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Cynthia M. Ohlenforst

Jeff W. Dorrill

J. Blake Rice

Sam Megally

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TAXATION

*Cynthia M. Ohlenforst**

*Jeff W. Dorrill***

*J. Blake Rice****

*Sam Megally*****

TEXAS tax discussions during the Survey period inevitably focused on the state's continuing, unsuccessful efforts during 2005 to enact meaningful tax-reform legislation to provide property tax relief, stabilize education funding, and replace or expand the exception-riddled franchise tax. Neither the regular session nor the two special sessions that followed achieved those goals. After one Survey period, the legislature moved toward yet another special session—and yet another plan.¹ In the meantime . . . this is an update of some of the year's most notable developments.

I. SALES TAX

A. APPLICATION OF THE TAX

A taxpayer arguing that the sale-for-resale exemption should apply to its sales of paper bags and plastic sacks to grocer-retailers found the Austin Court of Appeals unreceptive to its pleas.² E. de la Garza, a wholesale grocery supplier, accepted blanket resale exemption certificates from customers on sales of various products including grocery bags. On appeal from a district court ruling in favor of the comptroller on her motion for summary judgment, de la Garza first argued that the Texas Tax Code section that addresses the taxability of “bags” applies only to manufacturers

* B.A., Loyola University; M.A., University of Dallas; J.D., Southern Methodist University. Partner, Hughes & Luce, LLP, Dallas, Texas; cindy.ohlenforst@hughesluce.com.

** B.B.A., J.D., Baylor University. Partner, Hughes & Luce, LLP, Dallas, Texas; dorrilj@hughesluce.com.

*** B.A., Trinity University; J.D., University of Chicago. Associate, Hughes & Luce, LLP, Dallas, Texas; riceb@hughesluce.com.

**** B.B.A., Southern Methodist University; J.D., The University of Texas School of Law. Associate, Hughes & Luce, LLP, Dallas, Texas; sam.megally@hughesluce.com.

1. Changes to the Texas Tax Code made during the 2006 special session occurred during the October 31, 2005 to October 31, 2006 Survey period and will be discussed in next year's article.

2. E. de la Garza, Inc. v. Strayhorn, No. 03-05-00245-CV, 2005 WL 3004138, at *5 (Tex. App.—Austin Nov. 10, 2005, no pet.) (not designated for publication). Although the court designated the opinion as not for publication, its availability ensures that both the comptroller and taxpayers will pay attention to the decision, at least as an indicator of the court's adherence to the rule that exemptions are strictly construed against the taxpayer.

for packaging supplies and not to retailers for transporting products.³ Because the relevant section explicitly lists “bags” among the enumerated non-exempt items, and because another section of the Tax Code explicitly exempts from sales tax packaging materials used in manufacturing, the court rejected the taxpayer’s reading of the relevant Tax Code section.⁴ In the alternative, de la Garza argued that, notwithstanding the disputed applicability of section 151.302, the Tax Code allows the sale-for-resale exemption to apply to taxpayers that have in good faith, albeit erroneously, accepted resale certificates from customers.⁵ However, the parties did not dispute that a 1991 legislative change to section 151.302 first made the bags taxable and de la Garza’s audit period did not begin until 1993, well after this change had been enacted. Thus, the court held that the taxpayer could not rely on the good-faith provisions of section 151.054.⁶ The taxpayer’s argument that it was not notified of the legislative amendment did nothing to change the outcome in this case, as the court made clear in its holding that the very fact of an amendment is sufficient notice of such change. The court therefore upheld the lower court’s summary judgment against the taxpayer.

Taxpayers and the comptroller continue to struggle regarding the application of *Rylander v. San Antonio SMSA L.P.*⁷ This case provided that in certain transactions of bundled items (for example, a nontaxable service with a taxable good), taxpayers may distinguish between two sales, one of which is taxable and one of which is not. The comptroller’s position, which appears to be much narrower than the court’s analysis, is that in order for the two bundled items to be treated as separate items, the particular taxpayer requesting unbundled treatment must provide each of the two items on a stand-alone basis. Thus, in Hearing No. 45,205, the administrative law judge concluded that taxable rentals of portable toilets could not be separated from the non-taxable servicing of such toilets because the taxpayer failed to demonstrate that it regularly provided toilets on a stand-alone basis.⁸ While there may not be a large number of taxpayers who dispute the taxability of portable toilets (although there are at least some, as the issue was not one of first impression), many taxpayers may find themselves faced with what appears an overly narrow interpretation of the *SMSA* case, resulting in the comptroller’s denying taxpayers the opportunity to segregate two distinct items simply because the particular taxpayer does not regularly provide each item on a stand-alone basis. Sellers and buyers of management and consulting services may find them-

