *Brazos Cty. Appraisal Dist.*, 460 S.W.3d at 138. Noting that other provisions may limit the housing authority’s use of the property, the supreme court clarified that its decision was not meant as a *carte blanche* for the housing authority to use the property in any manner. *Id.* (noting that the housing authority “may be subject to . . . limitations affecting its” ability to use the property, but “the exemption statute is not one of them”).

212. *Id.* at 138–40 (citing TEX. EDUC. CODE ANN. § 53.46 (West 2015)).

213. *Id.* at 140.

214. *Id.* at 144.

use and benefit of the students, faculty, and staff members of an accredited institution of higher education, it is exempt from taxation of every character.”²¹⁵ The supreme court noted that the language of the provision “states a presumption” about how the property is used followed by “an unconditional proclamation (the property is tax-exempt).”²¹⁶ The supreme court cited the unambiguous language as well as an example of a tax exemption containing conditional language before holding that “the statute imposes no conditions but rather declares the property-tax exemption in absolute terms.”²¹⁷ The supreme court also noted that “[t]he Legislature is adept at qualifying tax exemptions, and if it wishes to disqualify properties that facilitate university-backed extracurricular programs, it can amend the statute.”²¹⁸

In *Signal International Texas L.P. v. Orange County, Texas*, the Beaumont Court of Appeals determined that a party to an agreement under Tax Code § 1.111(e) may not attack that agreement under contract law theories when the underlying basis for such an attack is a ground of protest for which there are exclusive remedies provided under the Tax Code.²¹⁹ Signal and the appraisal district entered into a written settlement agreement that related, in part, to a barge; the settlement agreement constituted a § 1.111(e) agreement in which Signal explicitly waived its right to take any other actions under the Property Tax Code. Signal later discovered that the barge was in Mexico for the entirety of the tax year at issue.²²⁰

Signal contended that there was “mutual mistake” with respect to the settlement agreement, and as such, Signal raised a claim in equity to rescind the agreement.²²¹ The trial court ruled against Signal, and Signal appealed, arguing that the trial court erred in both dismissing for lack of subject matter jurisdiction as well as determining that “Signal was required to exhaust administrative remedies under the Tax Code.”²²²

In ruling against Signal, the court of appeals distinguished *In re Willacy County Appraisal District* and *Dallas Central Appraisal District v. 1420*

215. *Id.* at 142 (quoting TEX. EDUC. CODE ANN. § 53.46).

216. *Id.*

217. *Id.* at 144.

218. *Id.*

219. *Signal Int’l Tex. L.P. v. Orange Cty., Tex.*, No. 09-13-00412-CV, 2014 WL 7183667, at *3–4 (Tex. App.— Beaumont, Dec. 18, 2014, pet. denied) (mem. op.). Signal’s equitable claim for rescission of the § 1.111(e) agreement was based on mutual mistake with respect to the taxable situs of its property. The court of appeals determined that because the Tax Code provides a remedy for corrections to the appraisal roll when the taxable situs of the property was not in the district in which the tax was assessed, the relief sought is not rescission based on mutual mistake, but rather is a ground of protest covered by the Tax Code’s exclusive remedies. *Id.* at *5. The court of appeals left open the possibility that an agreement may be rescinded when there is fraud or a different claim for equitable rescission. *Id.*

220. *Id.* at *1.

221. *Id.* at *1–2.

222. *Id.* at *2, *5. Chapters 41 and 42 of the Tax Code “establish[] a detailed set of procedures” for a taxpayer to protest certain actions of the appraisal district, including “inclusion of the owner’s property on the appraisal records”; moreover, these administrative procedures are generally mandatory. *Id.* at *2–3.

Viceroy Limited Partnership on which Signal relied to establish its position that contract law can and should be applied to reform or rescind a § 1.111(e) agreement under the circumstances at issue.²²³ In *Willacy*, the Corpus Christi Court of Appeals determined that the trial court abused its discretion by denying discovery that would allow the appellant to develop the affirmative defense of fraud with respect to a § 1.111(e) agreement; however, in *Signal International*, the court of appeals stressed that it was not deciding on the merits of, nor did it find any authority that would allow an affirmative defense of fraud with respect to a § 1.111(e) agreement under the Tax Code.²²⁴ Similarly, the court of appeals distinguished *1420 Viceroy* because it did not involve a § 1.111(e) agreement and because the basis of the complaint was not a ground of protest contained in the Property Tax Code; here, “Signal’s equitable suit,” based on an alleged mutual mistake with respect to the taxable situs of property, “is an attempt to protest . . . [t]he situs of property . . . an issue on which a property owner must first exhaust its administrative remedies before asserting the issue in a lawsuit.”²²⁵ Moreover, the court of appeals noted that Signal waived its right to exercise these remedies in the settlement agreement.²²⁶ Accordingly, the court of appeals concluded that Signal’s failure to exhaust administrative remedies under the Tax Code deprived the trial court of subject matter jurisdiction.²²⁷

