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Taxation

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TAXATION

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I. SALES TAX

A. Application of the Tax***

IN *Dixon v. State*¹ the Austin court of appeals affirmed a lower court's holding that an individual was liable for a corporation's unpaid taxes even though the corporation had not lost its charter.² Although *Dixon* involved a fuel tax liability,³ its holding should also apply to sales tax liabilities. However, because the corporation collected taxes but failed to pay them to the state, the court's rationale⁴ should not be construed to hold corporate officers liable for the taxes that a corporation has not collected. Nevertheless, the court's decision evidences the attorney-general's expanding effort to hold individuals responsible for unpaid corporate taxes. The Austin court of appeals confirmed in *Bullock v. Foley Brothers Dry Goods Corp.*⁵ that the state may collect sales tax from either the buyer or the seller.⁶

The United States Supreme Court again faced the question of whether a state must provide relief to taxpayers who paid taxes pursuant to a statute

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*** Cases, regulations and other developments that fell within this survey period but were included in last year's survey article are not included in this article. See Cynthia M. Ohlenforst & Jeff W. Dorrill, *Taxation, Annual Survey of Texas Law*, 45 Sw. L.J. 647 (1991).

1. 808 S.W.2d 721 (Tex. App.—Austin 1991, writ dismissed w.o.j.).

2. See TEX. TAX CODE ANN. § 171.255 (Vernon 1982) (corporate officers may become liable for debts of corporation, including taxes, when the corporation forfeits its charter for failure to pay taxes). See, e.g., Comptroller Hearing No. 26,398 (Oct. 18, 1990). The United States Tax Court recently held that when a state revokes a corporation's charter, the corporation ceases to exist as a legal entity and may no longer petition the Tax Court. *Vahlco Corp. v. Commissioner*, 97 T.C. (No. 29) (1991) (relying on Texas law).

3. 808 S.W.2d at 722; see TEX. TAX CODE ANN. §§ 153.101, 153.201 (Vernon Supp. 1992) (imposing a tax on the first sale of fuel).

4. The court held that TEX. TAX CODE ANN. § 111.016 (Vernon Supp. 1992), which provides that any person who collects a tax holds the amount collected in trust for the state and is liable for the full amount (plus penalties and interest), imposes a fiduciary relationship between the state as principal and the tax collecting entity as agent. *Dixon*, 808 S.W.2d at 723. According to the court, a corporate officer "is liable for any tort committed by the corporation through him, regardless of whether the officer personally benefits from the tort committed." *Id.*

5. 802 S.W.2d 835 (Tex. App.—Austin 1991, writ denied). This decision, which was summarized at Ohlenforst & Dorrill, 1991 Survey at 649 (1991), was originally designated by the court as not for publication.

6. *Id.* at 838-39.

that is subsequently declared unconstitutional. In *James B. Beam Distilling Co. v. Georgia*⁷ a divided court held that taxpayers whose claims are not barred by procedural requirements, such as statutes of limitation or res judicata, are entitled to retroactive application of the court's holding that Georgia's alcoholic beverage tax is unconstitutional.⁸ In another state tax case, *Dennis v. Higgins*,⁹ the United States Supreme Court held that taxpayers may bring certain claims under a civil rights statute¹⁰ that permits an award of attorney's fees to the prevailing party.¹¹

A significant issue facing Texas and other states in 1992 concerns the ability of a state to impose sales or use taxes on mail order sales. The landmark *National Bellas Hess, Inc. v. Illinois Department of Revenue*¹² has long stood for the proposition that states may not impose sales or use taxes on mail-order sales. As catalog sales have expanded rapidly throughout the country, *National Bellas Hess* has been questioned with increased frequency.¹³ Two lower court cases in Tennessee held out-of-state mail order sellers liable for sales taxes on goods sold to Tennessee residents.¹⁴ In *North Dakota v. Quill Corp.*¹⁵ that state's supreme court accepted the state's broad definition for use tax purposes of "retailer"¹⁶ and concluded that imposition of state use tax on an out-of-state direct marketing retailer was permissible even though the retailer had no physical presence in the state.¹⁷ The court's conclusion rested in part on its determination that the "economic, social, and commercial landscape upon which *Bellas Hess* was premised no longer exists, save perhaps in the fertile imaginations of attorneys representing mail order interests."¹⁸ The United States Supreme Court has accepted certiorari on *Quill*,¹⁹ and the Texas legislature has already enacted language similar to the North Dakota statute.²⁰

On the other hand, in *Direct Marketing Association, Inc. v. Bennett*²¹ a

7. 111 S. Ct. 2439 (1991).

8. 111 S. Ct. at 2448.

9. 111 S. Ct. 865 (1991).

10. 42 U.S.C. § 1983 (1981). The court held that Commerce Clause claims concerning state taxes may be brought under this 1871 civil rights statute, which provides a cause of action against any person who, acting under color of state law, deprives another person of "rights, privileges, or immunities secured by the Constitution and laws of the United States." *Dennis*, 111 S. Ct. at 868.

11. See 42 U.S.C. § 1988 (1981).

12. 386 U.S. 753 (1967).

13. See *infra* notes 15-23 and accompanying text.

14. *Bloomington's by Mail, Ltd. v. Huddleston* (No. 89-3017-II) (Tenn. Chanc. Ct.) (March 8, 1991); *SFA Folio Collections, Inc. v. Huddleston* (No. 89-0315-III) (March 11, 1991).

15. 470 N.W.2d 203 (N.D. 1991) (*cert. granted in part* 112 S. Ct. 49 (Oct. 7, 1991)).

16. See N.D. CENT. CODE § 57-40.2-01 (1991 Supp.), which includes within the definition of retailer "every person who engages in regular or systematic solicitation of a consumer market in this state by the distribution of catalogs, periodicals, advertising flyers, or other advertising, or by means of print, radio or television media, by mail, telegraphy, telephone, computer data base, cable, optic, microwave or other communication system."

17. 470 N.W.2d at 215.

18. *Id.* at 208.

19. 112 S. Ct. 49.

20. See *infra* notes 59-60 and accompanying text.

21. No. CIVS-88-1067, MLS, U.S. Dist. LEXIS 10736 (E.D. Cal. July 12, 1991).

California court, relying on *National Bellas Hess*,²² concluded there is an insufficient nexus for imposing the state tax "where the only connection with customers in the taxing state is by common carrier or the United States mail."²³

As during past survey periods, the comptroller issued far too many administrative decisions and letters to taxpayers to review in this survey. However, a brief overview of a few decisions illustrates some recurring substantive issues. Several decisions focused on the sales tax exemption for occasional sales.²⁴ Although the relevant administrative rule²⁵ allows a buyer to claim an exemption for an acquisition of all operating assets of a business (or of a separate division, branch or segment of a business)²⁶ and further provides that operating assets do not include "assets maintained and used for general business purposes in addition to use by the specific enterprise,"²⁷ there is some uncertainty concerning the availability of the exemption to a buyer who buys less than all the assets of a business or of a segment of a business. However, in Decision 26,443²⁸ the administrative law judge found that assets used for company-wide accounting were not operating assets of the particular segment purchased, and permitted a sales tax exemption notwithstanding the taxpayer's not having purchased those assets. The administrative law judge in Decision 26,520²⁹ correctly concluded that the purchaser of a segment of a business (rather than of the entire business) is not liable for the seller's taxes under the successor liability rules.³⁰ Other decisions addressed the prior contract rule,³¹ extended the circumstances in

22. 386 U.S. 753 (1967).

23. 1991 U.S. Dist. LEXIS at *3.

24. See *infra* notes 25-35 and accompanying text.

25. 34 TEX. ADMIN. CODE § 3.316 (1984).

26. *Id.* § 3.316(d)(1).

27. *Id.* § 3.316(d)(3).

28. Comptroller Hearing No. 26,443 (Feb. 5, 1991).

29. Comptroller Hearing No. 26,520 (Feb. 7, 1991).

30. However, the comptroller has drafted, but not yet proposed, a new Rule 3.7 concerning liability incurred by a purchaser of a business which provides that a person who "sells the business or stock of goods of a business or quits the business" for purposes of this successor liability statute includes, but is not limited to, the person who sells the capital assets of a business, sells the inventory of a business, sells the name and goodwill of a business or sells capital assets, inventory or name and goodwill of a separate division, branch or identifiable segment of a business.

31. 34 TEX. ADMIN. CODE § 3.319 (1990). Recent administrative decisions appear to expand this rule; see, e.g., Comptroller Hearing Nos. 27,421 (June 26, 1991) (agreements signed by customer but not by seller were enforceable under state law and qualified for prior contract status, notwithstanding administrative requirement in Rule 3.319(a)(2) that contracts be signed by both parties); 26,321 (Dec. 19, 1990) (price list agreements treated as "as needed" contracts eligible for prior contract exemption); 26,510 (Oct. 2, 1991) (holding invalid, in the facts in that case, the portion of § 3.319 which eliminates the prior contract exemption upon contact renegotiation).

which use tax is imposed,³² and dealt with taxable services,³³ successor liability,³⁴ and numerous other issues.³⁵

B. Legislative and Regulatory Developments

House Bill 11,³⁶ enacted during the Texas legislature's first 1991 special session, made many significant changes to Texas sales and use taxes.³⁷ Pursuant to newly created chapter 160 of the Tax Code,³⁸ a new Texas sales and use tax is imposed on every retail sale of a taxable boat or motor sold in Texas.³⁹ The new tax rate is 6.25 percent of the total consideration paid.⁴⁰ In addition, new Texas residents who bring a taxable boat or motor into the state are required to pay a one-time \$15 tax for each such taxable boat or motor.⁴¹

The list of taxable services was expanded to include telephone answering

32. Comptroller Hearing No. 26,653 (Jul. 26, 1991), for example, focused on a taxpayer that bought materials outside Texas and, through a manufacturing process that occurred outside Texas, converted the materials into building components that were then brought into Texas. The taxpayer argued that use tax should not be imposed on the materials because the materials were never used in Texas. The administrative law judge concluded, however, that use tax nonetheless is due, and that holding otherwise would place Texas sellers at a competitive disadvantage. *See also*, Comptroller Hearing No. 26,951 (Apr. 12, 1991) (use tax imposed on machine purportedly held for sale by taxpayer because taxpayer had claimed depreciation on the machine for federal income tax purposes); Comptroller Hearing No. 26,321 (Dec. 19, 1990) (computer data storage on discs physically stored in Virginia resulted in Texas use tax because charges were for services that benefitted Texas customers); Comptroller Hearing No. 26,279 (Feb. 11, 1991) (use tax due on out-of-state repairs to property to be used in Texas).

33. Comptroller Hearing No. 27,337 (June 26, 1991), for example, illustrates the difficulty of distinguishing between new construction and remodeling. Acknowledging that the distinction is unclear, the administrative law judge concluded that new construction should be defined narrowly so that it includes only new structures or the addition of square footage, and that real property repair and remodeling should be construed broadly enough to include other improvements. Several other decisions focus on this distinction. *See, e.g.*, Comptroller Hearing Nos. 26,660 (June 11, 1991) (completion of building following demolition phase held remodeling); 27,683 (July 30, 1991) (alterations to building finished out 50 years after construction constituted remodeling). *See generally* Bruskin & Porter, *State Sales Taxes on Services: Massachusetts As a Case Study*, 45 TAX LAW. 49 (1991) (concerning the difficulty of determining how and to what extent a state may tax professional services).

34. *See, e.g.*, Comptroller Hearing No. 26,933 (July 2, 1991) (focusing on whether successor had intended to buy "a business" and concluding that he had not, and that he was not liable for taxes).

35. *See, e.g.*, Comptroller Hearing No. 26,144 (Dec. 4, 1990) (resale exemption for airplane sales not available because planes were not purchased to be resold "in the normal course of [the parties'] business - beer distribution and banking").

36. Act of Aug. 22, 1991, ch 5, 1991 Tex. Sess. Law Serv. (1st C.S.) 134 (Vernon) (hereafter, H.B. 11).

37. Although the limited sales and use tax rate did not change in 1991, the Texas hotel occupancy tax and the motor vehicle and interstate motor carrier sales and use taxes increased to 6.25 percent from 6.0 percent. TEX. TAX CODE ANN. §§ 152.021(b), 152.028(b), 156.052, and 157.102 (Vernon Supp. 1992).

38. *Id.* §§ 160.001-.122.

39. *Id.* §§ 160.021(a), 160.022(a). The term "taxable boat or motor" generally means (i) boats other than those designed to be propelled by paddle, oar or pole, or (ii) outboard motors. *Id.* § 160.001(8).

40. *Id.* §§ 160.021(b), 160.022(a). The 6.25 percent sales and use tax is an obligation of the purchaser or user. TEX. TAX CODE ANN. §§ 160.021(a), and .022(a) (Vernon Supp. 1992).