3. See TEX. TAX CODE ANN. § 151.302 (Vernon 2006).

4. See *id.* § 151.318(a), (d) (Vernon 2006).

5. See *id.* § 151.054(b) (Vernon 2006).

6. See *E. de la Garza*, 2005 WL 3004138, at *4 (citing Tex. Comptroller Pub. Accounts STAR System No. 9701010H (Jan. 27, 1997), available at <http://cpastar2.cpa.state.tx.us:8765/index.html>).

7. 11 S.W.3d 484 (Tex. App.—Austin 2000, no pet.); see Cynthia M. Ohlenforst et al., *Taxation*, 54 SMU L. REV. 1595, 1596-97 (2001).

8. Tex. Comptroller Pub. Accounts STAR System No. 200507262H (July 12, 2005), available at <http://cpastar2.cpa.state.tx.us:8765/index.html>.

selves at odds with the comptroller's interpretation on these issues, particularly in the context of nontaxable services.

While multiple telecommunications-related issues continue to wind their way through the legislature and the courthouse, telecommunications services issues also arise in the context of bundled services. An internal letter from the comptroller's office during the Survey period confirmed that a taxpayer who provides taxable debt collection services via the telephone could reasonably claim that telecommunications services are integral to its debt collection services and essential to the performance of the services so that the taxpayer could give a resale certificate to the seller of such services.⁹

Hurricane Katrina triggered several tax-related announcements. The comptroller confirmed quickly, for example, that purchasers could claim an exemption from sales tax on separately stated labor charges to repair or restore non-residential real property and should provide an exemption certificate to the repair contractor.¹⁰ Even lump-sum contracts for non-residential repair are eligible for labor exemption if the purchaser provides the contractor an exemption certificate and if the contractor separately states the charge for labor from the charge for incorporated materials.¹¹

B. LEGISLATION

During both the regular and special sessions, the Texas Legislature again considered multiple proposals for tax reform. As in the past several sessions, the challenge of extending the franchise tax (or a replacement tax for the franchise tax) to non-corporate entities, including the net income from partnerships, proved too difficult a task for the legislators, particularly given the competing political goals and Texas constitutional prohibition on taxing individuals' net income. Whereas the House remained willing to extend and expand the sales tax to multiple additional items (including possibly expanding the sales tax to bottled water, snack foods, certain computer repairs, and other items), the Senate resisted such significant raising of the sales tax—already one of the highest in the country.¹²

In a year marked by political animosity, the House never formally considered the comptroller's tax bills, and sales tax-related legislation was

9. Tex. Comptroller Pub. Accounts STAR System No. 200508264L (July 12, 2005), available at <http://cpastar2.cpa.state.tx.us:8765/index.html>. Letter (Aug. 31, 2005).

10. Texas Comptroller-Disaster Relief-Frequently Asked Questions, http://www.window.state.tx.us/taxinfo/disaster_relief_faq.html (last visited Apr. 23, 2006) [hereinafter *Disaster Relief*]. The comptroller also issued a statement confirming that her office would waive the state hotel/motel tax for Hurricane Katrina victims seeking shelter in Texas (Press Release, Carol Keeton Strayhorn, Texas Comptroller (Sept. 1, 2005), available at <http://www.window.state.tx.us/news/50901hoteltax.html>).