In *Town & Country Suites, L.L.C. v. Harris County Appraisal District*, the First Houston Court of Appeals addressed whether a 2013 amendment to the Tax Code allowing “judicial review of tax appraisals when a protest and appeal have been filed” by an incorrect party applies when the property owner is misidentified as opposed to merely misnamed.²²⁸ The property at issue was correctly identified, but the protest was filed by Gowan, Sheenan & Patterson—the former owners of the property. Town & Country filed an amended petition naming itself as the property owner, but the appraisal district requested—and the trial court granted—a plea to the jurisdiction “because the property owner was not the party that

223. See *In re Willacy Cty. Appraisal Dist.*, No. 13-13-00550-CV, 2013 WL 5942707, at *1 (Tex. App. Nov. 1, 2013, no pet.); *Dall. Cent. Appraisal Dist. v. 1420 Viceroy Ltd. P’ship*, 180 S.W.3d 267, 268 (Tex. App.—Dallas 2005, no pet.).

224. *Signal*, 2014 WL 7183667, at *4–5 (citing *Willacy*, 2013 WL 5942707, at *10).

225. *Id.* at *5 (citing TEX. TAX CODE ANN. §§ 41.42, 42.09 (West 2015); *Gen. Elec. Credit. Corp. v. Midland Cent. Appraisal Dist.*, 826 S.W.2d 124, 124–25 (Tex. 1991)).

226. *Id.* The court of appeals noted that because there were remedies to which Signal was entitled and Signal chose to reach an agreement instead, Signal was not deprived of due process of law. *Id.*

227. *Id.*

228. *Town & Country Suites, L.L.C. v. Harris Cty. Appraisal Dist.*, 461 S.W.3d 208, 210, 214 (Tex. App.—Houston [1st Dist.] 2015, pet. denied). The Tax Code section at issue was § 42.21(h) which reads in relevant part:

The court has jurisdiction over an appeal under this chapter brought on behalf of a property owner . . . regardless of whether the petition correctly identifies the plaintiff as the owner Whether the plaintiff is the proper party to bring the petition . . . must be addressed by means of a special exception . . . and may not be the subject of a plea to the jurisdiction.

TEX. TAX CODE ANN. § 42.21(h).

pursued the appeal within the statutory deadline.”²²⁹ Town & Country appealed.

Town & Country argued that a 2013 amendment adding subsection (h) to Tax Code § 42.21 allowed judicial review of a property tax appeal even when the owner has been misidentified; the appraisal district argued that the amendment only applies to cases of misnomer, in which the actual property owner has appealed but is listed under the wrong name.²³⁰ Relying on the plain language of the statute, the court of appeals agreed with Town & Country that the misidentification of the property owner did not deprive the trial court of jurisdiction.²³¹ The appraisal district further argued that § 42.21(h) was unconstitutional because “it would lead to advisory opinions . . . because misidentified property owners do not have standing to challenge tax valuations.”²³² The court of appeals, however, rejected this argument in part because § 42.21(h) is a vehicle for bringing the proper party before the court; it does not allow parties without standing to obtain a final judgment in a suit that “does not affect the true parties in interest.”²³³ The court of appeals concluded that “the newly enacted subsection 42.21(h) grants a trial court subject matter jurisdiction over a suit appealing a Board decision as long as the suit meets the filing requirements contained in section 42.21(h), even if the petition misidentifies the property owner and must be corrected through amendment.”²³⁴

In *EXLP Leasing LLC v. Webb County Appraisal District*, the San Antonio Court of Appeals addressed whether the jurisdictional requirement of § 42.08(b) requires a taxpayer protesting the entire amount of its tax assessment to pay any portion of the taxes assessed to sustain its right to an appeal.²³⁵

Tax Code § 42.08(b) requires a property owner to pay a certain portion of the assessed taxes before the property tax delinquency date in order to sustain an appeal.²³⁶ Among several other options for satisfying its requirements, § 42.08(b)’s requirements may be met if an owner pays “the

229. *Town & Country*, 461 S.W.3d 208 at 211.

230. *Id.* at 214.

231. *Id.* at 216 (holding, “based on the text of . . . § 42.21(h), other relevant Tax Code amendments, and the implications of the various asserted interpretations when reading these provisions as a whole, § 42.21(h) is not limited to cases of misnomer and can be relied on by property owners in cases of misidentification”).