41. *Id.* § 160.023.

services and wash and detail services.⁴² However, car wash services by certain exempt organizations are not taxable.⁴³

House Bill 11 repealed the exemption from sales and use tax that previously existed for internal and external wrapping, packing, and packaging supplies sold to a person for use, stored for use in furthering the sale of the product wrapped, packed or packaged, or furthering the distribution of any newspaper, whether it is distributed with or without charge.⁴⁴ The terms "wrapping," "packing," and "packaging supplies" are defined very broadly.⁴⁵

There was quite a furor over this legislative change, and in response, the comptroller adopted on an emergency basis a rule which alleviates many of taxpayers' concerns.⁴⁶ The rule provides sales or use tax is not due on containers or packaging supplies purchased by manufacturers for use as part of the completion of the manufacturing process.⁴⁷ However, sales or use tax is due on the sale of packaging supplies to "persons who repack tangible personal property prior to sale, produce shippers who are not original producers, wholesalers, retailers, and service providers for use . . ." in the performance of services, the rental of tangible personal property, or the sale of tangible personal property.⁴⁸ The rule further provides that sales or use tax is not due on containers when sold with the contents, if sales or use tax is not due on the sales price of the contents.⁴⁹

Prior to the enactment of House Bill 11, section 151.311⁵⁰ exempted from sales and use tax tangible personal property purchased by a contractor if used in the performance of a contract for the improvement of realty for (i) the State of Texas, (ii) a county, city, special district, or other political subdivision of the State of Texas, (iii) exempt religious, educational or public service organizations or (iv) in certain circumstances, the Department of Defense.⁵¹ Under the new law, this exemption applies only if the construc-

42. *Id.* § 151.0101(a)(15), (16). The term "telephone answering services" does not include the automated receiving and relaying of telephone messages included within the definition of telecommunications services. *Id.* § 151.0102.

43. *Id.* § 151.350. The phrase "telephone answering services" is defined as the receiving and relaying of telephone messages by a human operator. *Id.* § 151.0102. The term "wash and detail services" means services purchased at a car wash, or the full-service cleaning of the exterior or interior of a motor vehicle. *Id.* § 151.0105.

44. See TEXAS TAX CODE ANN. § 151.321 (Vernon 1982) (repealed by Act of Aug. 22, 1991, ch. 5, § 14.12(3), 1991 Tex. Sess. Law Serv. (1st C.S.) 190 (Vernon)). The resale, manufacturing, container and newspaper exemptions have also been amended to effect the repeal of this former exemption. See TEX. TAX CODE ANN. §§ 151.302(c), .318(c)(5), .319(e)(5) and .322(b)(3) (Vernon Supp. 1992).

45. *Id.* § 151.302(d).

46. 34 TEX. ADMIN. CODE § 3.314 (eff. Oct. 1, 1991, 16 Tex. Reg. 5446).

47. *Id.* § 3.314(b)(1).

48. *Id.* § 3.314(c).

49. *Id.* § 3.314(e)(1). The rule also provides certain exemptions for "export packers," which are persons who package property to be exported outside the United States territorial limits, and makes distinctions between returnable and non-returnable containers. *Id.* § 3.314(c)(2), (3).

50. TEX. TAX CODE ANN. § 151.311 (Vernon Supp. 1992) (as in effect prior to amendment by Act of 1991, ch. 5, § 14.07, 1991 Tex. Sess. Law Serv. (1st C.S.) 188 (Vernon)).

51. *Id.*

tion is for school districts or certain non-profit hospitals.⁵² This legislation had a dramatic impact on the construction industry, and industry representatives quickly sought, and received, assurance from the comptroller that materials used in construction projects for tax-exempt entities other than school districts and hospitals may nonetheless be purchased and used tax free if the underlying construction contract is a "separated contract."⁵³ Amended section 151.318⁵⁴ of the Tax Code alters the phase-in of the manufacturing exemption.⁵⁵ The revised section provides that equipment used or consumed in the manufacturing process will be eligible for a complete or partial exemption from sales and use tax pursuant to the following schedule: (i) for manufacturing equipment purchased after September 30, 1993 and before January 1, 1994, the exemption equals fifty percent of the sales price; (ii) for manufacturing equipment purchased during 1994, the exemption equals seventy-five percent of the sales price; and (iii) for manufacturing equipment purchased in 1995 and after, there is a complete exemption.⁵⁶ Prior to this 1991 amendment, the phase-in of the exemption was more rapid. There was a twenty-five percent exemption in 1991 and 1992 (although in 1991 the exemption was in the form of a refund) and a fifty percent exemption throughout 1993, with the same exemption as exists under the new legislation for 1994 and thereafter.⁵⁷ This delay in the phase-in of the exemption is somewhat ameliorated by the new franchise tax credit for sales taxes paid on manufacturing equipment.⁵⁸

In order to broaden the scope of persons required to collect and remit sales tax, the Texas legislature broadened the definitions of "sellers" and "retailers" to include any person engaging in regular or systematic solicitation of sales of taxable items in Texas by the distribution of catalogs, periodicals, advertising flyers or other advertising, by means of print, radio or television media, or by mail, telegraphy, telephone, computer data base, cable, optic, microwave, or other communication system for the purpose of effecting taxable sales.⁵⁹ The legislature similarly revamped the definition of "retailer engaged in business in this state."⁶⁰

The sales and use tax on taxable real property services was amended to exempt the removal or collection of hazardous wastes, industrial solid wastes

52. TEX. TAX CODE ANN. § 151.311 (Vernon Supp. 1992).

53. See 34 TEX. ADMIN. CODE § 3.291 (eff. Sept. 13, 1988, 13 Tex. Reg. 4097) (explaining the difference between separated and lump-sum contracts).

54. TEX. TAX CODE ANN. § 151.318 (Vernon Supp. 1992).

55. *Id.*

56. *Id.* § 151.318(h).

57. TEX. TAX CODE ANN. § 151.318(h) (Vernon Supp 1992) (as in effect prior to amendment by Act of 1991, ch. 5, § 14.081, 1991 Tex. Sess. Law Serv. (1st C.S.) 189-90 (Vernon)).

58. For a discussion of the new franchise tax credit for sales taxes paid on manufacturing equipment, see notes 153-57 and accompanying text.

The Texas legislature also narrowed the exemption for amusement services exclusively provided by nonprofit corporations or associations. The exemption now does not apply to entities described under Section 501(c)(7) of the Internal Revenue Code (i.e., certain clubs organized for pleasure, recreation and other non-profitable purposes). TEX. TAX CODE ANN. § 151.3101 (Vernon Supp. 1992).

59. *Id.* § 151.008(b)(5).

60. *Id.* § 151.107(a)(4). This change adopts language similar to the North Dakota statute

and certain other waste materials.⁶¹ Certain other exemptions were added to benefit the deaf and blind.⁶² The natural gas exemption is now limited to natural gas that is taxed as a motor fuel.⁶³ Tangible personal property transferred as an integral part of an exempt service may not be purchased for resale.⁶⁴ Pursuant to new section 151.060⁶⁵ of the Tax Code, a person repairing a motor vehicle is treated as the seller of all tangible personal property consumed in providing the repairs, and as seller, the repair person must collect tax from the consumer on such property.⁶⁶ However, if the contract between the repair person and the customer contains a lump-sum price covering services and tangible personal property, the repair person is treated as the consumer.⁶⁷

As in past years, the comptroller issued new regulations and made significant revisions to others. The purpose of some of the new rules and revisions was to make regulations consistent with new legislation. For example, an emergency rule was adopted to reflect the 1991 legislation that imposes a sales and use tax on purchases of taxable boats and boat motors.⁶⁸ In addition, amended emergency Rule 3.310⁶⁹ provides that wrapping and packaging supplies (such as clothes hangers and bags) used by those providing laundry or dry cleaning services, which supplies are transferred to the customer with the laundered or cleaned item, are not exempt.⁷⁰ Amended Rule 3.285⁷¹ provides that tax is due on an item removed from a tax-free inventory for use in Texas.⁷² The rule also makes clear that a purchaser may give a resale certificate on the purchase of an item which the purchaser intends to sell, lease or rent as an integral part of a taxable service.⁷³ The

at issue in *State v. Quill Corp.*, 470 N.W.2d 203 (N.D. 1990), *cert. granted in part*, 112 S. Ct. 49 (Oct. 7, 1991). See *supra* notes 15-20 and accompanying text.

House Bill 11 also eliminated the \$25 sales tax permit fee. TEX. TAX CODE ANN. § 151.201(d) (repealed by Act of 1991, ch. 5, § 14.12(1), 1991 Tex. Sess. Law Serv. (1st C.S.) 190 (Vernon)).

61. *Id.* § 151.0048.

62. Pursuant to TEX. TAX CODE ANN. § 151.313(b) (Vernon Supp. 1992), a light signal and device to adapt certain items for the deaf, and adaptive devices or software for computers used by deaf persons, are exempt.

63. *Id.* § 151.308(b).

64. *Id.* § 151.346(e).

65. *Id.* § 151.060.

66. *Id.* § 151.060(a). However, the repair person is not considered to be the seller of electricity and gas. *Id.* § 151.060(a).

67. *Id.* § 151.060(b).

68. 34 TEX. ADMIN. CODE § 3.741 (eff. Feb. 5, 1992, 17 Tex. Reg. 475).

69. 34 TEX. ADMIN. CODE § 3.310 (eff. Jan. 1, 1992, 16 Tex. Reg. 7360).

70. *Id.* § 3.310(d). See also *supra* notes 44-49 and accompanying text discussing Rule 3.314, which addresses the sales and use tax on wrapping and packaging supplies.

In addition to these rule changes based on new legislation, an emergency amendment has been made to the rule addressing the calculation of the proportioned sales and use tax applied to motor vehicles of interstate carriers to reflect the recent increase in tax rates applied to such carriers. 34 TEX. ADMIN. CODE § 3.444 (eff. Feb. 5, 1992, 17 Tex. Reg. 474).

71. 34 TEX. ADMIN. CODE § 3.285 (eff. Sept. 18, 1991, 16 Tex. Reg. 4957).

72. *Id.* § 3.285(e)(1).

73. *Id.* § 3.285(b)(3). Under the prior rule, a resale certificate could not be given if, at the time of purchase, the purchaser did not know whether the item would be resold, leased, rented or used for some other purpose. See 16 Tex. Reg. 3245.

comptroller made other important changes with respect to resale certificates in Rules 3.282,⁷⁴ 3.285,⁷⁵ and 3.287.⁷⁶

Rule 3.253,⁷⁷ as amended, broadened the types of activities that cause a retailer to be engaged in business within a county and thereby subject to the county use tax.⁷⁸ Rules 3.425⁷⁹ and 3.375⁸⁰ were similarly amended to change the definition of "engaged in business" for transit and city use tax purposes.⁸¹ Rule 3.313⁸² was amended to provide that cable television service connection fees are taxable.⁸³ The rule defining data processing services was amended to clarify that interpretive and enhancement geophysical services are not taxable data processing services.⁸⁴ Rule 3.346,⁸⁵ addressing the use tax, was amended to implement⁸⁶ legislation following a United States Supreme Court decision upholding the imposition of the Louisiana use tax on catalogs shipped from outside the state to Louisiana residents.⁸⁷ New Rule 3.359⁸⁸ addresses the sales and use tax responsibilities of repair persons of motor vehicles and aircraft.⁸⁹ The rule addressing exempt organizations was amended by adding a new subsection which provides a list of entities that must prove exempt status.⁹⁰

II. FRANCHISE TAX

A. Liability for Tax - Doing Business in Texas

In *Sharp v. House of Lloyd, Inc.*,⁹¹ the Texas supreme court reversed an appellate decision⁹² that had been a significant victory for taxpayers. Taxpayers argued that the comptroller had construed the "doing business" standard to exclude companies whose only ties to Texas were sales effected by independent contractors, that the legislature had re-enacted the franchise tax without changing this standard, and that the comptroller could therefore not change his interpretation without clear statutory authority.⁹³ However, the

74. 34 TEX. ADMIN. CODE § 3.282 (eff. Sept. 16, 1991, 16 Tex Reg. 4844).

75. 34 TEX. ADMIN. CODE § 3.285.

76. 34 TEX. ADMIN. CODE § 3.287 (eff. Sept. 10, 1991, 16 Tex. Reg. 4681). Among other changes, these rules tightened verification procedures for resale certificates. See 34 TEX. ADMIN. CODE ANN. §§ 3.282, 295, 3.297.

77. 34 TEX. ADMIN. CODE § 3.253 (eff. Sept 10, 1991, 16 Tex Reg. 4681).

78. *Id.*

79. 34 TEX. ADMIN. CODE § 3.425 (eff. Sept. 10, 1991, 16 Tex. Reg. 4682).

80. 34 TEX. ADMIN. CODE § 3.375 (eff. Sept. 10, 1991, 16 Tex. Reg. 4681).

81. *Id.* § 3.375(a)(1).

82. 34 TEX. ADMIN. CODE § 3.313 (eff. June 25, 1991, 16 Tex. Reg. 3195).

83. *Id.* § 3.313(b)(1).

84. 34 TEX. ADMIN. CODE § 3.330 (eff. Feb. 28, 1991, 16 Tex. Reg. 987).

85. TEX. ADMIN. CODE § 3.346 (eff. Dec. 21, 1991, 15 Tex. Reg. 7029).

86. § 3.346(b)(3).

87. *Id.*; see *D.H. Holmes Co., Ltd. v. McNamera*, 486 U.S. 24 (1988).

88. 34 TEX. ADMIN. CODE § 3.359 (eff. Oct. 7, 1991, 16 Tex. Reg. 5216).