11. See *Disaster Relief*, *supra* note 10.

12. In an interesting sidelight, legislators discussed imposing an additional tax on unhealthy snack foods, but not on healthier snack foods. Political and substantive debate to draw the lines between the two categories could be mind boggling.

extraordinarily limited. The Texas emissions surcharge expiration date was extended from 2008 to 2010.¹³ Also, as oenophile readers probably know, the legislature provided that, subject to certain requirements (for example, twenty one years old with proof of identity to buy), out-of-state wineries may ship wine to ultimate consumers, including those in dry areas. Sales tax relevance? Sales tax must be paid on the wine.¹⁴

II. FRANCHISE TAX

Taxpayer challenges to franchise tax generally continued to fare poorly, with one notable exception. In *Home Interiors & Gifts, Inc. v. Strayhorn*, a Texas corporation successfully challenged the constitutionality of the Texas franchise tax provision known as the “throwback rule.”¹⁵ Receipts from sales of products that are delivered outside of Texas are generally not treated as Texas receipts for purposes of calculating the gross receipts factor of the Texas franchise tax.¹⁶ However, the throwback rule works as an exception to this general rule. When a taxpayer ships tangible personal property from Texas to a purchaser in another state where the taxpayer is not subject to a net income tax, the receipts from that sale are “thrown back” to Texas (that is, they are treated as Texas receipts for purposes of the gross receipts factor of the Texas franchise tax calculation).¹⁷ Most of Home Interiors’ sales originated outside of Texas through independent salespersons in states in which Home Interiors had no business operations and, due to the operation of Public Law 86-272 (a federal statute preventing states from taxing the net income of a business whose sole activity within a state is sales solicitation), were not subject to a tax on net income.¹⁸ Under the throwback rule, all such sales receipts were treated as Texas receipts for Home Interiors’ franchise tax calculations. Home Interiors contended that the throwback rule caused the franchise tax to be unfairly apportioned in violation of the Commerce Clause of the United States Constitution as tested by the internal consistency prong of the Complete Auto¹⁹ Although the comptroller presented a number of variations on the argument that the Texas franchise tax, including its reliance on the throwback rule, is internally consistent (or would be, but for the operation of Public Law 86-272) and therefore passed the Complete Auto tests, the court disagreed.²⁰ The court’s analysis hinged on the fact that, under a hypothetical tax scheme in which every state imposed a tax identical to the Texas franchise tax, a corpora-

13. See TEX. TAX CODE ANN. § 151.0515(d) (Vernon Supp. 2006).

14. See Tex. S.B. 877, 79th Leg., R.S. (2005) (Being able to drink wine while editing or writing a law review article: priceless.).

15. 175 S.W.3d 856, 858-59 (Tex. App.—Austin 2005, pet. filed) (addressing the throwback rule in TEX. TAX CODE ANN. §§ 171.101(1), 171.1032(a)(1) (Vernon 2006)).

16. Tex. Tax Code Ann. § 171.1032 (Vernon 2006).

17. *Id.* § 171.1032(a)(1).

18. 15 U.S.C. § 381-84 (1997).

19. *Home Interiors*, 175 S.W.3d at 867 (relying on Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977)).

20. *Id.* at 865-68.

tion with interstate receipts like Home Interiors would be taxed, despite the protections of Public Law 86-272, in a manner that a corporation with solely intrastate receipts would never bear.²¹ Consequently, the court ruled that Home Interiors' franchise tax assessment was unfairly apportioned and ordered refund of the franchise taxes resulting from that unfair apportionment.

The full impact of this decision will depend in part on how narrowly the courts construe this opinion and how long Texas retains the current franchise tax regime.²² However, even with a reformed franchise tax, the invalidation of the throwback rule—at least in some circumstances—will remain relevant, particularly given the fact that many of the most popular tax reform proposals retain the single gross receipts factor for apportionment purposes. Taxpayer refund claims for past periods will undoubtedly result in further controversy, as the comptroller may well take a narrower view of this case than taxpayers.

The taxpayer in *INOVA Diagnostics v. Strayhorn* did not fare nearly as well as Home Interiors.²³ INOVA, a California corporation, had a single employee in the State of Texas, a salesperson who worked an average of seven to ten days per month demonstrating, marketing, and taking orders for INOVA's medical-testing products. The comptroller imposed the franchise tax based upon the activities of this single Texas employee. INOVA filed suit after the comptroller denied its refund claim, asserting that it was not subject to the franchise tax by application of Public Law 86-272 and that it lacked substantial nexus with Texas to be subject to the franchise tax under the Commerce Clause.²⁴ INOVA's Public Law 86-272 argument was comprised of two distinct arguments. First, the taxpayer argued that the franchise tax was a single integrated tax that could not be separated into two components to avoid application of Public Law 86-272; because INOVA had no activities in Texas other than solicitation of orders, Public Law 86-272 protected its earned surplus from the franchise tax because the earned surplus tax is a net income tax. However, Public Law 86-272 does not reach taxes that, like Texas' tax calculation with respect to taxable capital, are not computed by reference to net income. While the comptroller has conceded that the earned surplus component of the franchise tax is a net income tax and, therefore, subject to the restrictions imposed by Public Law 86-272, the comptroller has continued to treat the taxable capital as a separate tax that, just as before the 1991 enactment of the earned-surplus tax, is not subject to Public Law 86-272.