232. *Id.* at 217.

233. *Id.*

234. *Id.* at 218.

235. *EXLP Leasing LLC v. Webb Cty. Appraisal Dist.*, No. 04-14-00343-CV, 2015 WL 3505107, at *1 (Tex. App.—San Antonio, June 3, 2015, pet. denied). At trial, the taxpayer asserted a similar argument addressed in the “heavy equipment dealer” cases discussed in this article, specifically that the 2011 amendments to Tax Code § 23.1241(a) allowed them to pay taxes to the county in which they maintained their business address (here, Victoria County); as such, the taxpayer here asserted that it owed no taxes on the property at issue in Webb County and, therefore, the entire amount of the tax assessed by Webb County was at issue. *See supra* notes 181–92 (discussing the changes to “heavy equipment dealer inventory”).

236. *EXLP Leasing LLC*, 2015 WL 3505107, at *2 (citing TEX. TAX CODE ANN. § 42.08(b) (West 2015)).

amount of taxes due on the portion of the taxable value of the property that is *not in dispute*.”²³⁷ EXLP argued that it was required to pay nothing because it disputed the entire tax assessment; the appraisal district disagreed and claimed that “courts have repeatedly held that if the property owner does not pay any portion of the assessed taxes by the delinquency date then the owner has not complied” with the statute.²³⁸ The court of appeals sided with EXLP, relying on the plain language of the statute.²³⁹

B. LEGISLATION

If the franchise tax rate reduction in House Bill 32, discussed *supra*, formed one half of this legislative session’s tax relief package, Senate Bill 1 and Senate Joint Resolution 1 comprise the other half. These legislative enactments increase the mandatory property tax homestead exemption from \$15,000 to \$25,000 and require districts to prepare their 2015 tax rolls and rates by reference to the new, higher exemption amount.²⁴⁰ Interestingly, though all sides have long seemed to agree that a real estate transfer tax is politically unviable in Texas, these enactments also made official—by constitutional amendment—that the legislature may enact no law imposing a transfer tax on fee simple transfers of real property.²⁴¹

Many taxpayers are concerned that another bill, House Bill 2083, foreshadows a more vigorous, coming assault on taxpayers’ ability to point to the constitutional and statutory requirements that property in Texas be taxed equally and uniformly.²⁴² Case law has confirmed that taxpayers relying on equal and uniform challenges to property tax values need not employ experts to select and adjust the values of other properties for purposes of comparing those properties to their own properties.²⁴³ House Bill 2083 requires that the selection and adjustment of comparable properties must utilize generally accepted appraisal methods and techniques.²⁴⁴ Whether and the extent to which this new provision may be inconsistent with the legislative history behind the comparable properties prong of Tax Code § 42.26(a)(3) has been a topic of much debate among practitioners and taxpayers since its enactment, and may be the focus of

237. *Id.* at *2 (emphasis in original) (quoting TEX. TAX CODE ANN. § 42.08(b)).

238. *Id.* at *3.

239. *Id.* at *4–5 (distinguishing the appraisal district’s cases because in all of the cases there was at least some portion of taxes that was not in dispute). The court of appeals also dismissed the appraisal district’s argument that EXLP had committed a jurisdictional error by not filing a statement under Tax Code § 42.08(b-1) stating the amount of undisputed taxes it would pay. The court of appeals noted that while the case was pending the legislature amended § 42.08 to expressly provide that the failure to file such a statement is not jurisdictional. *Id.* at *5 (citing Act of June 14, 2013, 83rd Leg., R.S., ch. 1259, § 29, 2013 Tex. Gen. Laws 3182, 3193 (codified at TEX. TAX CODE ANN. § 42.08(b-1))).

240. Tex. S.B. 1, 84th Leg., R.S. (2015); Tex. S.J.R. 1, 84th Leg., R.S. (2015).

241. Tex. S.B. 1, 84th Leg., R.S. (2015); Tex. S.J.R. 1, 84th Leg., R.S. (2015).

242. See Tex. H.B. 2083, 84th Leg., R.S. (2015).

243. See, e.g., Harris Cty. Appraisal Dist. v. United Inv’rs Realty Trust, 47 S.W.3d 648, 653 (Tex. App.—Houston [14th Dist.] 2001, pet. denied).

244. Tex. H.B. 2083, 84th Leg., R.S. (2015).

future litigation construing this provision.²⁴⁵

IV. PROCEDURE

A. REPORTED CASES

The Survey period saw significant development in the state's tax administration jurisprudence in the form of several taxpayer-favorable court decisions addressing multiple procedural issues.