89. *Id.*

90. TEX. ADMIN. CODE § 3.322(b) (eff. Sept. 10, 1991, 16 Tex. Reg. 4681).

91. 815 S.W.2d 245 (Tex. 1991).

92. *Bullock v. House of Lloyd, Inc.*, 797 S.W.2d 133 (Tex. App. —Austin 1990), *rev'd*, *Sharp v. House of Lloyd, Inc.* See Ohlenforst & Dorrill, 1990 Survey at 655-56 for a summary of *Bullock v. House of Lloyd*.

93. 805 S.W.2d at 248; 797 S.W.2d at 135.

Supreme Court concluded that the statute extends to corporations effecting sales through independent contractors,⁹⁴ that the comptroller had never affirmatively adopted an agency policy to the contrary,⁹⁵ and that he had no discretion to adopt a policy inconsistent with the legislature's intent to tax such businesses.⁹⁶ The decision is a disappointing one for taxpayers, not only because it reverses a favorable and well-reasoned appellate decision, but also because it accords so little weight to longstanding comptroller enforcement policies. (The parties had stipulated that the comptroller had, prior to 1983, never interpreted the "doing business" requirement to impose a tax on foreign corporations that effected sales in Texas through independent contractors.⁹⁷) The decision is also noteworthy for its apparent conclusion that, notwithstanding the long history of contested cases and revised interpretations from the comptroller, the statutory "doing business" standard is not ambiguous.⁹⁸

B. Calculation and Allocation of Taxable Capital

Several administrative decisions focused on the calculation of surplus. In Decision 25,528,⁹⁹ for example, a taxpayer was permitted to establish by evidence other than its financial books and records that a loan to its parent corporation should be treated as a loan to the taxpayer. Decision 26,751¹⁰⁰ required a taxpayer to include in surplus certain liability accounts set up for warranty and product liability expenses, and for pension and other post-retirement benefits.¹⁰¹ The administrative law judge relied heavily in reaching his decision on the fact that the account amounts were estimates rather than exact amounts. The comptroller also confirmed, in Decisions 23,873 and 26,405,¹⁰² his view that pre-acquisition earnings of second-tier and lower-tier subsidiaries must be included in surplus.

Decision 24,365¹⁰³ held invalid a regulatory requirement that taxpayers use a particular accounting method for investment tax credit in computing

94. 805 S.W.2d at 248.

95. *Id.*

96. *Id.* at 249.

97. *Id.* at 247.

98. *Id.* at 248.

99. Comptroller Hearing No. 25,528 (April 17, 1991).

100. Comptroller Hearing No. 26,751 (Feb. 7, 1991).

101. The legislature specifically required inclusion of certain retirement benefits in surplus by its 1991 revisions to the Texas Tax Code. See TEX. TAX CODE ANN. § 171.109(j)(1) (Vernon Supp. 1992). The amendatory statute recites that the employee benefit inclusion in surplus is intended to be a "clarification of existing law and not a substantive change" (H.B. 11, art. 8, § 8.081), although the accuracy of that statement is open to question. See also Comptroller Hearing No. 26,424 (May 2, 1991) (holding a reserve for layoff and plant closing employee benefits includable in surplus). However, in the past the comptroller apparently permitted taxpayers to exclude retirement benefits that were vested, even if such benefits had not actually been paid during the tax year.

102. Comptroller Hearing Nos. 23,873 and 26,405 (Apr. 29, 1991). This decision, which the administrative law judge found consistent with *State v. Sun Refining & Marketing*, 740 S.W.2d 552 (Tex. App.—Austin, writ denied), also required inclusion in surplus of first tier subsidiary formed to acquire target corporation.

103. Comptroller Hearing No. 24,365 (Dec. 6, 1990).

taxable surplus,¹⁰⁴ the administrative law judge found that the rule exceeded the comptroller's rulemaking authority by prohibiting the taxpayer from using a method permitted by the Tax Code.¹⁰⁵

C. Legislative Developments

The franchise tax changes enacted by the Texas legislature this summer as part of House Bill 11¹⁰⁶ were the product of a last-minute furor of drafting and compromising. These changes reflect both the accomplishment of avoiding a disastrous budget shortfall and the failure of enacting a bill marred by confusing provisions and drafting errors. As amended, the franchise tax effectively imposes an income tax on many corporations.

1. Entities subject to tax.

According to section 171.001 of the Tax Code,¹⁰⁷ Texas franchise tax applies to:

- (1) each corporation that does business in this state or that is chartered or authorized to do business in this state, and
- (2) each limited liability company that does business in this state or that is organized under the laws of this state or is authorized to do business in this state.¹⁰⁸

The definitional sections make clear that the tax applies to banking corporations,¹⁰⁹ limited liability companies,¹¹⁰ and savings and loans.¹¹¹ Banks have been subject to the tax for several years,¹¹² but savings and loan associations had previously been exempt.¹¹³ The legislature tightened the

104. See 34 TEX. ADMIN. CODE § 3.405(e)(2).

105. Comptroller Hearing No. 24,365 (Dec. 6, 1990).

106. See *supra* note 36.

107. TEX. TAX CODE ANN. § 171.001 (Vernon Supp. 1992).

108. *Id.* § 171.001(a)(1), (2).

109. *Id.* § 171.001(b)(1) ("banking corporation" includes each state, national, domestic, or foreign bank, and each bank organized under 12 U.S.C. §§ 611-31 (section 25(a) of the Federal Reserve Act), but does not include bank holding companies as defined by 12 U.S.C. § 1841 (section (2) of the Bank Holding Act of 1956)).

110. TEX. TAX CODE ANN. § 171.001(b)(2)(A) (Vernon Supp. 1992) (the term "corporation" includes a limited liability company as defined under the Texas Limited Liability Company Act (TEX. REV. CIV. STAT. ANN. art. 1528n (Vernon Supp. 1992))). This definition could allow an argument that a limited liability company organized under the law of another state is not subject to the tax. However, references in the Texas Limited Liability Act to foreign limited liability companies (see, e.g., art. 1.02(9) of the Texas act which defines "Foreign Limited Liability Company") indicate that the Texas act contemplates not only limited liability companies organized under the Texas act, but also those organized under the laws of other states. Moreover, the Tax Code statement that franchise tax is imposed on "each limited liability company that does business in this state or that is organized under the laws of this state or is authorized to do business in this state" (TEX. TAX CODE ANN. § 171.001(a)(2)) parallels the references to corporations in section 171.001(a)(1), which encompasses both domestic and foreign entities.

111. TEX. TAX CODE ANN. § 171.001(b)(2)(B) (Vernon Supp. 1992). Note that former TEX. TAX. CODE ANN. § 171.054 (that exempted savings and loan associations from the franchise tax) was repealed by H.B. 11, art. 8, § 8.24.

112. The legislature repealed the exemption from franchise tax for banks (formerly TEX. TAX CODE ANN. § 171.078) in 1984. Acts 1984, 68th Leg., 2nd C.S., ch. 31, art. 3, part B.

113. See *supra* note 111.

rules applicable to tax exempt entities by terminating the franchise tax exemption more quickly for corporations whose federal exemption is terminated.¹¹⁴

Although the legislature considered adopting a franchise tax that would have applied to all business entities,¹¹⁵ the tax as finally enacted does not extend to partnerships, joint ventures, trusts,¹¹⁶ sole proprietorships or limited liability partnerships.¹¹⁷ Some businesses may, therefore, be able to escape the tax by conducting business through noncorporate vehicles, including limited partnerships comprised of corporations. As more companies strive to shield corporate limited partners from the franchise tax, the comptroller may have more incentive than ever to assert that a limited partnership or its general partner is an agent for its corporate limited partners or that the corporate limited partners are otherwise doing business in Texas.

Because the legislature retained the "doing business" standard for imposing franchise tax on foreign corporations,¹¹⁸ existing law continues to apply in determining which entities are subject to Texas franchise jurisdiction. However, Public Law 86-272,¹¹⁹ a federal law that limits states' ability to impose a net income tax on taxpayers whose only ties to the taxing state are certain limited solicitation activities, will limit the franchise tax to the extent it is computed by reference to a corporation's net taxable earned surplus. Thus, some taxpayers may be subject to Texas jurisdiction for purposes of the tax on capital but not for purposes of a tax on income.

Congress enacted Public Law 86-272 in 1959¹²⁰ to prohibit a state from imposing a net income tax on the income derived within the state by any

114. TEX. TAX CODE ANN. § 171.063(g) (Vernon Supp. 1992), as revised by H.B. 11, provides that if a corporation's federal tax exemption is withdrawn by the Internal Revenue Service because the corporation has failed to qualify or maintain qualification for exemption, the corporation's exemption from franchise tax ends on the withdrawal date. Prior law had allowed the exemption to continue until April 30 (the end of the regular franchise tax annual period) following the withdrawal.

115. See, e.g., House Bill 1553 (introduced by Rep. James Hury).

116. However, certain REITS (Real Estate Investment Trusts) incorporated under state law are subject to tax.

117. The 1991 legislature also created registered limited liability partnerships (TEX. REV. CIV. STAT. ANN. art. 6132b, § 45-A (Vernon Supp. 1992)) to allow general partners protection from liability for the "errors, omissions, negligence, incompetence or malfeasance" committed in the course of partnership business by another partner or representative "not working under the supervision or direction of such partner" provided the partnership complies with certain statutory requirements. The Tax Code does not extend the franchise tax to limited liability partnerships.

118. It is now well-established that the threshold for "doing business" for franchise tax purposes is much lower than the "transacting business" standard for TBCA purposes. See, e.g., Comptroller Decision No. 10,216 (Aug. 19, 1981) (comptroller interpretation that TBCA art. 8.01 exclusions from "transacting business" do not apply to "doing business" test). Subsequent decisions made clear that the standards are different. See also, supra notes 91-98 and accompanying text.

119. Pub. L. 86-272, 73 Stat. 555, 15 U.S.C. § 381 (West 1976).

120. Several court cases construing Public Law 86-272 offer a good overview of its history and purpose. See generally, *Heublein, Inc. v. South Carolina Tax Comm'n*, 409 U.S. 275 (1972); *William Wrigley, Jr. Co. v. Wisconsin Dep't of Revenue*, 465 N.W.2d 800 (Wis. 1991), cert. granted, 112 S. Ct. 49 (U.S. 1991) (No. 91,194) (oral argument Jan. 22, 1991) (case discusses development of the law).

person from interstate commerce if the only business activities within such state are "the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State"¹²¹ or similar solicitation for a prospective customer.¹²² This prohibition, which does not extend to corporations incorporated under the laws of the taxing state¹²³ or to individuals who are domiciled in or residents of the taxing state,¹²⁴ is likely to result in significant interpretative problems as the comptroller is required, for the first time, to incorporate the Public Law 86-272 restrictions into his regulations.¹²⁵

2. Calculation of the tax.

The revised franchise tax, which is technically a combination of a tax on net taxable capital and a tax on net taxable earned surplus, is generally the greater of 0.25% per year of privilege period of net taxable capital or 4.5% of "net taxable earned surplus."¹²⁶ The part of the new tax that is based on taxable capital is a modification of the old franchise tax, although the legislature further expanded taxable capital by requiring taxpayers to calculate surplus without reduction for deferred income taxes,¹²⁷ deferred investment tax credit,¹²⁸ or liabilities for compensation and other non-wage employee bene-

121. 15 U.S.C. § 381(a)(1) (West 1976).

122. *Id.* § 381(a)(2).

123. *Id.* § 381(b).

124. *Id.*

125. 15 U.S.C. § 381 further provides that a person will not be considered to have engaged in business activities in a state during a taxable year

merely by reason of sales in such State, or the solicitation of orders for such sales in such State, of tangible personal property on behalf of such person by one or more independent contractors, or by reason of the maintenance, of an office in such State by one or more independent contractors whose activities on behalf of such person in such State consist solely of making sales, or soliciting orders for sales, of tangible personal property.

This restriction undercuts the comptroller's ability to extend the earned surplus component of the tax to taxpayers subject to Texas jurisdiction under the rationale of *Sharp v. House of Lloyd*.

126. TEX. TAX CODE ANN. § 171.002 (Vernon Supp. 1992). Neither the capital tax nor the earned surplus tax can be a negative number for purposes of this calculation. TEX. TAX CODE ANN. § 171.002(c) (Vernon Supp. 1992). Treating a portion of the tax as a tax on capital is intended to help taxpayers who claim a credit in other states for taxes paid on capital. Although the tax is generally the same for all entities, specialized rules apply to certain taxpayers. *See, e.g.*, TEX. TAX CODE ANN. § 171.1031 (Vernon Supp. 1992) (for apportionment of taxable capital and taxable earned surplus of banking corporations and savings and loan association taxpayers, interest and dividends received are gross receipts from business in Texas if the taxpayer has its commercial domicile in Texas). Taxpayers may also claim a deduction from apportioned taxable capital or earned surplus for a portion of its investment in an enterprise project or solar energy device. *See* TEX. TAX CODE ANN. §§ 171.1051, 171.107 (Vernon Supp. 1992).