The court, unconvinced by the taxpayer's arguments, ruled that although the franchise tax is one integrated tax, it has two components, one

21. *Id.* at 866.

22. The new "margin tax" enacted after the Survey period replaces the current franchise tax but retains the gross-receipts calculation.

23. 166 S.W.3d 394, 395 (Tex. App.—Austin 2005, pet. denied).

24. *Id.* at 397-98.

that applies to INOVA and one that, by operation of Public Law 86-272, does not.²⁵ The taxpayer also argued that the taxable capital component of the franchise tax was actually a tax “imposed on, or measured by, net income,” and, therefore, precluded by Public Law 86-272. The court was equally unimpressed with this argument and instead ruled that the definition of “net income” in Public Law 86-272 was a narrow one, and thus, the capital component of the franchise tax was not subject to any limitation by Public Law 86-272.²⁶ Finally, the court denied INOVA’s alternative nexus argument by summarily upholding the comptroller’s long-standing bright-line rule that physical presence in a state establishes a sufficient nexus to allow taxation under the Commerce Clause.²⁷

A number of interesting franchise tax issues appear in pending court cases and deserve mention. At least three pending cases deal with a variety of apportionment issues, including how to apportion gross receipts from certain intangibles and proceeds from sales of certain accounts receivable.²⁸ In addition, multiple taxpayers are challenging the franchise tax provision that requires taxpayers to add back certain compensation paid to officers and directors to the franchise tax base.²⁹ In *First Co. v. Rylander*, another taxpayer is following the path tread by Home Interiors and challenging the throwback rule based upon the Commerce Clause of the United States Constitution, among other arguments.³⁰ Finally, the comptroller’s application of the franchise tax to the telecommunications industry continues to give rise to litigation.³¹

Taxpayers had few successes before administrative law judges while contesting franchise taxes during the Survey period and, in large part, the franchise tax issues that appeared before the judges recur on a regular basis. One of these recurring issues involves the determination of whether amounts provided by a parent company to a subsidiary should be considered an equity contribution (and included in the recipient’s taxable capital) or recognized as debt (and therefore not included in the recipient’s taxable capital). In Hearing No. 42,745, the administrative law judge focused on whether advances from a parent corporation should be treated as contributions to capital or debt. After reviewing multiple criteria often considered by the comptroller, the administrative law judge focused on the “risks and economic reality, and whether a disinterested third party would have made a loan under similar circumstances” as being

25. *Id.* at 399.

26. *Id.* at 401.

27. *Id.* at 402.

28. *DaimlerChrysler Servs. N. Am., LLC v. Strayhorn*, No. D-1-GN-04-001380 (53d Dist. Ct., Travis County, Tex.); *TGS-NOPEC Geophysical Co. v. Strayhorn*, No. D-1-GN-05-000637 (126th Dist. Ct., Travis County, Tex.); and *Viacom Int’l, Inc. v. Strayhorn*, No. D-1-GN-04-002433 (345th Dist. Ct., Travis County, Tex.).

29. *7-Eleven, Inc. v. Strayhorn*, No. D-1-GN-05-001845 (53rd Dist. Ct., Travis County, Tex.); *CTX Mortgage Co., L.L.C. v. Strayhorn*, No. D-1-GN-03-000145 (353rd Dist. Ct., Travis County, Tex.).

30. No. GN-20029 (Dist. Ct., Travis County, Tex.).

31. *See, e.g., Sw. Bell Tel. Co. v. Rylander*, No. GN-204559 (Dist. Ct., Travis County, Tex.).

key.³²

In this taxpayer's case, no formal debt instrument had ever been signed, although the advances were treated as a liability on taxpayer's books, and repayments were made through a lockbox sweep arrangement. Recognizing that in the parent-subsidary context, the rights and remedies of the parties may not be as formally set forth as with unrelated parties, and, given the parent's control over a subsidiary, the judge concluded that a third-party lender might well have made the loans to the taxpayer, including subsequent advances that were made after the taxpayer's financial condition had deteriorated. The judge therefore ruled in the taxpayer's favor.