In *Hegar v. Ryan, LLC*, the Austin Court of Appeals addressed whether Rule 3.325, pertaining to refund claims, exceeds the comptroller's authority by imposing requirements beyond those permitted under Tax Code § 111.104.²⁴⁶ More specifically, the court of appeals addressed whether a taxpayer that files a refund claim must provide certain "transactional detail and supporting documentation" with the initial filing of the claim, or whether it may do so at a later point during the administrative process.²⁴⁷ Key to the comptroller's publicly-stated justifications for the stricter requirements appears to be a concern about the administrative burdens of processing voluminous and complex refund claims. Many taxpayers and practitioners have pointed out the flaws in the comptroller's apparent view that making refunds harder to claim is an effective and permissible way to prevent frivolous claims; still, senior comptroller personnel have long pointed to the significant cost and time required to meet their statutory obligations to process these claims. So, while the unsupported policy shifts in the rule may have been disappointing, they were largely also unsurprising.

At trial, Ryan, LLC challenged the validity of Rule 3.325(a)(4), (b)(10), and (e), the effects of compliance with these requirements on the tolling of the statute of limitations, and the taxpayer's ability to introduce evidence at hearing. The trial court ruled in favor of Ryan, LLC and invalidated all of subsection 3.325(a)(4) of the 2011 rule and subsections 3.325(a)(4), (b)(10), and (e) of the 2013 rule.²⁴⁸

Focusing on the statutory text, the court of appeals noted that "the parties' dispute here primarily turns on [the court's] interpretation of subsection 111.104(c)(2) of the Tax Code . . . [which] requires a claim for a refund to 'state fully and in detail each reason or ground on which the claim is founded.'"²⁴⁹ Relying on the plain language of the statute, the court of appeals held invalid portions of the rule setting forth nine categories of transactional detail and supporting documentation the comptroller required taxpayers to file at the outset of a refund claim pursuant

245. See TEX. TAX CODE ANN. § 42.26(a)(3) (West 2015).

246. *Hegar v. Ryan, LLC*, No. 03-13-00400-CV, 2015 WL 3393917, at *1 (Tex. App.—Austin, May 20, 2015, no pet. h.) (mem. op.).

247. *Id.* at *11.

248. *Id.* at *3.

249. *Id.* at *9 (internal citations omitted) (quoting TEX. TAX CODE ANN. § 111.104(c)(2)).

to Rule 3.325(a)(4).²⁵⁰ The court of appeals reasoned that these requirements exceeded the comptroller's authority as inconsistent with the provisions of Tax Code § 111.104.²⁵¹ The court of appeals concluded that the statute's plain language allows the taxpayer to prove its entitlement to a refund "during the administrative or judicial process."²⁵² The court of appeals upheld the remaining portions of the rules.²⁵³

In *Sanadco, Inc. v. Office of the Comptroller of Public Accounts of the State of Texas*, the Austin Court of Appeals addressed whether a taxpayer may challenge an assessment in response to collection actions.²⁵⁴ The comptroller audited Sanadco's books, and subsequently filed suit to collect delinquent taxes from Sanadco.²⁵⁵ In response to the comptroller's collection suit, Sanadco asserted several counterclaims, relying in part on the Administrative Procedure Act and the Uniform Declaratory Judgments Act.²⁵⁶ Among its claims, Sanadco argued that AP 92 and AP 122—audit procedure memos issued by the comptroller providing guidance to auditors performing audits of convenience stores—were invalidly promulgated administrative rules.²⁵⁷

The court of appeals initially held that the audit procedure memos were invalidly promulgated rules, but on rehearing, determined that the trial court lacked jurisdiction over Sanadco's counterclaims because Sanadco failed to fulfill the Chapter 112 jurisdictional prerequisites.²⁵⁸ The court of appeals noted that the state's immunity from suit is limited,

250. *Id.* at *12. Although generally authorized to promulgate rules to enact Tax Code legislation, the comptroller may not impose restrictions or qualifications beyond those permitted under the Tax Code. A rule is valid if the legislature unambiguously authorized the rule or if the rule reasonably resolves a statutory ambiguity. *Id.* at *7. Here, the statute was not ambiguous so the court of appeals refused to defer to the comptroller's interpretation. *Id.* at *9.

251. The court of appeals's decision invalidated the last sentence of subsection (e)(3) of the 2013 rule requiring the aforementioned documentation to be provided when the refund is first claimed. *Id.* at *14; 34 TEX. ADMIN CODE § 3.325(e) (2013).

252. *Ryan, LLC*, 2015 WL 3393917, at *12; see also TEX. TAX CODE ANN. § 111.105(e) (allowing at least 180 days for taxpayers claiming a refund under § 111.104 to submit documentation to enable the comptroller to verify the claim for refund).