127. *See* TEX. TAX CODE ANN. § 171.109 (Vernon Supp. 1992). (H.B. 11 rewrote Tex. Tax Code Ann. § 171.109 to exclude Section 171.109(i)(e) which had permitted deferred income taxes to be excluded from surplus).

128. TEX. TAX CODE ANN. § 171.109(j)(2) (Vernon Supp. 1992).

fits that are not payable in the current accounting year.¹²⁹

The new component of the tax is based on "net taxable earned surplus"¹³⁰ and is, in essence, a tax on a corporation's income. A corporation's earned surplus is based on its reportable federal taxable income, less certain deductions not including net operating loss deductions.¹³¹ Because this component of the tax is calculated by reference to taxable income for federal income tax purposes, the Tax Code now includes a definition of the Internal Revenue Code.¹³² The Texas drafters were concerned that defining the Tax Code by reference to the Internal Revenue Code as in effect at any future time would effectively permit federal legislation to modify Texas law, and thus constitute an impermissible delegation of legislative power. Therefore, the legislators defined the Internal Revenue Code as in effect for "the federal tax year beginning on or after January 1, 1990, and before January 1, 1991, and any regulations adopted under that code applicable to that period."¹³³

One of the most significant provisions in the new law is the requirement that compensation for officers and directors of corporations with more than thirty-five shareholders be added to taxable income.¹³⁴ This requirement potentially imposes a tax, payable by the corporation, of up to 4.5% of the compensation of some of its most highly compensated individuals. Although the thirty-five shareholder restriction is a significant one, there is some flexibility in computing the number of shareholders. For example, the legislature provided that an approved Employee Stock Ownership Plan controlling a minority interest and voting through a single trustee is considered one shareholder,¹³⁵ and the comptroller confirmed orally soon after the legislation was enacted that a partnership is considered one shareholder, regardless of the number of its partners.¹³⁶ Some corporations will be able to reduce the number of their shareholders to thirty-five or fewer, and thereby escape the

129. *Id.* § 171.109(j)(1). See *supra* note 101 and accompanying text.

130. See TEX. TAX CODE ANN. §§ 171.002(a)(2), 171.110 (Vernon Supp. 1992).

131. TEX. TAX CODE ANN. § 171.110(a), (d).

132. *Id.* § 171.001(b)(4).

133. *Id.*

134. See *id.* § 171.110(a)(1) (Vernon Supp. 1992), which requires a corporation to include in its computation of net taxable earned surplus "any compensation of officers or directors, or if a bank, any compensation of directors and executive officers, to the extent excluded in determining federal taxable income . . ." The legislature granted banks relief from the general rule that, if applicable, would have required adding back the salaries of untold numbers of bank vice-presidents. *Id.* The savings and loan industry, on the other hand, must follow the general rule that compensation of all officers be included in the addback. For a limited liability company, officer and director includes its directors and managers, and shareholder includes its members. *Id.* § 171.001(b)(5), (7).

135. *Id.* § 171.110(g) (Vernon Supp. 1992).

136. Speculation exists that the comptroller may retract this interpretation and attempt to "look through" the partnership to its partners. See *Tax Policy News* (Comptroller, Austin, Texas) Jan. 1991, at 6 ("[t]he Comptroller's position is that a separate legal entity holding shares in a corporation will be treated as one shareholder unless it is determined that the entity was organized for the primary purpose of holding stock in the corporation."). However, there appears to be no statutory authority for such a look-through approach. Contrast the legislature's silence on this partnership issue with the specific legislative provision allowing a limited look-through in the corporate context. See TEX. TAX CODE ANN. § 171.110(c) (Vernon Supp. 1992) (a corporation with fewer than 35 shareholders will be required to add back compensation if its parent corporation has more than 35 shareholders).

compensation tax. Although such planning may frustrate the comptroller, a company decision to buy out minority shareholders or a shareholder decision to hold shares through a partnership is much like the decision to operate as a partnership rather than as a corporation: it is a choice of a form that, under Texas law, should allow certain tax benefits to those who are willing and able to implement those decisions.

The compensation addback has its origins in early drafts of franchise tax legislation which would have applied the tax to unincorporated entities as well as to corporations.¹³⁷ The addback of certain salaries to corporate taxable income was intended, at least in part, to put corporations on a more even footing with unincorporated entities (such as partnerships) whose income often includes the equivalent of corporate officers' compensation and to avoid the disparity in calculating taxable income that might otherwise have existed between corporations and non-corporate entities. Although the legislature opted not to tax non-corporate entities (except for limited liability companies and other entities specifically included, as noted above),¹³⁸ it retained the addback of employee compensation because of the significant revenue involved.¹³⁹

The tax rates are applied only to the taxable capital and taxable earned surplus that are apportioned to Texas.¹⁴⁰ The apportionment of capital and of earned surplus to Texas is based on a single-factor gross receipts formula. Taxable capital and taxable earned surplus are both apportioned to Texas by multiplying the corporation's taxable capital by a fraction, the numerator of which is the corporation's gross receipts from business done in Texas and the denominator of which is the corporation's gross receipts from its entire business.¹⁴¹ The taxable capital test is based on generally accepted accounting principles,¹⁴² however, and the earned surplus test is based on federal income tax principles.¹⁴³ The legislature apparently intended to exclude all foreign-source income from the earned surplus base and the earned surplus gross receipts formula.¹⁴⁴ However, the statutory language enacted¹⁴⁵ excludes only certain types of foreign-source income, specifically, amounts in-

137. See *supra* note 115 and accompanying text.

138. See *supra* notes 108-111 and accompanying text.

139. According to budget numbers provided to legislators, approximately 50% of the increased revenue from the franchise tax is attributable to the compensation addback.

140. See TEX. TAX CODE ANN. § 171.106 (Vernon Supp. 1992).

141. *Id.* § 171.106(a) as determined under § 171.103 (general rule for gross receipts from business done in Texas for taxable capital) or § 171.1031 (apportionment of taxable capital and earned surplus of banking corporations and savings and loan associations). *Id.* § 171.106(b), as determined under § 171.1031 (apportionment of taxable capital and earned surplus of banking corporations and savings and loan associations) or § 171.1032 (determination of gross receipts from business in Texas for taxable earned surplus).

142. *Id.* § 171.112(b).

143. *Id.* § 171.1121(b).

144. The language with respect to foreign income was based on an Ohio statute (OHIO REV. CODE ANN. § 5733.04 [§ 143-065] (Anderson 1991)); a drafting error resulted in omitting language that would have excluded all foreign source income from the tax base. Legislators have confirmed this intent informally.

145. See TEX. TAX CODE ANN. §§ 171.110(a)(1), 171.1032(b).

cluded pursuant to Internal Revenue Code Section 78¹⁴⁶ (relating to deemed dividends to certain domestic corporations) or Sections 951 through 964¹⁴⁷ (relating to controlled foreign corporations), and dividends received from a subsidiary, associate, or affiliated corporation that "does not transact a substantial portion of its business or regularly maintain a substantial portion of its assets in the United States."¹⁴⁸ The Texas legislature did not exclude other foreign-source income, such as income earned directly from foreign sources, and further legislative action would apparently be necessary to exclude all-foreign-sourced income.

A complex provision of the new law¹⁴⁹ allows taxpayers to elect a credit designed to offer relief to taxpayers who are subject to reporting deferred income taxes under an accounting standard that, in the absence of the credit provisions, could result in unfavorable financial reporting requirements for certain taxpayers.¹⁵⁰ Although the credit was designed for companies that have a higher book basis than tax basis for assets, the statutory language appears to allow a company with a higher tax basis than book basis to claim a credit. Section 171.111(b) refers to the difference between the basis used for financial accounting purposes and the basis used for federal income tax basis that at some future date will reverse,¹⁵¹ without specifying that the difference must result from an excess of book basis over tax basis. The comptroller, however, is taking the position that no credit is available with

146. 26 U.S.C. § 78 (1999).

147. *Id.* §§ 951-64.

148. States' ability to tax foreign dividends has given rise to litigation in other states. *See, e.g., Kraft, Inc. v. Iowa Dep't of Revenue & Finance*, 465 N.W.2d 664 (Iowa 1991), *petition for cert. filed*, 60 U.S.L.W. 3000 (U.S. July 2, 1991) (No. 90-1918) (Iowa tax which excludes from the tax base dividends from domestic subsidiaries, but not dividends from foreign subsidiaries, is constitutional); *White v. Kimberly-Clark Corp.*, 503 So.2d 296, 303-04 (Ala. Civ. App. 1986), *aff'd sub. nom. Ex parte Kimberly-Clark Corp.*, 503 So.2d 304 (Ala. 1987) (a state is permitted to tax Internal Revenue Code Section 78 gross up income and Section 951 income).

149. TEX. TAX CODE ANN. § 171.111 (Vernon Supp. 1992).

150. Financial Accounting Board Standard 96. A corporation is not permitted to convey, assign or transfer the election to claim the credit. TEX. TAX CODE ANN. § 171.111(a) (Vernon Supp. 1992). A taxpayer that wishes to elect this credit must notify the Comptroller in writing of its intent to preserve its right to take a credit no later than March 1, 1992. The corporation may thereafter elect to claim the credit for the current year and any future year at or before the original due date of any report due after January 1, 1992, until the earlier of (i) corporation's revoking the election, or (ii) the date the credit section expires (September 1, 2012 according to § 171.111(i)). *Id.* A taxpayer that claims this credit is required to pay an additional tax equal to 0.2 % of the corporation's net taxable capital per year of privilege period. *Id.* § 171.111(h). Some confusion arose concerning this "additional tax" because a pre-enactment version of the relevant statutory language increased the rate of the capital component of the tax, but did not create a separate "additional tax." The statute provides that a corporation may claim the credit for not more than 20 consecutive privilege periods beginning with the first report due after January 1, 1992. Only one election is permissible. *Id.* § 171.111(a). The comptroller's position is that the corporation must pay the additional 0.2% tax on net taxable capital to maintain the election — even for years in which the corporation is unable to utilize the credit. Comptroller representatives have said that a taxpayer who inadvertently fails to pay the surtax will therefore be deemed to have revoked its election and will be unable to elect again to take a credit.

151. TEX. TAX CODE ANN. § 171.111(b) (Vernon Supp. 1992).

respect to assets with a tax basis in excess of book basis.¹⁵²

Section 171.0021¹⁵³ of the Tax Code now provides for a credit against the franchise tax for sales and use taxes paid (i) by a corporation engaged in manufacturing, processing, fabricating, or repairing tangible personal property for ultimate sale or engaged in certain jet turbine engine repairs, overhauls and retrofittings,¹⁵⁴ or (ii) for certain property (including certain manufacturing equipment, replacement parts, or certain equipment used in connection with jet turbine engines)¹⁵⁵ with a useful life in excess of six months if used or consumed in or during the manufacturing, processing, fabricating, or repair process.¹⁵⁶ The total amount of the credit against franchise tax allowed is equal to the sum of (i) twenty-five percent of the Texas sales and use tax paid for property purchased on or after October 1, 1991, and before January 1, 1993, and (ii) fifty percent of the Texas sales and use tax paid for property purchased on or after January 1, 1993, and before October 1, 1993.¹⁵⁷

The legislature recognized that companies might escape the tax on earned surplus by escaping Texas jurisdiction (at least for purposes of the tax on earned surplus) after the effective date of the tax but prior to year-end. Section 171.0011¹⁵⁸ is designed to impose an additional tax on a corporation that is subject to the franchise tax, but which is "no longer subject to the taxing jurisdiction of this state in relation to the tax on net taxable earned surplus."¹⁵⁹ This additional tax is equal to the 4.5% rate on earned surplus (or whatever the rate on earned surplus is for the year at issue)¹⁶⁰ multiplied by the corporation's net taxable earned surplus for the period beginning on the day after the last day for which the tax imposed on net taxable earned surplus was computed and ending on the day the corporation is no longer subject to Texas' taxing jurisdiction on net taxable earned surplus.¹⁶¹ Is a corporation that is subject to tax at the beginning of the year, and which

152. According to the instructions that accompany the form promulgated to preserve the right to the credit:

[t]he credit is for timing differences that exist at the corporation's normal accounting year end in 1991. These differences represent the *excess of the basis used for financial accounting purposes over the the basis used for federal income tax purposes* of qualifying assets or liabilities that at some future date will reverse.

(emphasis added).

153. *Id.* § 171.0021.

154. *Id.* at § 171.0021(a).

155. *Id.*

156. *Id.*

157. *Id.* § 171.0021(b)(1), (2). The credit may be claimed on the first franchise tax report due after January 1, 1994. *Id.* § 171.0021(c), (d) (gives specific rules with respect to carryovers, and provides that a corporation may not convey, assign, or transfer the credit allowed under this section to another entity). Section 171.0021 expires September 1, 1999. *Id.* § 171.0021(g). Existing law under TEX. TAX CODE ANN. § 151.318 (exemptions from sales tax for certain property used in manufacturing) provides substantial guidance on issues with respect to the types of qualified property, including with respect to the six-month requirement.