A. LEGISLATION

As noted earlier, the legislature struggled unsuccessfully during the Survey period to revise Texas franchise tax or to enact a different, broader tax. Indeed, the only meaningful franchise tax changes were the extension of several credits to December 31, 2009 that would otherwise have expired on January 1, 2005.³³ As with sales tax, there were few accomplishments to show for the heated battles of the legislative session.

III. PROPERTY TAX

A. APPLICATION OF THE TAX/EXEMPTIONS

The Dallas Court of Appeals in *Carrollton-Farmers Branch Independent School District v. JPD, Inc.* addressed the refund of payments for penalties and interest when the taxable value of the property was subsequently reduced.³⁴ The taxpayer originally appealed a district court's property valuation of \$2,992,780. During the pendency of that appeal, the City of Irving and the Carrollton-Farmers Branch Independent School District filed delinquent tax suits against the taxpayer. They issued tax warrants, for which the taxpayer paid \$73,463.80 before the determination of final value based on the taxpayer's appeal. The final value was set at \$186,300, reducing the property valuation by over \$2,500,000. The school district refunded the tax that was paid on the difference between the original valuation and the district court's valuation, but it refused to refund the taxpayer's payments of approximately \$20,000 of penalties and interest. The school district argued that section 42.43(a) of the Texas Tax Code requires the taxing unit to refund only taxes, not any penalties or interest.³⁵ A trial court resolved the matter in favor of JDP,

32. Tex. Comptroller Pub. Accounts STAR System No. 200503097H (Mar. 10, 2005), available at <http://cpastar2.cpa.state.tx.us:8765/index.html>.

33. See TEX. TAX CODE ANN. § 171.752 (eligibility for tax credit by qualified business creating ten qualifying jobs), § 171.801 (definitions relating to credit), and § 171.804 (providing credit claimed in five equal installments). The legislature also added definitions relating to credit for certain insurance premium taxes. See *id.* § 171.891 (definitions).

34. 168 S.W.3d 184 (Tex. App.—Dallas 2005, no pet.).

35. *Id.* at 186-87.

and the school district appealed.

The Dallas Court of Appeals resolved the question without focusing on the meaning of the word "taxes" in section 42.43(a). Instead, the court said that once the district court determined the appraised value, the tax rolls should have been corrected, and that roll must be used to calculate penalties and interest recoverable in a delinquency lawsuit under Chapter 33 of the Texas Tax Code.³⁶ The court of appeals further reasoned that, based on the current tax rolls and the facts as stipulated by the parties, JPD should have been awarded the refund of penalties and interest in excess of those due under the updated tax rolls; therefore, the trial court's decision court was upheld.³⁷

However, the taxpayer did not win on all counts or with all audiences. The court found that JPD was not entitled to attorney's fees because section 42.43(d) of the Tax Code provides that attorney's fees can be recovered only if the suit for refund is filed on or after the 180th day after the appraisal roll is corrected, and the taxpayer's suit was filed approximately ninety days after the appraisal roll was corrected.³⁸ Also, though the court's determination appears to be necessitated by fairness and public policy, Justice Lang-Miers, in a vigorous dissent, opined that the school district should be entitled to keep all amounts of penalty and interest and that JPD should take nothing.³⁹

The Supreme Court of Texas considered the assessment and taxation of underground salt-dome caverns that were used for the storage of hydrocarbons in *Matagorda County Appraisal District v. Coastal Liquids Partners, L.P.*⁴⁰ The taxpayer rented the salt caverns for almost \$500,000 per year and argued that: (1) the caverns should not be assessed separately from the rest of the property; and (2) in the alternative, if the caverns could be taxed, they must be taxed as part of the surface estate. The court disagreed with both arguments. Although the Texas Supreme Court did not promulgate a test to determine which aspects of land should be taxed, when the court viewed the facts surrounding the construction and commercial use of the salt caverns through the lens of its prior rulings on separate taxability, the court found that the caverns were rightfully assessed and taxed as separate property.⁴¹ The court was unconvinced by the taxpayer's argument that the caverns must be taxed with the surface estate and found that the caverns were taxable separately from the surface estate because they were improvements, not realty.⁴² Finally, the court pointed out that there was no question as to the separate taxability of similar storage facilities built above ground and that no logical reason dictated different tax treatment simply because building

36. *Id.* at 188.