253. *Ryan, LLC*, 2015 WL 3393917, at *8, *14.

254. *Sanadco, Inc. v. Office of the Comptroller of Pub. Accounts of the State of Tex.*, No. 03-11-00462-CV, 2015 WL 1478200, at *1 (Tex. App.—Austin Mar. 25, 2015, pet. denied) (mem. op.). Sanadco also filed a separate suit seeking a temporary injunction against the comptroller and alleging that certain rules "impaired or threatened to impair [its] rights." See *Sanadco, Inc. v. Hegar*, No. 03-14-00771-CV, 2015 WL 4072091, at *2 (Tex. App.—Austin July 3, 2015, no. pet.) (upholding the trial court's order denying Sanadco's application for a temporary injunction).

255. *Sanadco, Inc.*, 2015 WL 1478200, at *2.

256. *Id.* at *3–4.

257. *Id.* at *3. Sanadco also asserted on appeal that the comptroller's actions were *ultra vires* and that the Tax Code provision permitting the use of sampling methods in audits was unconstitutional. *Id.* at *4.

258. See *Sanadco, Inc. v. Office of the Comptroller of Public Accounts of the State of Texas*, No. 03-11-00462-CV, 2013 WL 5477484 (Tex. App.—Austin Sept. 26, 2013) (mem. op.), *withdrawn and superseded by* 2015 WL 1478200 (Tex. App.—Austin Mar. 25, 2015, pet. denied) (concluding that AP 92 and AP 122 are rules and were invalidly promulgated); *Sanadco, Inc.*, 2015 WL 1478200, at *6 (concluding that the trial court lacked jurisdiction over Sanadco's counterclaims).

and even more so in the context of tax assessments.²⁵⁹ While Sanadco had relied on the Administrative Procedure Act, the Uniform Declaratory Judgments Act, and the doctrine of *ultra vires*, the court of appeals concluded that all of these grounds for relief are “preempted by Chapter 112 of the Tax Code.”²⁶⁰ Therefore, because Sanadco did not file a redetermination request or follow the procedures for a protest suit or refund claim, Sanadco was not permitted to challenge the tax assessment against it upon collection.²⁶¹ The court of appeals noted, “If Sanadco were able to pursue its counterclaims free of Chapter 112’s restrictions, the State’s entire tax collection scheme would be disrupted.”²⁶² The court of appeals, however, qualified its holding by noting that Chapter 112 does not preempt challenges to a rule’s or statute’s constitutionality if such challenges are brought “prior to the finality of an agency determination.”²⁶³

In addition to addressing the constitutionality of the twenty-four-hour waiting period for certain exports, *H.K. Global Trading, Ltd. v. Combs* also addressed the level of specificity required in an administrative protest letter’s citation to a Tax Code subsection in order for a court to have jurisdiction over the protest.²⁶⁴ The comptroller argued that because H.K. Global did not cite specifically to subsection 151.307(e), the trial court did not have jurisdiction to determine that subsection’s constitutionality.²⁶⁵ Section 112.053 provides that the “issues to be determined in the suit are limited to those arising from the reasons expressed in the written protest as originally filed.”²⁶⁶ The Austin Court of Appeals noted that although H.K. Global did not specifically cite subsection 151.307(e), it did cite other subsections in § 151.307 and more generally to the section as a whole.²⁶⁷ Furthermore, in its tax protest, H.K. Global was challenging an assessment against it, which was the result of the operation of subsection (e).²⁶⁸ The court of appeals therefore concluded that the comptroller was sufficiently alerted that subsection (e) was at issue, and the trial court had jurisdiction to determine the constitutionality of the subsection.²⁶⁹

B. COMPTROLLER RULES

During the Survey period, the comptroller overhauled its rule involving

259. *Sanadco, Inc.*, 2015 WL 1478200, at *4.

260. *Id.*

261. *Id.* at *5.

262. *Id.* (internal quotations omitted).

263. *Id.* at *6 n.9.

264. *H.K. Glob. Trading, Ltd. v. Combs*, 429 S.W.3d 132 (Tex. App.—Austin 2014, pet. denied); *see also supra* text accompanying notes 43–51 (discussing *H.K. Global Trading, Ltd.*, 429 S.W. 3d 132).

265. *Id.* at 135–36.

266. TEX. TAX CODE ANN. § 112.053(b) (West 2015).

267. *H.K. Glob. Trading, Ltd.*, 429 S.W.3d at 136.

268. *Id.*; *see also* TEX. TAX CODE ANN. § 151.307(e) (“A retailer who makes a refund before the time prescribed by subsection (d) or makes a refund that is undocumented or improperly documented is liable for the amount of the tax refunded with interest.”).