158. TEX. TAX CODE ANN. § 171.001 (Vernon Supp. 1992).

159. *Id.*

160. *Id.*

161. *Id.*

subsequently withdraws completely from the state, subject to the additional tax? The statutory language could be construed to apply only to corporations that continue to be subject to the tax on capital, but this section is likely to be construed to impose a tax on corporations that withdraw completely from the state during the year. Because this provision was not effective until January 1, 1992,¹⁶² it does not reach corporations that withdrew from Texas during 1991. The comptroller's 1992 Transition Rule¹⁶³ is essentially an effort to do what the legislature did not do — make the additional tax apply to 1991 withdrawals.

3. *Criminal Liability for Wilful and Fraudulent Acts.*

Section 171.363¹⁶⁴ of the Tax Code is a new section that imposes criminal penalties for "wilful and fraudulent acts."¹⁶⁵ This section provides that a corporation commits an offense if it is subject to the franchise tax provisions and wilfully fails to file a report or to keep required books and records, files a fraudulent report, violates "any rule of the comptroller for the administration and enforcement" of the franchise tax provisions, or attempts "in any other manner to evade or defeat any tax"¹⁶⁶ imposed under the franchise tax statutes. Section 171.363 was apparently intended, at least in part, to encourage taxpayers to file all required reports and returns.¹⁶⁷ However, the language is so broad (especially the references to violating "any rule of the Comptroller" or attempting "in any other manner to evade or defeat any tax")¹⁶⁸ that the state could argue that the statute reaches a taxpayer who in good faith takes a position that is contrary to an administrative rule, or applies to corporate reorganizations, mergers or other planning devices, although such an interpretation seems far too broad to justify. The statute should be construed to apply to fraudulent alteration of the books and

162. H.B. 11, § 8.27.

163. 34 TEX. ADMIN. CODE ANN. § 3.572 (proposed Nov. 19, 1991, 16 Tex. Reg. 6847). See *supra* notes 171-175 and accompanying text.

164. TEX. TAX CODE ANN. § 171.363 (Vernon Supp. 1992).

165. TEX. TAX CODE ANN. § 171.363(a)(5) parallels Internal Revenue Code Section 7201 (26 U.S.C. § 7201), and TEX. TAX CODE ANN. § 171.363(a)(1), (2) appears to cover types of offenses that, on a federal level, would be covered by Internal Revenue Code Section 7203 (26 U.S.C. § 7203). It may not be necessary (and may be unwise) to tie the interpretation of the Texas Tax Code criminal provisions to the Internal Revenue Code, but authority concerning the Internal Revenue Code sections is instructive because it demonstrates the significant difference that exists between actions that give rise to criminal liability and those that give rise to civil liability. See, e.g., *United States v. Bishop*, 412 U.S. 346, 360, 93 S. Ct. 2008, 2017 (1973) ("willfully," in the federal taxing statutes at issue, "generally connotes a voluntary, intentional violation of a known legal duty" and includes a requirement of "bad faith" or "evil intent").

166. TEX. TAX CODE ANN. § 171.363(a)(1)-(5) (Vernon Supp. 1992). Criminal penalties also extend to a person who is an accountant or an agent for a corporation who knowingly enters false information on the corporation's report. An offense under this section is a felony of the third degree. See *id.* § 171.363(b)-(d).

167. A corporation with a tax liability of less than \$100 is not considered to owe any tax, and is not required by the statute to file a tax return. *Id.* §§ 171.002(d), .2022. However, as permitted by the Tax Code (TEX. TAX CODE ANN. § 171.204), the comptroller plans to require all corporations to file a report, thereby eliminating the much touted advantage of allowing small taxpayers to bypass filing requirements.

168. TEX. TAX CODE ANN. § 171.363(a)(4), (5) (emphasis added).

records of a company to misrepresent its capital, income or gross receipts, to fraudulent backdating of documents to establish that a company began doing business, stopped doing business or changed its corporate structure on a date different from the date that such action actually occurred, and to other fraudulent activities.¹⁶⁹ However, a taxpayer that takes a return position based on an interpretation for which there is some basis should not be treated as guilty of a wilful or fraudulent act within the meaning of Section 171.363, notwithstanding the existence of an administrative rule that adopts a contrary interpretation.

E. Regulatory Developments

Comptroller John Sharp's goal of revising all the franchise tax regulations involves issuing over thirty new or revised rules. The difficult issues presented by the new franchise tax significantly delayed the release of these rules and, as of January 1, 1992, none of the rules with respect to the new franchise tax had been adopted. However, several proposed rules¹⁷⁰ merit discussion.

One of the comptroller's most controversial proposals is Rule 3.572,¹⁷¹ which purports to impose a supplemental tax on the surviving corporation of certain mergers and other year-end transfers by requiring the survivor to pay tax on the non-survivor's income. This requirement that the income of the non-surviving corporation be included in determining taxable earned surplus of the survivor is at odds with Decision 26,516¹⁷² which notes that, in calculating the franchise tax of a merger survivor, the receipts of the non-surviving corporation are not counted for purposes of determining gross receipts. If the non-survivor's gross receipts are not taken into account in computing the survivor's tax liability, neither should the non-survivor's income.

The proposed rule was apparently designed both to deter taxpayers from year-end tax-planning reorganizations and to set forth the comptroller's view that he has the authority to change administratively the legislatively adopted effective date for imposing the additional tax due under Section 171.0011,¹⁷³ to impose an additional tax on the survivors of 1991 mergers and other reorganizations, and to require that such additional taxes be paid by May 15,

169. Comptroller Hearing No. 26,386 (July 2, 1991) illustrates the comptroller's ability to impose a penalty for such actions (taxpayer assessed 25% penalty pursuant to TEX. TAX CODE ANN. § 151.502 (Vernon 1982) on its sales tax deficiency for altering its records between auditor's visits).

170. The comptroller proposed 15 new franchise tax rules in December 1991. See 16 Tex. Reg. 7706-21 (Dec. 27, 1991).

171. See 16 Tex. Reg. 6847 (proposed Nov. 26, 1991). Interestingly, this rule was not issued in emergency form, despite the fact that the comptroller clearly intended it to deter year-end planning. Therefore, the rule should not have the binding effect on taxpayers that it might have had if the comptroller had issued it in emergency form. See generally TEX. REV. CIV. STAT. ANN. art. 6252-13a (Administrative Procedure and Texas Register Act), § 5(a) (procedure for proposing and adopting rules) and § 5(d) (procedure for adopting emergency rules).

172. Comptroller Hearing No. 26,516 (Mar. 27, 1991).

173. TEX. TAX CODE ANN. § 171.0011 (Vernon Supp. 1992).

1992.¹⁷⁴ Because administrative rules cannot expand the statute they purport to interpret,¹⁷⁵ and because Rule 3.572 seeks to expand the legislatively enacted tax, it should be held invalid if adopted in its proposed form.

The comptroller proposed two new rules¹⁷⁶ to set forth the nexus standards that apply to the new franchise tax. Appropriately, these rules acknowledge that Public Law 96-272¹⁷⁷ requires the standard for the earned surplus component of the tax to differ from the existing standards for application of the tax on capital. Proposed Rule 3.546, which describes the nexus standard as it applies to the capital tax,¹⁷⁸ would replace existing Rule 3.406.¹⁷⁹ Current Rule 3.406 provides that a foreign corporation is liable for the franchise tax if it is authorized to "transact business under a certificate of authority from the secretary of state"¹⁸⁰ pursuant to Article 8.01 of the Texas Business Corporation Act,¹⁸¹ or if it is actually doing business without a certificate. Proposed Rule 3.546 deletes the reference to transacting business and to a certificate of authority and instead provides that a foreign corporation is liable for the franchise tax "if it is authorized to do business in this state or if it is actually doing business in this state."¹⁸² Eliminating the reference to the Texas Business Corporation Act is consistent with current interpretations of "doing business" as being entirely independent from "transacting business."¹⁸³ The proposed rule also has different language concerning nexus. Rule 3.406(b) provides that a corporation is doing business in Texas for purposes of franchise tax "when it has constitutional nexus with Texas for the purpose of franchise taxation."¹⁸⁴ The proposed revised standard provides that:

A corporation is doing business in this state, for the taxable capital component of the franchise tax, when it has sufficient contact with this state to be taxed without violating the United States Constitution. A corporation may be subject to the taxable capital component, but not subject to the earned surplus component, because of Public Law 86-272. See § 3.554 of this title (relating to Earned Surplus: Nexus) for the nexus standards for the earned surplus component of the franchise

174. 34 TEX. ADMIN. CODE § 3.572 (proposed Nov. 19, 1991, 16 Tex. Reg. 6847). This provision is intended to accelerate payments for certain corporations, including certain new corporations, that, under the statute, would not be required to file a franchise tax report until 1993. See TEX. TAX CODE ANN. §§ 171.151(a), 171.152(a) (Vernon Supp. 1992) (a corporation's initial period ends one year after it begins doing business, and its payment for that period is due within 90 days thereafter).

175. See, e.g. *Firestone Tire & Rubber Co. v. Bullock*, 575 S.W.2d 498 (Tex. 1978).

176. 34 TEX. ADMIN. CODE §§ 3.546, 3.554 (proposed Dec. 18, 1991, 16 Tex. Reg. 7709, 7715).

177. See *supra* notes 120-25 and accompanying text.

178. 34 TEX. ADMIN. CODE § 3.546(b) (proposed Dec. 18, 1991, 16 Tex. Reg. 7706, 7709).

179. 34 TEX. ADMIN. CODE § 3.406 (Dec. 1987).

180. *Id.* § 3.406(a).

181. TEX. BUS. CORP. ACT. § 8.01-18 (Vernon Supp. 1992).

182. 34 TEX. ADMIN. CODE § 3.546(b) (proposed Dec. 18, 1991, 16 Tex. Reg. 7706, 7709).

183. Prior to the mid-1980's, many believed, including comptroller representatives, that the "doing business" standard for franchise tax purposes was the same as the "transacting business" standard for a certificate of authority; the reference in the rule to the Tex. Bus. & Com. Code provided some support for taxpayers' argument that the two standards were the same.

184. 34 TEX. ADMIN. CODE § 3.406(a) (Nov. 1988).

tax.¹⁸⁵

This reformulation is consistent with the legislature's statements that the franchise tax will reach as far as the United States Constitution will permit it to reach,¹⁸⁶ and with the fact that Public Law 86-272 will prohibit the imposition of the income tax component of the new franchise tax, even where nexus exists, if the activities that constitute nexus are protected under Public Law 86-272.¹⁸⁷ Proposed Rule 3.546 also sets forth a specific list of activities which constitute doing business in Texas¹⁸⁸ and confirms that a limited partner in a limited partnership is not doing business in Texas;¹⁸⁹ this list is substantively the same as in existing Rule 3.406.¹⁹⁰

Proposed Rule 3.554¹⁹¹ sets forth the nexus standard for earned surplus purposes.¹⁹² The cross reference in this rule to the standards in Proposed Rule 3.546¹⁹³ may mean that the standards in the two rules are the same except to the extent Public Law 86-272 mandates a different result; however, neither proposed rule specifically states that the standards are the same, and comptroller representatives have indicated orally that the comptroller has not yet decided whether he believes the standards should be the same. Nonetheless, regardless of the interpretation ultimately adopted by the comptroller, the threshold for imposing the income tax should be no different from the threshold for imposing the capital tax except for differences required by Public Law 86-272. Activities that do not constitute doing business for purposes of the capital tax should not constitute doing business for purposes of the income tax.¹⁹⁴

185. 34 TEX. ADMIN. CODE § 3.546(b) (proposed Dec. 18, 1991, 16 Tex. Reg. 7706, 7709).

186. The legislature's statement in H.B. 11 that the franchise tax "extends to the limits of the United States Constitution and the federal law adopted under the United States Constitution" (TEX. TAX CODE ANN. § 171.001(c) Vernon Supp.1992)) evidences a trend in Texas to expand not only the state's taxes but also the state's taxing jurisdiction. *See also* TEX. TAX CODE ANN. § 111.002(a) (Vernon Supp. 1992) ("the comptroller may adopt, repeal, or amend such rules to reflect changes in the power of this state to collect taxes . . . due to changes in the constitution or laws of the United States and judicial interpretations thereof." (adopted in 1989)); *Id.* § 101.002(b) ("[e]xcept as otherwise provided by statute, the jurisdiction and authority of the state to determine the subjects and objects of taxation shall extend to the limits of the then-current interpretations of the Texas Constitution and the United States Constitution and laws.") (adopted in 1989).

187. *See supra* notes 120-125 and accompanying text.

188. 34 TEX. ADMIN. CODE § 3.546(c) (proposed Dec. 18, 1991, 16 Tex. Reg. 7706, 7709-10).

189. *Id.* § 3.546(c)(12)(B).

190. 34 TEX. ADMIN. CODE § 3.406(c) (Nov. 1988).

191. 34 TEX. ADMIN. CODE § 3.554 (proposed Dec. 18, 1991, 16 Tex. Reg. 7706, 7715).

192. *Id.* § 3.554(b).