37. *Id.*

38. *Id.* at 189.

39. *Id.* at 189-97.

40. 165 S.W.3d 329 (Tex. 2005).

41. *Id.* at 332-34.

42. *Id.* at 335.

the facilities underground was more practical.⁴³

Dan's Big & Tall Shop, Inc. v. County of Dallas addressed a variety of issues surrounding the property taxation of a taxpayer who purchased and continued to operate an ongoing business.⁴⁴ The taxpayer bought a business through an asset purchase and continued to operate the business under its previous trade name through a d/b/a filing. As stated in the d/b/a filing, the taxpayer continued to operate the acquired business at its previous address. The taxpayer did not pay property taxes or render on the business' personal property for either the acquisition year or the following year. Without receiving notice of the asset purchase, the taxing authority mailed appraisals and tax bills to the former owner at the business address based on the authority's tax roll, as required by statute.⁴⁵ Ultimately, the taxing authority sued the purchaser for collection of the delinquent taxes, and the trial court held that the taxpayer must pay the entirety of the past-due taxes, penalties, and interest. The taxpayer unsuccessfully appealed, arguing that: (1) its due process rights were violated; and (2) it should only pay a pro rata share of the taxes due from the year of acquisition.⁴⁶

The Dallas Court of Appeals dealt with appellant's arguments in reverse order. First, the court quickly dismissed the taxpayer's argument that section 31.081(c) of the Tax Code requires the purchaser of a business to withhold and pay only a pro rata share of the taxes imposed on the personal property of such business. Instead, the court found that section 31.081, when read as a whole, requires a purchaser to withhold and pay all of the property taxes due from the purchase price of a business.⁴⁷ Next, the court ruled that the appellant received sufficient notice of the property's appraised value when the taxing authority delivered the tax bill to the taxpayer's correct business address under the taxpayer's assumed name, especially because the taxpayer failed to give the appraisal district the information needed to change the tax rolls by rendering the property as required by section 22.01(a) of the Texas Tax Code.⁴⁸ Finally, the court held that, even if the appellant did not receive adequate notice of the appraisals, there was still no due process violation because the taxpayer failed to maintain its rights to final determination of its protest because the taxpayer did not file a notice of protest or pay the amount of taxes required under section 42.08(b) of the Tax Code.⁴⁹

B. PROCEDURE

In Letter Opinion GA-0317, the Attorney General addressed whether section 6.025(d) of the Tax Code, which requires chief appraisers to use

43. *Id.* at 336.

44. 160 S.W.3d 307 (Tex. App.—Dallas 2005, pet. denied).

45. Tex. Tax Code Ann. § 25.19(a)(1) (Vernon 2006).

46. *Dan's Big & Tall Shop, Inc.*, 160 S.W.3d at 309.

47. *Id.* at 309-10.

48. *Id.* at 311.

49. *Id.* at 312.

the lowest appraised value in connection with property that sits in overlapping appraisal jurisdictions, violates certain provisions of the Texas Constitution.⁵⁰ The Dallas County District Attorney, on behalf of the Dallas County Appraisal District, asked the Attorney General whether section 6.025(d) of the Tax Code violated two separate portions of the Texas Constitution: (1) Article VIII, sections 1(a)-(b), which require that property be taxed in proportion to its value; and (2) Article VIII, section 18(c), which requires that the legislature will “provide for a single board of equalization for each appraisal entity consisting of qualified persons residing in the territory appraised by that entity.”⁵¹ The Attorney General concluded that section 6.025(d) did not violate Article VIII, Section 1(a)-(b) as a matter of law, based on the legislature’s authority to adopt laws governing overlapping appraisals.⁵² However, the Attorney General also stated that, in some instances, a court could determine that the property value required by section 6.025(d) does not appraise property at its market value, thereby causing the taxing units to tax the property in a manner that is not equal and uniform.⁵³ Such a determination must be made based on the particular facts of each case. The Attorney General dealt with the Dallas County District Attorney’s second question in a more final manner. First, the Attorney General pointed out that section 6.025(d) could not cause a violation of the portion of Article VIII, section 18 that requires that appraisal review boards consist of persons residing within the territory appraised, because no matter which appraisal district’s determination is ultimately applied to property that lies in overlapping appraisal districts, the property’s value will be always be determined by an appraisal review board for an appraisal district in which the property lies.⁵⁴ Next, the Attorney General concluded that section 6.025(d) did not violate the portion of Article VIII, section 18 that requires the legislature to provide for a single board of equalization of an appraisal entity. Though section 6.025(d) may require some taxing units to use a value that was set by a foreign district’s review board, this possibility alone does not violate the legislature’s duty to provide for a single board of equalization for each appraisal entity.⁵⁵