269. *H.K. Glob. Trading, Ltd.*, 429 S.W.3d at 136.

waiver of penalty and interest.²⁷⁰ The rule in many regards effectively codifies comptroller policy, including long-standing policy that the comptroller has discretion to grant penalty and interest waivers.²⁷¹ Among other changes, the amendment to the rule clarifies that the comptroller may grant a partial waiver of interest and that an interest waiver may be reviewed during an independent audit review.²⁷²

Significantly, although the rule still maintains a basic structure of setting out differing standards for waiver requests in audit and non-audit situations, the standards related to both—particularly as they relate to waiver of penalty—have been amended to add factors the comptroller will consider in determining whether to grant a waiver. Regarding penalty waiver in the audit context, the new rule indicates that the comptroller may consider errors identified in prior audits.²⁷³ The comptroller may also consider any changes to the law during the audit period, the taxpayer's recordkeeping efforts, and the current audit's error rate.²⁷⁴ In the non-audit context, the rule indicates that the comptroller may consider whether waiver was previously granted or denied for any tax type, not just the tax at issue.²⁷⁵ The comptroller may also consider the taxpayer's size and sophistication (a factor that was previously listed only in the factors for waiver requests in the audit context); whether collection actions have been taken, and whether the waiver request includes multiple liabilities.²⁷⁶

Also, relevant for those taxpayers seeking relief from an assessment based on insolvency under Tax Code § 111.102, the comptroller adopted new Rule 1.2 during the Survey period.²⁷⁷ The rule sets out procedural guidelines and deadlines that a taxpayer must meet in order to preserve its insolvency claim.²⁷⁸ Importantly, the rule states that an insolvency request and all documentation required by Rule 1.2 should be submitted to the comptroller after a hearing number has been assigned but before a notice of hearing is issued.²⁷⁹

V. OTHER SIGNIFICANT APPELLATE COURT DECISIONS

In addition to significant developments with respect to Texas's big three taxes—sales, franchise, and property taxes—the Survey period saw

270. See 39 Tex. Reg. 3565 (2014), *adopted* 39 Tex. Reg. 8406 (2014) (codified as an amendment to 34 TEX. ADMIN. CODE § 3.5 (2016) (Tex. Comptroller of Pub. Accounts, Waiver of Penalty or Interest)).

271. *Id.*

272. See *id.* § 3.5(c)(4), (e) (Tex. Comptroller of Pub. Accounts, Waiver of Penalty or Interest).

273. *Id.* § 3.5(b)(3)(A).

274. *Id.* § 3.5(b)(3)(D), (I), (L).

275. *Id.* § 3.5(c)(3)(C), (D).

276. *Id.* § 3.5(c)(3)(F), (G), (H).

277. 39 Tex. Reg. 5961 (2014) (codified as 34 TEX. ADMIN. CODE § 1.2 (2016) (Tex. Comptroller of Pub. Accounts, Settlement in a Contested Case Based on Insolvency)).

278. 34 TEX. ADMIN. CODE § 1.2.

279. *Id.* § 1.2(c), (f) (Tex. Comptroller of Pub. Accounts, Settlement in a Contested Case Based on Insolvency).

significant developments concerning several other areas administered by the comptroller.

In *Highland Homes Ltd. v. State*, the Texas Supreme Court addressed when property is presumed abandoned for unclaimed property purposes.²⁸⁰ Highland Homes, a construction company, would dock its subcontractors' pay if they did not provide proof of general liability insurance.²⁸¹ Highland Homes was sued in a class action to recover these docked amounts and later settled the suit. As part of the settlement, Highland Homes agreed to refund these amounts to the class. The settlement stipulated that amounts from checks issued to class members that were not negotiated within ninety days of issuance would be distributed to The Nature Conservancy as a *cy pres* award.²⁸² The State intervened, arguing that the amounts subject to the *cy pres* award should be held by Highland Homes for three years and then remitted to the comptroller pursuant to the Texas Unclaimed Property Act.²⁸³

The State argued that Property Code §§ 74.308 and 74.309—which prohibit private escheat agreements and nullify for unclaimed property purposes periods of limitations set by contract, statute, or court—prohibited the *cy pres* award.²⁸⁴ The supreme court, however, side-stepped this argument by concluding that the amounts at issue should not be presumed abandoned, and therefore the Unclaimed Property Act did not apply to these amounts.²⁸⁵ The supreme court reasoned that the amounts at issue were in fact claimed by the class members through their class representatives. The supreme court stated:

Chapter 74 does not apply when a claim to property has been asserted or an act of ownership exercised. It is of no consequence that several owners have not collected their property within the time period to which they agreed through class representatives. An owner need not actually *collect* his property to rebut the presumption of abandonment and render the Act inapplicable; he need only *claim* it.²⁸⁶

Focusing on Texas Rule of Civil Procedure 42, which addresses a class representative's authority to act on behalf of a class, the supreme court noted that the State's argument would succeed only by disregarding the class representatives' authority to act on behalf of the class.²⁸⁷

280. *Highland Homes Ltd. v. State*, 448 S.W.3d 403, 405 (Tex. 2014).