193. *Id.*

194. The Comptroller initially confirmed that being a limited partner in a limited partnership does not constitute doing business in Texas for purposes of the earned surplus tax, but later indicated that the issue is still under review. Taxpayers' apparent willingness to do business in partnership rather than corporate form to escape the franchise tax may cause the comptroller to revise his view that a corporate limited partner is not doing business in Texas by virtue of his interest in the partnership. *Sharp v. House of Lloyd supra* notes 91-98 and accompanying text, might provide an incentive for him to set aside the prior interpretation in 34 TEX. ADMIN. CODE § 3.406(c)(12)(B) concerning limited partnerships or to argue that the interpretation does not apply to the revised tax. However, the holding in *House of Lloyd* should not be used to support abandoning the rule on limited partners. *House of Lloyd* found

III. PROPERTY TAX

A. Application of Tax

As is noted below,¹⁹⁵ Senate Bill 351¹⁹⁶ created a two-tier tax-levying and revenue distribution system, and consolidated existing school districts into county education districts for the sole purpose of exercising some of the taxing power formerly exercised by separate school districts.¹⁹⁷ In *Carrollton-Farmers Branch Independent School District v. Edgewood Independent School District*. (*Edgewood III*),¹⁹⁸ the Texas supreme court held that the public school finance system enacted under Senate Bill 351 violates the Texas Constitution.¹⁹⁹ However, the Texas Supreme Court deferred the effect of this ruling so as not to interfere with the collection of 1991 and 1992 county education district taxes, requiring that corrective measures be adopted by the Texas legislature by June 1, 1993.²⁰⁰

The court ruled the public school finance system unconstitutional on two grounds. First, the court held that Senate Bill 351 levies a state property tax in violation of article VIII, section 1-e²⁰¹ of the Texas Constitution. The court reasoned that because the Texas legislature mandated county education districts to levy taxes, set the tax rate county education districts must use, and prescribed how county education district tax proceeds must be distributed, county education district taxes are, in reality, state taxes.²⁰² The state argued that because taxes levied by county education districts were not deposited in the state treasury, such taxes are not state taxes. The court reasoned, however, that the prohibition against state ad valorem taxes would be meaningless if the prohibition could be avoided by depositing tax proceeds in some lesser instrumentality's account.²⁰³

Second, the court held that the bill levied an ad valorem tax without an election in violation of article VII, section 3²⁰⁴ of the Texas Constitution. The state argued that local taxes may be levied without voter approval, and, alternatively, that article VII, section 3-b²⁰⁵ of the Texas Constitution, which does not require an election in instances where boundaries of any independ-

that the state's failure to impose franchise tax on corporations with independent contractors in Texas did not constitute an administrative policy, whereas the comptroller's treating limited partners as not doing business in Texas is a clear administrative policy reflected in a duly promulgated rule. Moreover, the legislature's deliberate enactment of a tax that excludes partnerships from the tax base would seem contrary to an attempt to tax the partnerships' income by looking through to partners that are not otherwise subject to the franchise tax.

195. See *infra.*, notes 254-273 and accompanying text.

196. Act of April 15, 1991, ch. 20, 1991 Tex Sess. Law Serv. 381 (Vernon).

197. See *Edgewood I.S.D. v. Meno*, No. 362, 516-A (Dist. Ct. of Travis County, 345th Judicial Dist. of Texas, Aug. 7, 1991), *rev'd*, *Carrollton-Farmers Branch I.S.D. v. Edgewood I.S.D.*, 35 Tex. Sup. Ct. J. 374 (Jan. 30, 1992).

198. 35 Tex. Sup. Ct. J. 374 (Jan. 30, 1992).

199. *Id.* at 376.

200. *Id.* at 400-01.

201. TEX. CONST. art. VIII, § 1-e.

202. *Carrollton-Farmers Branch I.S.D.*, 35 Tex. Sup. Ct. J. at 382.

203. *Id.* at 383.

204. TEX. CONST. art. VII, § 3 (1876, amended 1883, 1908, 1909, 1918, 1920, 1926).

205. TEX. CONST. art. VII, § 3-b (1962), amended 1966).

ent school district are changed by consolidation, excuses the voting requirement in this case because Senate Bill 351 merely consolidates school districts. Although recognizing that article VII, section 3 is a "constitutional wilderness," the court ruled that the Texas Constitution requires that voters must approve the tax²⁰⁶ before a county education district levies an ad valorem tax. In support of its holding, the court relied on the fact that in the more than seventy years since a relevant amendment has been added to article VII, section 3 of the Constitution, the Texas legislature has never acted as if the Texas Constitution authorizes local ad valorem taxes without voter approval.²⁰⁷ In addressing the consolidation argument, the court reasoned that the creation of county education districts did not result in the physical change of any school district's boundaries.²⁰⁸

Although virtually every aspect of the Texas supreme court's decision in *Edgewood III* is controversial, the court's action to defer the effect of its decision for over two years has sparked the most debate. While it is not unusual for a tax to be ruled unconstitutional on a prospective basis, *Edgewood III* takes the prospective analysis one step further by requiring the collection of 1992 taxes, which generally will not be due until January 31, 1993.²⁰⁹ The court was strongly influenced by its belief that retroactive application would be so damaging to Texas' school system that retroactivity could not promote any constitutional purpose.²¹⁰

There was considerable litigation during the Survey period with respect to the taxable value of fee interests subject to leases. In *Cherokee Water Co. v. Gregg County Appraisal District*²¹¹ the taxpayer leased substantial portions of its property to its shareholders pursuant to annually renewable one year term lease agreements providing substantially below market rents. The taxpayer contended that it should have been taxed only on the value of its reversionary interest in the property subject to the leases, which is insubstantial, given the remote possibility of a lessee's returning possession to the taxpayer. The Texas Supreme Court rejected the taxpayer's argument, reasoning that there is no statutory basis for taxing property not under lease at full value but taxing leased property only at the value attributable to the lessor's

206. *Carrollton-Farmers Branch I.S.D.*, 35 Tex. Sup. Ct. J. at 387.

207. *Id.*

208. *Id.* at 389.

209. *Id.* at 400. In deciding to defer the effect of its holding, the court employed the United States Supreme Court's test for determining whether a decision should be applied retroactively. *Id.* at 392-99. See *Chevron Oil v. Huson*, 404 U.S. 97, 106-07 (1971). See also *supra* notes 7-8 and accompanying text.

210. *Carrollton-Farmers Branch I.S.D.*, 35 Tex. Sup. Ct. J. at 399. The court stated that a retroactive holding would cause schools to close, delay payments to teachers and administrators and cause serious damage to children as a result of an interruption of their education. *Id.*

In a stinging dissent, Justice Doggett (joined by Justice Mauzy) wrote that the majority "has led the Legislature down the primrose path. Today's unconstitutional legislation is only yesterday's judicial vision . . ." *Id.* at 413 (Doggett, J., dissenting). The dissenting opinion concludes that Senate Bill 351 passed constitutional muster, and that the Texas supreme court in *Edgewood II* strongly implied that a school financing system in the nature of that adopted by Senate Bill 351 would be constitutional. *Id.* at 416-18.

211. 801 S.W.2d 872 (Tex. 1990).

interest.²¹²

In *Irving Independent School District v. Packard Properties, Ltd.*²¹³ the United States District Court addressed the validity of liens for unpaid property taxes, penalties, interest and attorney's fees that attached to real property owned by the Federal Deposit Insurance Corporation (FDIC) as receiver for a failed savings and loan association.²¹⁴ A provision of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) prohibits attachment of an involuntary lien to real property held by the FDIC as receiver.²¹⁵ Two taxing authorities sued to collect such taxes, penalties, interest and attorney's fees for taxes assessed on January 1, 1986 through January 1, 1990 on property owned by the FDIC since January 1, 1989. The court held that the liens for 1986-1988 remain on property because such liens existed before the FDIC acquired the property.²¹⁶ The court also recognized the tax lien for 1989 because FIRREA had not been enacted by January 1, 1989, the date the lien for such taxes first existed.²¹⁷ The predecessor statute subjected FDIC real property to local taxation to the same extent as property owned by other taxpayers.²¹⁸ The court barred the lien for 1990 taxes, reasoning that FIRREA is quite clear in prohibiting such an involuntary lien.²¹⁹ Finally, the court held that attorney's fees are recoverable against the FDIC only pursuant to the Equal Access to Justice Act,²²⁰ and the taxing units had not met the procedural requirements of that statute.²²¹

The Austin court of appeals in *Hays County Appraisal District v. Robinson*²²² addressed whether a tract of land, one-third of which had been used for crop planting and other agricultural uses, was open-space land. The tax-

212. *Id.* at 876. The Dallas court of appeals in *Dallas Central Appraisal District v. Jagee Corp.*, 812 S.W.2d 49 (Tex. App. — Dallas 1991, writ denied), addressed another fact situation in which the owner of a fee interest in property argued that the taxable value of his interest should be reduced because it was subject to a long-term lease with substantially below market rents. *Id.* at 52. In a different approach than taken by the taxpayer in *Cherokee Water*, the taxpayer asserted that taxing the fee owner on the value of the leasehold interest would violate the ownership and equal protection requirements of the Texas Constitution by taxing it on property (the lease) that it does not own. See Tex. Const. art. VIII, §§ 1, 11, 21(c). In holding for the appraisal district, the court stated that the value of the leasehold is subsumed within the value of the fee estate; thus, being taxed on the leasehold does not result in the fee owner being taxed on property it does not own. *Dallas Central Appraisal Dist.*, 812 S.W.2d at 52-53.

213. 762 F. Supp. 699 (N.D. Tex. 1991).

214. *Id.* at 702.

215. 12 U.S.C. § 1825(b)(2) (1989).

216. *Irving I.S.D.*, 762 F. Supp. at 703.

217. *Id.* at 704. With respect to the 1989 lien, the court discusses only 1989 taxes, and not interest, penalties and collection fees relating to such taxes. *Id.* It is unclear why the court does not expressly recognize a lien for interest, penalties and fees for such 1989 taxes.

218. *Id.*

219. *Id.*

220. 28 U.S.C. § 2412(d).

221. *Irving I.S.D.*, 762 F. Supp. at 704. In *Fort Bend County Municipal Utility District No. 30 v. Gayle*, 755 F. Supp. 746 (S.D. Tex. 1990), the United States District Court held that tax foreclosure suits cannot be brought against the FDIC without its consent. *Id.* at 748. In addition, the court ruled that the FDIC is not personally liable for penalties, interest or attorney's fees against property acquired by it. *Id.*

222. 809 S.W.2d 328 (Tex. App.—Austin 1991, no writ).

payers purchased a thirty-five acre tract of property and applied for an open-space valuation of the property two years later. In order to obtain open-space valuation, a property must (i) be currently devoted principally to agricultural use to the degree of intensity generally accepted in the area; and (ii) have been devoted principally to agricultural use for five of the preceding seven years.²²³ *Robinson* addressed this second requirement.

The prior owners of the property planted oats and wheat on approximately one-third of the property, but did not utilize the remainder of the tract because it was wasteland. The appraisal district contended that because the property was more suitable for running livestock than other agricultural uses, and because the previous owners farmed only one-third of the property, the land had not been devoted "principally" to agricultural use for five of the previous seven years. In holding that the tract met the requirements of open-space land, the court reasoned that "intensity of use" should not be considered in determining whether the subject property has historically been devoted "principally" to agriculture.²²⁴ Because the former owners cultivated the only cultivable land on the property, the historical use test was met, irrespective of whether the former owners could have engaged in more productive agricultural uses.²²⁵

In another case dealing with eligibility for open space valuation, the Dallas court of appeals in *HL Farm Corp. v. Self*²²⁶ held valid section 23.56(3)²²⁷ of the Tax Code, which denies open-space land valuation to land owned by any legal entity owned primarily by a nonresident alien or foreign government if such entity is required by federal law to register its ownership of the land.²²⁸ The taxpayer, a Virginia corporation, was a second-tier subsidiary of a Switzerland corporation. Pursuant to the Agricultural Foreign Investment Disclosure Act, the taxpayer was required to register its ownership of the land at issue with the United States.²²⁹ The taxpayer challenged the taxing unit's denial of open-space land designation for the land on the basis that section 23.56(3) violated (i) the Texas constitutional provision establishing special valuation for open-space land,²³⁰ (ii) the equal protection clauses of the United States and Texas Constitutions,²³¹ and (iii) the requirement of equal and uniform taxation under the Texas Constitution.²³²

The court rejected each of these arguments. First, the court concluded that the general purpose of allowing special appraisal for open-space land is

223. TEX. TAX CODE ANN. § 23.51(1) (Vernon Supp. 1992).

224. *Id.*, citing *Riess v. Williamson County Appraisal District*, 735 S.W.2d 633 (Tex. App.—Austin 1987, writ denied).

225. *Id.* at 332.

226. 820 S.W.2d 372 (Tex. App.—Dallas 1991, writ requested).

227. TEX. TAX CODE ANN. § 23.56(3) (Vernon 1982).

228. *Id.*

229. 7 U.S.C. § 3501 (1988).