C. LEGISLATION

The 2005 Texas Legislature adopted numerous property tax revisions, although few of them have broad impact. One dramatic revision involves Chapter 41A of the Tax Code, which provides that a taxpayer may elect binding arbitration to appeal an appraisal review board’s determination of the market or appraised value of the taxpayer’s real property, provided that the appraisal review board’s order set forth a value of \$1,000,000 or

50. Op. Tex. Att’y Gen. GA-0317 (2005).

51. TEX. CONST. art. VIII, § 18(c).

52. Op. Tex. Att’y Gen. GA-0317 (2005).

53. *Id.*

54. *Id.*

55. *Id.*

less.⁵⁶ The arbitrator's award is not appealable.⁵⁷

Several 2005 amendments relate to property tax exemptions. Section 11.13(j)(3) of the Tax Code was amended to enable a trust beneficiary's residence to qualify for the homestead exemption if a court order created the trust.⁵⁸ Section 23.76(h) of the Tax Code was amended to provide that a taxpayer does not lose its timber-land designation solely because a portion of the timber land is a residential homestead.⁵⁹ Section 23.76(i) of the Tax Code eliminates rollback taxes on timber land converted to religious use by a religious organization if the conversion occurs within five years of the property ceasing to be timber land.⁶⁰ Section 11.16 of the Tax Code provides that machinery and equipment used for the production of farm or ranch products is exempt from property tax irrespective of the primary design of such equipment.⁶¹

The legislature also enacted multiple amendments relating to tax liens. Section 33.57 of the Tax Code was amended to facilitate a streamlined foreclosure by tax units of properties with delinquent tax liens at least ten years old or with total delinquencies exceeding the property's appraised value.⁶² The streamlined procedures apply to foreclosures of property but do not apply to judgments against delinquent taxpayers.⁶³ Several amended provisions also address tax lien priorities.⁶⁴

IV. PROCEDURE

The Austin Court of Appeals held that merely labeling a tax payment as being made "Under Protest" does not give a district court jurisdiction over the resulting tax protest suit.⁶⁵ The taxpayer in that case, a neon sign manufacturer/retailer, challenged an assessment, asserting, among other arguments, that the taxing statutes were unconstitutional and that the taxpayer lacked nexus. According to the taxpayer, its terse protest language was sufficient notice of its position in view of the preexisting and ongoing controversy with the state. The court disagreed, holding that the taxpayer had to adhere to the statutory requirement for tax protest suits: payments made under protest must be accompanied by a letter "stat[ing] fully and in detail each reason for recovering the payment."⁶⁶ The comptroller's plea to the jurisdiction, which had been sustained by the lower court, was upheld on appeal, as was the lower court's dismissal of several of the taxpayer's claims for declaratory judgment under the

56. Tex. Tax Code Ann. § 41A.01 (Vernon Supp. 2006).

57. *Id.* § 41A.11.

58. *Id.* § 11.13(j)(3).

59. *Id.* § 23.76(h).

60. *Id.* § 23.76(i).

61. *Id.* § 11.16.

62. *Id.* § 33.57(b)(1)-(2).

63. *Id.* § 33.57(m).

64. *See, e.g., id.* § 32.05.

65. Local Neon Co. v. Strayhorn, No. 03-04-00261-CV, 2005 WL 1412171 (Tex. App.—Austin June 16, 2005, no pet. h.) (not designated for publication).

66. *See* TEX. TAX CODE ANN. § 112.051 (Vernon 2006).