281. *Id.* at 406.

282. *Id.* at 406–07.

283. *Id.* at 408. The State intervened after the parties to the class action suit had sent notice to the Attorney General of the *cy pres* award. *Id.*

284. *Id.* at 409; *see also* TEX. PROP. CODE ANN. §§ 74.308–74.309 (West 2015).

285. *Highland Homes*, 448 S.W.3d 403 at 410.

286. *Id.* at 411 (emphasis in original).

287. *Id.* at 412. In response to an additional State argument that *cy pres* awards can be the subject of abuse, the supreme court dismissed the argument but cautioned that “trial courts must be careful in class actions to protect class interests and scrutinize settlement.” *Id.*

In *Combs v. Texas Small Tobacco Coalition*, the Austin Court of Appeals addressed whether the cigarette tax imposed under the Health and Safety Code is unconstitutional.²⁸⁸ In 2013, the Texas legislature enacted a “fee” on cigarettes and tobacco products that applied only to tobacco companies that did not participate in settlement agreements with the state relating to claims for antitrust violations and deceptive advertising.²⁸⁹ Small Tobacco, representing several cigarette manufacturers that had not participated in the settlement agreements with the state, argued that the tax is unconstitutional as a violation of the Equal and Uniform Clause of the Texas constitution and the Equal Protection and Due Process clauses of the U.S. Constitution.²⁹⁰

Agreeing with Small Tobacco, the court of appeals concluded that the tobacco tax violates the Texas constitution.²⁹¹ Analyzing the reasonableness of the tax’s subject matter classification, the court of appeals stated that, although the purposes of the tax were laudable, “imposing a tax on only one class of identical products is not equal and uniform” where the only justification for the classification was whether a taxpayer entered into a settlement agreement with the state.²⁹² The court of appeals also noted that, under the law imposing the tax, Small Tobacco does not receive a release from claims akin to the release a participating tobacco company received by entering into a settlement agreement.²⁹³ Lastly, the court of appeals highlighted the differences between Texas’s tax on Small Tobacco and the majority of states’ solutions for leveling the playing field between participating and non-participating cigarette manufacturers and noted that its finding the Texas tax statute unconstitutional was not inconsistent with the decisions in other states to uphold escrow statutes as constitutional.²⁹⁴ The Texas Supreme Court granted the comptroller’s Petition for Review and reversed and remanded the court of appeals’s decision.²⁹⁵

Another case that made its way to the Texas Supreme Court—and ultimately to the U.S. Supreme Court—involved the sexually oriented business (SOB) tax. In *Texas Entertainment Association, Inc. v. Combs*, after multiple years of litigation, the validity of the SOB tax—a \$5-per-person

288. *Combs v. Tex. Small Tobacco Coal.*, 440 S.W.3d 304, 306 (Tex. App.—Austin, 2014), *rev’d and remanded*, *Hegar v. Tex. Small Tobacco Coal.*, No. 14-0747, 2016 WL 1267843 (Tex. Dec. 8, 2015).

289. *Id.* at 307–08.

290. *Id.* at 310–11.

291. *Id.* at 313.

292. *Id.* at 310–11.

293. *Id.* at 312.

294. *Id.* at 312–13. Other states established escrow statutes in which non-settling manufacturers are required to make deposits into escrow accounts for the purpose of securing damage awards for successful cigarette-related claims, along with a promise to return any escrow funds remaining in the accounts after 25 years; distinguishing these escrow accounts, the court of appeals noted that the Texas cigarette fee is a tax, from which proceeds are deposited in the state’s general fund with no chance of an eventual return. *Id.*

295. *Hegar v. Tex. Small Tobacco Coal.*, No. 14-0747, 2016 WL 1267843, at *1 (Tex. Dec. 8, 2015).

entry fee imposed on businesses that both sell alcoholic beverages and offer live nude entertainment—was upheld.²⁹⁶ On November 21, 2014, the Texas Supreme Court denied Texas Entertainment’s petition for review,²⁹⁷ and on March 23, 2015, the U.S. Supreme Court denied Texas Entertainment’s petition, preserving the Austin Court of Appeals decision that upheld the validity of the SOB fee.²⁹⁸