230. See TEX. CONST. art. VIII, § 1-d-1 (commonly referred to as a "1-d-1 valuation").

231. See U.S. CONST. amend. XIV; Tex. Const. art. I, § 3.

232. See TEX. CONST. art. VIII, § 1.

to preserve and benefit the family farm.²³³ The court indicated that the section 23.56(3) exclusion of non-resident aliens from open-space land qualification actually furthered the goal of preserving and benefiting the family farm.²³⁴ In addressing the equal protection clauses as they relate to section 23.56(3), the court stated that states may use classifications in assessing taxes so long as a rational basis supports the classification.²³⁵ The court concluded that the concerns prompting the enactment of the Agricultural Foreign Investment Disclosure Act (such as a concern that foreign owners are more likely to sell out to developers of non-farm projects)²³⁶ reflect threats to Texas family farmers, and provide a rational basis to support section 23.56(3).²³⁷ Finally, with regard to the taxpayer's third argument, the court noted that the Constitution does not require absolute equality in taxation, and concluded that a rational basis exist for assessing the value of land owned by non-resident aliens differently.²³⁸

B. Procedure

In *General Electric Credit Corp. v. Midland Central Appraisal District*²³⁹ the El Paso court of appeals held that the taxpayer's suit to determine which of two counties was the legal situs of its aircraft for property tax purposes was properly dismissed for failure to exhaust the taxpayer's administrative remedies.²⁴⁰ Two counties sought to tax the aircraft — the county in which hangar space was rented for the aircraft, and the county in which the lessee of the aircraft had built a hangar and airstrip for the aircraft. Although the taxpayer had never filed a formal protest with either county appraisal dis-

233. *HL Farm Corp.*, 820 S.W.2d at 375, citing *Gragg v. Cayuga Indep. School Dist.*, 539 S.W.2d 861, 865 (Tex.), *appeal dismissed*, 429 U.S. 973 (1976).

234. *HL Farm Corp.*, 820 S.W. 2d at 376.

235. *Id.* at 375. See also *Alexander Ranch, Inc. v. Central Appraisal District*, 733 S.W.2d 303, 307 (Tex. App.—Eastland 1987, writ ref'd n.r.e.), *cert. denied*, 486 U.S. 1026 (1988) (holding that section 23.56(3) does not violate the equal protection clauses of the United States Constitution).

236. See H.R. Rep. No. 1570, 95th Cong., 2d Sess. 7-21 (1978).

237. *HL Farm Corp.*, 820 S.W.2d at 376.

238. *Id.* In a strong dissenting opinion, Chief Justice Enoch stated that there is no rational basis for denying the taxpayer the open-space designation, and that preserving the family farm is not the purpose of section 1-d-1. *Id.* at 376-77.

There were two other interesting cases during the Survey period addressing the requirements of open-space land. In *Dallas County Appraisal Review Board v. Seven Investment Co.*, 813 S.W.2d 197 (Tex. App.—Dallas 1991, writ granted (35 Tex. Sup. Ct. J. 174)), the Dallas court of appeals held that merely because a portion of a farm could not be used for agricultural purposes during the year because the county was building a road on it does not prevent such area from qualifying as open-space land. *Id.* at 202. Rather, the taxpayer must clearly demonstrate an intent to permanently give up agriculture, which would not occur until the road construction was completed. *Id.* at 202-03. The Houston (1st District) court of appeals held in *Pizzitola v. Galveston County Central Appraisal District*, 808 S.W.2d 244 (Tex. App.—Houston [1st Dist.] 1991, no writ), that the operation of a bee hive on three acres of land did not result in the entire tract being classified as open-space land (even though the bees foraged the remaining tract) because there was no evidence of any human effort being used with respect to the care of bees on the other portion of the tract. *Id.* at 248-49.

239. 808 S.W.2d 169 (Tex. App.—El Paso 1991), *reversed, in part*, 35 Tex. Sup. Ct. J. 25 (1991) (reversing the lower court with respect to damages only).

240. *Id.* at 174.

tract, the taxpayer filed suit against both taxing authorities seeking a judicial determination of the aircraft's legal situs. The taxpayer argued that the suit should not be dismissed because the administrative provisions of the Tax Code are unconstitutional in that they deny taxpayers the right to challenge in one forum the conflicting tax claims of separate counties.²⁴¹ The court ruled that neither the Texas nor the United States Constitutions require a single forum to be provided for resolving conflicting claims between various taxing units.²⁴²

The Texarkana court of appeals in *Resolution Trust Corp. v. Williamson County Appraisal District*²⁴³ held that the amendments to section 42.08 of the Tax Code in 1989, one of which allows taxpayers to pay in full amounts due under the order being appealed, were intended to be retroactive.²⁴⁴ The taxpayer acquired the property at issue by foreclosure. The prior owner of the property had timely filed a notice of protest concerning the property's taxable value, and had complied with the partial tender requirements of section 42.08 of the Tax Code (as then in effect)²⁴⁵ by paying, prior to delinquency, the taxes due on the undisputed amount of value. In 1987, while intervening in this case, the taxpayer also paid the remaining amount of taxes due on the property. At that time, section 42.08 (as interpreted by courts) precluded a taxpayer's right to contest the appraised value of property if it paid in full the assessed taxes.²⁴⁶ However, in 1989, the statute was amended to allow full payment of the taxes due under the order being appealed without forfeiting the taxpayer's right to a final determination of the appeal.²⁴⁷ The court ruled that the 1989 amendments were specifically given retroactive effect.²⁴⁸

241. *Id.* at 171. Specifically, the taxpayer asserted that the administrative requirements of the Tax Code violated the due process requirements of the United States and Texas Constitutions, the open court requirements of the Texas Constitution and the prohibition against double taxation requirements of the Texas Constitution. *Id.*

242. *Id.* at 172-74. The court ruled that due process simply affords a right to be heard before final assessment and does not set forth a required review mechanism. *Id.* at 172. The court reasoned that the Tax Code's failure to provide a single forum in taxpayer's case does not violate the Texas Open Courts provision because such provision applies only to common law suits. *Id.* Finally, with respect to the double taxation argument, the court pointed out that it was the taxpayer's failure to comply with administrative provisions for challenging a taxing unit's actions that resulted in double taxation, not the administrative provisions themselves. *Id.* at 173.

243. 816 S.W.2d 452 (Tex. App.—Texarkana 1991, writ filed Sept. 26, 1991).

244. *Id.* at 454.

245. See Property Tax Code Act, ch. 841, § 42.08, 1979 Tex. Gen. Laws 2310, repealed by Act of 1989, ch. 796, § 43, 1989 Tex. Gen. Laws 3604.

246. *Id.* See Hunt County Tax Appraisal District v. Rubbermaid, Inc., 719 S.W.2d 215, 219 (Tex. App.—Dallas 1986, writ ref'd n.r.e.) (discussed in Cynthia M. Ohlenforst & Jeff W. Dorrill, *Taxation, Annual Survey of Texas Law*, 42 Sw. L.J. 633, 654-55 (1988)).

247. Act of 1989, ch. 798, § 43, 1989 Tex. Gen. Laws 3604.

248. *Resolution Trust*, 816 S.W.2d at 454. See also *Seven Investment Co.*, 813 S.W.2d at 203 (reaching same conclusion as *Resolution Trust* with respect to this issue).

In another case interpreting Section 42.08, the Dallas court of appeals in *Filmstrips and Slides, Inc. v. Dallas Central Appraisal District*, 806 S.W.2d 289 (Tex. App.—Dallas 1991, no writ), held that the taxpayer's suit challenging the appraised value of its property was properly dismissed. Contrary to the procedural requirements set forth in section 42.08 of the Tax Code for appealing a determination of the appraisal review board, the taxpayer did not pay taxes on

In *Burnet County Appraisal District v. J.M. Huber Corp.*²⁴⁹ the Austin court of appeals considered whether a letter from a taxpayer to the appraisal district disagreeing with the appraisal district's determination of the value of a property constituted a notice of protest under section 41.44²⁵⁰ of the Tax Code. The appraisal district contended that the letter did not constitute a valid notice of protest because it was filed with the appraisal district, not the appraisal review board. Section 41.44(d)²⁵¹ requires that a notice of protest must be filed with the appraisal review board having authority to hear the protest.²⁵² Relying on the fact that the appraisal district and the appraisal review board share the same staff, address and office, and on the general principle that doubts about the meaning of a law should be resolved in favor of taxpayers, the court held that such letter qualified as a notice of protest.²⁵³

C. Legislation

The Texas legislature passed numerous procedural and substantive property tax provisions during its 1991 regular session and special sessions. The most dramatic of these provisions is contained in Senate Bill 351,²⁵⁴ which creates new taxing authorities called county education districts in an attempt to meet the Texas Supreme Court mandate, set forth in the *Edgewood*²⁵⁵ cases, to equalize public education funding.²⁵⁶ Although the Texas Supreme Court held this rule unconstitutional, the effect of the court's ruling has been deferred so as not to interfere with collection of 1991 and 1992 county education district taxes.²⁵⁷

Under the Senate Bill 351 system of funding public schools, each school district uses a combination of funds from school district property taxes, county education district property taxes and state revenues to (i) provide a

the property subject to the appeal before the delinquency date. *Id.* at 290. The taxpayer contended that it should have been given the opportunity to cure its delinquency before dismissal. *Id.* The court disagreed, stating that taxpayers must pay before the delinquency date or forfeit their appeal. *Id.*

249. 808 S.W.2d 613 (Tex. App.—Austin 1991, writ denied).

250. TEX. TAX CODE ANN. § 41.44 (Vernon Supp. 1992).

251. *Id.* § 41.44(d).

252. *Id.*

253. *Burnet County Appraisal Dist.*, 808 S.W.2d at 616. *Id.* The court also considered whether the letter itself met the requirements of a notice of protest. Although no formal protest form was used and the letter did not identify itself as protest, the court held that the letter met the requirements under section 41.44(d) of the Tax Code because it identified both the property owner and the property that is the subject of the protest, and indicated apparent dissatisfaction with some determination of the appraisal office. *Id.* at 615. TEX. TAX CODE ANN. § 41.44(d) (Vernon Supp. 1992).

254. Act of April 15, 1991, ch. 20, 1991 Tex. Sess. Law Serv. 381 (Vernon).

255. *Edgewood I.S.D. v. Kirby*, 777 S.W.2d 391 (Tex. 1989) (*Edgewood I*); *Edgewood I.S.D. v. Kirby*, 804 S.W.2d 491 (Tex. 1991) (*Edgewood II*). Senate Bill 351 was not the Texas legislature's first attempt to establish an efficient school financing system after the issuance of *Edgewood I*. In response to *Edgewood I*, the 71st legislature passed Senate Bill 1, which was designed to reform Texas' public school financing system. However, in *Edgewood II* the Texas Supreme Court held that the system remained unconstitutional even after the enactment of Senate Bill 1. *Edgewood I.S.D.*, 804 S.W.2d at 496.

256. *Edgewood I.S.D.*, 777 S.W.2d at 397 (addressing Texas public school financing before enactment of Senate Bill 1).

257. See *supra* notes 198-210 and accompanying text.

basic education program meeting certain legal standards (Tier One) and (ii) supplement the basic program at a level of its choice and with access to additional funds for facilities (Tier Two).²⁵⁸ Tier One is financed primarily from county education district property taxes.²⁵⁹ Each county education district is composed of all school districts whose administrative offices are located in the county (except that in many cases counties are grouped together to form a single county education district).²⁶⁰ Each county education district is an independent school district established for the limited purpose of (i) exercising a portion of the taxing power previously authorized by voters in school districts from which such county education district is composed, and (ii) distributing the county education district's revenue to such school districts.²⁶¹ County education districts are required to levy ad valorem taxes at specified rates set forth in section 16.252²⁶² of the Education Code and must do so by September 1 of each year.²⁶³ Pursuant to section 16.252²⁶⁴ of the Education Code, each county education district must raise its total local share of the foundation school program.²⁶⁵ A county education district's share of the foundation school program equals the product of (i) the taxable value of property in such district for the prior tax year, and (ii) a specified tax rate for each hundred dollars of valuation, equalling \$0.72 for the 1991-92 school year, \$0.82 for the 1992-93 school year, \$0.92 for the 1993-94 school year and \$1.00 for each school year thereafter.²⁶⁶

School districts still have the authority to levy property taxes; however, a school district's total effective tax rate on each \$100 valuation of taxable property cannot exceed \$1.50 less the tax rate per \$100 valuation levied by the relevant county education district.²⁶⁷ Higher rates can be imposed under certain circumstances to the extent necessary to pay principal and interest on debt.²⁶⁸

Pursuant to subsection 312.002(e)²⁶⁹ of the Tax Code, county education districts are not eligible to enter into tax abatement agreements under the Property Redevelopment and Tax Abatement Act.²⁷⁰ However, tax abatement agreements entered into by school districts before September 1, 1991 apply to the relevant county education district.²⁷¹

258. *Edgewood*, 777 S.W.2d at 397.

259. *Id.*

260. TEX. EDUC. CODE ANN. § 20.941(a), (b) (Vernon Supp. 1992). Boundaries of county education districts can be changed to ensure that no district has a taxable value of property in excess of \$280,000 per weighted student in average daily attendance or a value set by a school fund committee. *Id.* § 20.941(c).

261. *Id.* § 20.942.

262. *Id.* § 16.252.

263. *Id.* § 20.945.

264. *Id.* § 16.252.

265. *Id.* § 16.252(d).

266. *Id.* § 16.252(a).

267. *Id.* § 20.09(a).

268. *Id.* § 20.09(d).