Uniform Declaratory Judgment Act as to what refund, if any, the state owed the taxpayer. Because the taxpayer had not exhausted all administrative remedies available under the tax protest suit procedure, the court of appeals held that a declaration by the lower court on such issues would have been “redundant and improper.”⁶⁷ The sole holding in favor of the taxpayer was the court’s reversal of the lower court’s dismissal of several claims for declaratory judgment based on unconstitutionality of the taxing statutes at issue. Unlike the claims for declaratory judgment regarding the refund owed to the taxpayer, the constitutional claims “[were] not an action which require[d] the State to pay money damages.”⁶⁸ Thus, the court of appeals held that the lower court’s dismissal of the constitutional claims was error and reversed on that point. The court of appeals also notably held that the lower court had jurisdiction over the taxpayer’s related claims for reasonable attorney’s fees based on the unconstitutionality claims and likewise reversed the lower court’s dismissal of those claims.

Although the 2005 legislature declined to enact substantial tax legislation, it did enact a new Tax Code provision relating to the use of tax audit information.⁶⁹ This section provides that parties who receive information about taxpayers that the comptroller is auditing may not use that information to solicit business before the sixth day after the comptroller makes the information available. By assessing fines for those who violate this provision, the legislature hopes to give taxpayers a chance to find out from the comptroller that they are being audited—before they are contacted by tax services or consultants or professionals about the audit. The legislature also reduced the interest rate payable on refunds or credit, by providing that for refunds claimed on or after September 1, 2005, the interest rate will be the lesser of the annual rate of interest earned on deposits from State Treasury during December of the prior calendar year or the rate set in section 111.060. This effectively reduces the interest rate paid to taxpayers so that it is lower than the rate taxpayers pay on underpayments.⁷⁰ The comptroller also issued a series of rulings (generally one ruling for each of several different taxes) setting forth the comptroller’s explanation of statute of limitations in the context of raising new issues during administrative hearings.⁷¹

Following the legislature’s unsuccessful efforts to revise Texas taxation, Governor Perry appointed a twenty-four member tax-reform commission, headed by former Comptroller John Sharp. The Sharp Commission proposed an “alternative margin” tax that would require virtually all

67. *Local Neon*, 2005 WL 1412171, at *7.

68. *Id.* at *8.

69. TEX. TAX CODE ANN. § 111.0075 (Vernon 2006).

70. See *id.* § 111.064. In addition to the fiscal advantage of this discrepancy, some point out that the lower rate may discourage taxpayers from deliberately overpaying their taxes.

71. See, e.g., Tex. Comptroller Pub. Accounts STAR System No. 200508240L (Aug. 9, 2005) (regarding franchise tax), available at <http://cpastar2.cpa.state.tx.us:8765/index.html>. These letters set forth the comptroller’s policy regarding the impact of *Strayhorn v. Willow Creek Res., Inc.*, 161 S.W.3d 716 (Tex. App.—Austin 2005, no pet.).

businesses other than sole proprietorships and general partnerships to pay a tax on the “margin” between the business’s total receipts and either the cost of goods sold or compensation. The resulting amount would then be apportioned to Texas based on the current single-factor gross receipts formula. This bifurcated plan, as well as a tax rate that would be lower for wholesalers and retailers than for other businesses, was designed to acknowledge the different business models and to avoid being categorized as a net income tax. Although there was significant support for the plan in some quarters, others attacked the plan on both substantive grounds (claiming that the tax on gross receipts net of deductions constituted a net income tax of individual partners in limited partnerships, thereby running afoul of the Texas constitutional prohibition on a net income tax on individuals) and on policy grounds. Additional issues arise from efforts to exclude not only sole proprietorships but also general partnerships, certain passive entities, and companies with a low level of gross receipts.

Although the pressure on legislators to enact tax reform before the *Orange Cove* court’s June 1, 2006 deadline was intense, the anticipated surplus tempted the legislators to again band-aid over the tax-reform problem by spending down the surplus and waiting for the 2007 Regular Session to enact meaningful tax reform. The legislators’ task was complicated not only by their differing approaches to the tax methodology, but also by their differing goals. Many viewed reducing property taxes as the key goal, whereas many others, particularly on the Senate side, believed that a buy-down of the property tax rate should be accompanied by some type of meaningful educational reform, which will address the margin tax as enacted.

Stay tuned for next year’s installment.