Texas Entertainment argued that the SOB tax was an invalid occupation tax because it did not allocate “25% of its revenue to public schools” as required by the Texas constitution, and alternatively, that the tax was not “equal and uniform because it applie[d] only to businesses that provide live nude entertainment to audiences of two or more.”²⁹⁹ The court of appeals concluded that the tax was not an invalid occupation tax and did not violate the Equal and Uniform Clause of the Texas constitution.³⁰⁰

Relying on the Texas Supreme Court’s definition of an occupation tax as “a form of excise tax imposed upon a person for the privilege of carrying on a business, trade or occupation,” the court of appeals explained that taxes imposed “for the privilege of doing business in Texas” must contain classifications that relate to the “differences that affect the value of doing business.”³⁰¹ The court of appeals looked at the substance of the classification, the primary purpose of the law, and the plain language of the statute to determine that the SOB tax was not a tax on “the privilege of providing nude entertainment in the presence of alcohol consumption” in part because a business could continue operations and avoid the tax by choosing not to serve alcohol in connection with nude entertainment.³⁰²

The court of appeals was not persuaded by Texas Entertainment’s assertion that limiting the SOB tax’s applicability to businesses that provide nude entertainment to audiences of two or more but excluding businesses that provide nude entertainment to audiences of one violates the Equal and Uniform Clause of the Texas constitution.³⁰³ The court of appeals also was not persuaded by Texas Entertainment’s argument that the classification at issue had no rational basis and overcame the strong presump-

296. *Tex. Entm’t Ass’n., Inc. v. Combs*, 431 S.W.3d 790, 793 (Tex. App.—Austin 2014, pet. denied), *cert. denied*, *Tex. Entm’t Ass’n, Inc. v. Hegar*, 135 S. Ct. 1568 (2015).

297. *Id.*

298. *Id.*

299. *Id.* at 795; *see also* TEX. CONST. art. VII § 3(a). Texas Entertainment also asserted that the SOB tax was an unconstitutional restraint on free speech. *Tex. Entm’t Ass’n*, 431 S.W.3d at 795. Texas Entertainment, however, offered no explanation as to why the Texas constitution offers greater protection than the U.S. Constitution with respect to free speech associated with nude entertainment; as such, the court of appeals overruled Texas Entertainment’s third issue claiming the SOB fee violated the Free Speech Clause of the Texas constitution. *Id.* at 800; *see also* TEX. CONST. art. I, § 8.

300. *Tex. Entm’t Ass’n*, 431 S.W.3d 790 at 800.

301. *Id.* at 797. (citing *Conlen Grain & Mercantile, Inc. v. Tex. Grain Sorghum Producers Bd.* 519 S.W.2d 620, 624 (Tex. 1975); *In re Nestle USA, Inc.* 387 S.W.3d 610, 622 (Tex. 2012)).

302. *Id.* at 798–99.

303. *Id.* at 799–800; *see also* TEX. CONST. art. VIII § 1(a).

tion of constitutional validity.³⁰⁴ Rather, the court of appeals concluded that the SOB tax's classification is not unreasonable and explained that "limiting the [SOB] tax's applicability to businesses with audiences of two or more reasonably relates" to the goal of alleviating adverse effects of nude entertainment combined with alcohol consumption.³⁰⁵ According to the court of appeals, the legislature could have reasonably believed that such adverse effects did not exist at businesses offering nude entertainment to an audience of one to the extent that such effects may exist at businesses offering such entertainment to larger audiences.³⁰⁶

VI. CONCLUSION

This Survey period saw many novel legal arguments come out of Texas state and local tax litigation and likewise saw the comptroller propose a number of significant revisions to the state's regulatory regime. Already, the comptroller's office is working on making further changes to existing rules and on promulgating new rules around issues that taxpayers and agency personnel could benefit from more, or clearer, guidance. Though the 84th Texas legislature was relatively quiet from a tax perspective, key reforms are on the horizon. The Texas state tax community talks on a biennial basis about repealing and replacing the franchise tax, of course, and that topic promises to come up again over the course of the next year. There has also been much discussion—and, already, some action—relating to a potential overhaul of the state's system of property tax administration. While Texas has long been, and in many ways remains, the superlative business-friendly state, it will be interesting to see how much effort legislators, the governor, and the comptroller devote in the coming months and in the 2017 session to reviewing and enhancing the state's tax incentive programs. The months preceding a legislative session in Texas are always full of unexpected twists and turns. If the 84th Texas legislative session was the calm before a gathering storm in the state tax world, the run-up to the 85th Texas legislative session promises to bring even more intrigue than usual.

304. *Id.* at 799–800.

305. *Id.* at 800.

306. *Id.*