269. TEX. TAX CODE ANN. § 312.002(e) (Vernon Supp. 1992).

270. *Id.*

271. *Id.* § 312.002(e), (f)

Texas voters approved a Texas constitutional amendment in August 1991 authorizing county education districts to adopt, by election, a property tax exemption for residence homesteads of no less than \$5,000 and no more than twenty percent of the property's market value.²⁷² In addition, Texas voters approved a homestead exemption of \$3,000 for persons 65 years of age or older and disabled persons.²⁷³

There were a myriad of other important property tax provisions enacted during 1991. For example, the Texas legislature created new exemptions, while modifying some exemptions already in place. In November 1991, Texas voters approved a constitutional amendment authorizing the Texas legislature to exempt property owned by a nonprofit corporation organized to supply water or to provide waste water services if the corporation's by-laws provide that on dissolution its assets remaining after discharge of debt shall be transferred to an exempt entity that provides a water supply or waste water service, or both.²⁷⁴ Pursuant to section 11.30,²⁷⁵ the Texas legislature exempted such property.²⁷⁶

New subsection 11.18(d)(17)²⁷⁷ of the Tax Code provides that property owned by a public television station producing or broadcasting public interest programming and which receives grants from the Corporation for Public Broadcasting is eligible for exemption.²⁷⁸ Amended subsection 11.23(a)²⁷⁹ alters the exemption for veteran's organizations. Prior to amendment, the subsection exempted buildings owned by certain veteran's organizations (such as the American Legion) that are not used to produce revenues or held for gain.²⁸⁰ As amended, the subsection exempts buildings and other property not used to produce revenues or held for gain that are owned by nonprofit organizations composed primarily of veteran's organizations chartered or incorporated by the United States.²⁸¹ The freeport exemption was amended to provide that the term "freeport goods" has the definition provided in the article VIII, section 1-j of the Texas Constitution.²⁸² Under prior law, the definition of "freeport goods" under section 11.251 did not track the Texas Constitution; the wording differences between the two definitions created confusion in some of the taxing jurisdictions.²⁸³ Finally, property used for wildlife management now qualifies for open-space valuation.²⁸⁴

272. TEX. CONST. art. VIII, § 1-b(e).

273. *Id.* § 1-b(b).

274. TEX. CONST. art. VIII, § 1-k. *See* North Alamo Water Supply Corp., 804 S.W.2d 894 (Tex. 1991) (holding that under prior law water supply corporations were not exempt from property tax under prior law).

275. TEX. TAX CODE ANN. § 11.30 (Vernon Supp. 1992).

276. *Id.*

277. *Id.* § 11.18(d)(17).

278. *Id.*

279. *Id.* § 11.23(a).

280. TEX. TAX CODE ANN. § 11.23(a) (Vernon 1982), *repealed by* Act of 1991, ch. 162, § 1, 1991 Tex. Sess. Law Serv. 773 (Vernon).

281. TEX. TAX CODE ANN. § 11.23(a) (Vernon Supp. 1992).

282. *Id.* § 11.251.

283. *See* TEX. CONST. art. VIII, § 1-j.

284. TEX. TAX CODE ANN. § 23.51 (Vernon Supp. 1992).

In addition to amending and creating exemptions, the legislature made other important changes to substantive property tax law provisions. Section 25.21²⁸⁵ of the Tax Code was amended to provide that the chief appraiser may seek to tax real property that was omitted from an appraisal roll in any one of the five preceding years.²⁸⁶ Prior to amendment, the section allowed the chief appraiser to tax property omitted from an appraisal roll during any one of the preceding ten years.²⁸⁷ The period of time to correct clerical and other errors on an appraisal roll has been lengthened from three years to five years.²⁸⁸ The scope of property covered by the omitted property statutes was narrowed from property that "escaped taxation" to property that was omitted from an appraisal roll.²⁸⁹

There were also several legislative changes with respect to tax liens. Amended section 32.03²⁹⁰ of the Tax Code provides that a tax lien on personal property is not effective against a buyer in the ordinary course of business or a bona fide purchaser for value.²⁹¹ Prior law merely provided that such liens were not effective against bona fide purchasers.²⁹² Amended subsection 32.05(c)²⁹³ now provides that a property tax lien is inferior to restrictive covenants running with the land and valid easements of record recorded prior to January 1 of the year the tax lien arose.²⁹⁴

Although there were several substantive property tax legislative changes made in 1991 in addition to the legislation relating to school taxes, the number and scope of procedural changes was much more comprehensive. One important change was the transfer of the State Property Tax Board's duties and assets to the comptroller.²⁹⁵

Pursuant to new article 8886,²⁹⁶ an individual may not perform property tax consulting services for compensation unless the individual registers with the Texas Department of Licensing and Regulation,²⁹⁷ however, attorneys, certified public accountants, certain real estate brokers, in-house consultants and certain other individuals are exempt from the registration require-

285. *Id.* § 25.21.

286. *Id.* § 25.21(a).

287. TEX. TAX CODE ANN. § 25.21(a) (Vernon 1982) (prior to amendment by Act of 1991, ch. 367, § 1, 1991 Tex. Sess. Law Serv. 1417 (Vernon)).

288. TEX. TAX CODE ANN. § 25.25 (Vernon Supp. 1992).

289. *Id.* § 25.21.

290. *Id.* § 32.03.

291. *Id.*

292. TEX. TAX CODE ANN. § 32.05 (Vernon Supp. 1992) (prior to amendment by Act of 1991, ch. 617, § 12, 1991 Tex. Sess. Law Serv. 2248 (Vernon) and Act of 1991, ch. 836, § 5.2, 1991 Tex. Sess. Law Serv. 2893 (Vernon)).

293. TEX. TAX CODE ANN. § 32.05(c) (Vernon Supp. 1992).

294. *Id.* See also TEX. TAX CODE ANN. § 34.01(d) (Vernon Supp. 1992) (addressing restrictive covenants and easements in connection with the sale of property).

295. Act of June 16, 1991, ch. 843, 1991 Tex. Sess. Law Serv. 2905 (Vernon); Act of Aug. 29, 1991, 2nd C.S., ch. 6, 1991 Tex. Sess. Law Serv. 26-41 (Vernon).

296. TEX. REV. CIV. STAT. ANN. art. 8886 (Vernon Supp. 1992).

297. *Id.* § 2(a). "Property tax consulting services" is defined as preparing a property tax rendition or report for another person, representing another person in a protest, consulting another person concerning a protest or the preparation of a property tax rendition or report, negotiating or entering an agreement with an appraisal district on behalf of another concerning a protested matter, or acting as the designated agent of a property owner. *Id.* § 1(a)(7).

ment.²⁹⁸ Persons have until September 1, 1992 to register and obtain a license from the department.²⁹⁹ Senate Bill 772³⁰⁰ made numerous procedural changes to the Property Tax Code. Amended section 41.66(b)³⁰¹ now expressly provides that each party to an appraisal review board hearing is entitled to offer evidence, examine or cross-examine witnesses and other parties and present argument.³⁰² Section 42.29³⁰³ was amended to increase the amount of attorney's fees that may be awarded from the greater of \$5,000 or 20 percent of the amount of taxes in dispute to the greater of \$15,000 or 20 percent of the total amount by which the taxpayer's tax liability is reduced as a result of the appeal (but not to exceed the total amount by which the taxpayer's tax liability is reduced as a result of the appeal).³⁰⁴ Pursuant to new subsection 31.01(j)³⁰⁵ of the Tax Code, mortgagees who receive tax bills must mail a copy of the bill to the property owner within 30 days of receipt.³⁰⁶

New subsection 1.04(18)³⁰⁷ defines the term "clerical error" as any mistake or failure in writing, copying, transcribing, entering or retrieving computer data, computing or calculating, and any error that prevents an appraisal roll or tax roll from reflecting accurately a determination of the chief appraiser, appraisal review board or assessor, but does not include mistakes in judgment or reasoning in making a finding or determination.³⁰⁸ This definition comes into play under section 25.25(b),³⁰⁹ which addresses the procedures to correct errors on the appraisal roll. Amended subsection 25.25(d)³¹⁰ provides that a taxpayer or the chief appraiser may motion to change the appraisal roll to correct a significant error, i.e., an error resulting in an appraised value exceeding by more than one-third the correct appraised value.³¹¹ If the roll is changed as a result of such motion, the taxpayer is required to pay to each affected taxing unit a late-correction penalty of ten percent of the taxes as recalculated on the basis of the corrected ap-

298. *Id.* § 2(d).

299. Act of 1991, ch. 869 § 5, 1991 Tex. Sess. Law Serv. 2979 (Vernon). Effective February 1, 1995, a registered property tax consultant may not perform property tax consulting services for compensation unless the individual is employed by or associated with a registered senior property tax consultant. TEX. REV. CIV. STAT. ANN. art. 8886, § 2(b) (Vernon Supp. 1992). To qualify as a registered senior property tax consultant, a person must meet all of the requirements for a registered property tax consultant plus (i) obtain at least 25 credits (given for various courses and degrees), (ii) have performed property tax consulting services as its primary occupation for at least four of the last seven years, and (iii) pass an examination administered by the department. *Id.* § 3(c).

300. Act of June 16, 1991, ch. 836, 1991 Tex. Sess. Law Serv. 2890 (Vernon).

301. TEX. TAX CODE ANN. § 41.66(b) (Vernon Supp. 1992).

302. *Id.*

303. *Id.* § 42.29.

304. *Id.*

305. *Id.* § 31.01(j).

306. *Id.*

307. *Id.* § 1.04(18).

308. *Id.*

309. *Id.* § 25.25(b).

310. *Id.* § 25.25(d).

311. *Id.*

praised value.³¹²

IV. ADMINISTRATIVE SERVICES TAX

In *E-Systems, Inc. v. Pogue*³¹³ the Fifth Circuit held that the federal Employee Retirement Income Security Act of 1974³¹⁴ (ERISA) preempts Texas' administrative services tax on fees received by persons administering welfare benefit plans and violates the Supremacy Clause of Article VI of the United States Constitution.³¹⁵ Therefore, Texas could not collect the administrative services tax from employers' self-insured and self-administered employee welfare benefit plans governed by ERISA.³¹⁶ The administrative services tax (established pursuant to the Texas Administrative Services Tax Act)³¹⁷ imposes a 2.5 percent annual tax on insurance carriers and others recipients of administrative or services fees, consideration, payments, premiums, funds, reimbursements, or compensation for providing services for employer-employee, multiple employer-employee, self-insurance group, member, and other medical, accident, sickness, injury, indemnity, death, or health benefit plans.³¹⁸ The court reasoned that the administrative services tax is imposed on plans nearly identical to plans covered by ERISA, and that ERISA preempts every state law relating to an employee benefit plan covered by ERISA.³¹⁹

V. PROCEDURE

Comptroller representatives frequently issue advisory letters in reply to specific requests by taxpayers or taxpayers' representatives. This ruling process, which has existed for many years, is much less formal and generally significantly faster than the Internal Revenue Service ruling process. Although the Tax Code does not require the comptroller to follow these rulings, he has a longstanding administrative policy of allowing a taxpayer who received a ruling to rely on it. Although this ruling process is likely to remain extraordinarily helpful to taxpayers, it appears likely to change somewhat during 1992. The comptroller's efforts to issue responses quickly to questions about the new franchise tax resulted in the issuance of some rulings that were later withdrawn pending further analysis of the issues involved. The effort to bring greater substantive consistency to the ruling process, as well as the effort to avoid issuing rulings prematurely has already resulted in a more thorough review process which has, in turn, extended the

312. *Id.*

313. 929 F.2d 1100 (5th Cir.), *cert. denied*, *Barnes v. E-Systems, Inc.*, 60 U.S.L.W. 3404 (1991).

314. 29 U.S.C. §§ 1001-1461 (1988).

315. U.S. CONST. art. VI, cl. 2.

316. *E-Systems*, 929 F.2d at 1103-04.

317. Act of July 21, 1987, 70th Leg., 2d C.S., ch. 5, art. 8, § 1, 1987 Tex. Gen. Laws 9, 28-31 (amended 1989) (current version at Tex. Ins. Code Ann. art. 4.11a (Vernon Supp. 1992)).

318. TEX. INS. CODE art. 4.11A, § 1 (Vernon Supp. 1992).

319. *E-Systems*, 929 F.2d at 1103.

time required to obtain a ruling. Moreover, the new ethics bill³²⁰ may make it more difficult for taxpayers to obtain rulings on a no-names basis. Although taxpayers and their representatives may still submit ruling requests on a "no-names" basis, the new lobbyist registration requirements are likely to require the taxpayer or representative to file a lobbying report.³²¹

In addition to revising the sales and franchise tax rules, the comptroller is revising several procedural rules. Some revisions are substantive,³²² so taxpayers should take care to review these procedural rules as well as the other regulatory and legislative changes made during the Survey period.

320. Act of 1991, 72nd Leg., R.S., ch 304, 1991 Tex. Sess. Law Serv. 1290 (Vernon).

321. See TEX. GOV'T CODE ANN. § 305.003(a)(2) (Vernon Supp. 1992).

322. See, e.g., 34 TEX. ADMIN. CODE § 3.5 (proposed Dec. 30, 1991, 17 Tex. Reg. 98) (returning final consideration of penalty and interest waiver requests to the administrative hearings process).

