2008

Taxation

Cynthia M. Ohlenforst

Sam Megally

Angela Johnson

Follow this and additional works at: https://scholar.smu.edu/smulr

Recommended Citation
https://scholar.smu.edu/smulr/vol61/iss3/25

This Article is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in SMU Law Review by an authorized administrator of SMU Scholar. For more information, please visit http://digitalrepository.smu.edu.
AFTER the 2006 enactment of Texas' most substantial franchise tax reform in almost a hundred years, the legislature turned its attention to, among other things, Technical Corrections of the revised franchise tax during the 2007 regular session. This Survey focuses primarily on these legislative changes, as well as and on published court decisions affecting or interpreting tax issues.

I. SALES TAX

A. REPORTED CASES

In *Houston Wire & Cable Co. v. Combs*, the appellate court in a memorandum opinion affirmed the denial of a sales tax refund for taxpayer's purchase of cable reels.\(^1\) *Houston Wire & Cable Co.* ("HWC"), a supplier of electrical wire and cable, contended that it qualified for the manufacturing exemption, and that the cable reels on which it ships cable to customers qualified for a sale-for-resale exemption.\(^2\) HWC's central argument was that the reels possess additional characteristics resulting in a single wire or cable assembly, distinguishing them as a matter of law from the "packaging" exclusion described in Texas Tax Code section 151.302.\(^3\) The court, however, held that the reels are merely packaging materials and not sale-for-resale items.\(^4\)

As a secondary argument HWC claimed that it was a manufacturer and its purchase of reels was exempt under the manufacturing exemption.\(^5\)

---

1. No. 03-07-00006-CV, 2008 Tex. App. LEXIS 1820 (Tex. App.-Austin Mar. 12, 2008, pet. denied). This case was issued shortly after the Survey period ended, but merits inclusion. Consistent with this inclusion, cases discussed in last year's Survey are not discussed again here.
2. *Id.* at *3.
3. *Id.* at *7, *9 (discussing TEX. TAX CODE ANN. § 151.302 (Vernon 2008)). The court noted that the manufacturing exemption had changed during the relevant period, but concluded that the changes were not material to this case. *Id.*
4. *Id.* at *12.
5. *Id.*
The parties did not dispute that the reels qualified as "ingredients or component parts" under the exemption, but the court found that HWC's operations do not amount to "manufacturing, processing, or fabrication" within the meaning of Tax Code section 151.318(d) and Rule 3.300(a).\(^6\) The court concluded that HWC's product is the cable, not the cable assemblies, and that the reels are packaging for the cable. Therefore, "none of the changes made to the reels amount to processing of the product."\(^7\) In addition, the court found that HWC does not transform the cable and does nothing to change the cable's intrinsic characteristics, "so HWC cannot be said to be engaging in processing."\(^8\) The court also noted that HWC was not a fabricator because it does nothing to make the cable itself work in a new or different manner.\(^9\) In sum, HWC was not a manufacturer, and the reels did not qualify for the sale-for-resale exemption because the reels were packaging within the section 151.302(c) and (d) exclusion.

In another case related to the manufacturing exemption, *Sabine Mining Co. v. Combs*, the Corpus Christi Court of Appeals affirmed a finding that Sabine Mining Co. ("Sabine") was not entitled to a refund for sales tax paid on replacement parts for draglines (crane-like machines used in coal surface mining) used to remove overburden in order for the manufacturer to access coal.\(^10\) The court determined that draglines are not property used directly in the manufacturing of coal because draglines do not directly make a chemical or physical change to marketable coal, and because surface mining is not a stage in the actual manufacturing of the coal.\(^11\) The court considered what it viewed as legislative intent underlying the 1997 amendments to Texas Tax Code section 151.318 (a)(2) relating to property used in the manufacturing process. Those amendments added the following, italicized language to the section which allows an exemption for: "tangible personal property directly used or consumed in or during the *actual manufacturing*[,] . . . is necessary or essential to the *manufacturing*[,] . . . and *directly makes or causes a chemical or physical change to* . . . the product being manufactured."\(^12\) In deciding whether the draglines directly caused a chemical or physical change, the court interpreted the 1997 legislative intent to rebuke the reasoning of the 1996

\(^{6}\) Id. at *13 (discussing *Tex. Tax Code Ann.* § 151.318(d) (Vernon 2008) and 34 *Tex. Admin. Code* § 3.300 (2008) (Comptroller of Pub. Accounts, Manufacturing)).

\(^{7}\) Id. at *17.

\(^{8}\) Id. at *18.

\(^{9}\) Id. at *19.


\(^{11}\) Id. at *10-11.

Tyler Pipe\textsuperscript{13} and Chevron\textsuperscript{14} cases, which had more broadly construed the manufacturing exemption to include not only equipment that directly changed the final product, but also equipment that is one-step removed from the final product. The court construed the new language of section 151.318 very narrowly finding that the changes to the coal were not a “direct” result of the draglines because air intervened to cause the coal to dry and water to escape.\textsuperscript{15} As a result, the court viewed “direct” as implying “a close link with no intervening causes.”\textsuperscript{16} In addition, the court determined that the draglines do not actually manufacture, “but merely prepare the site for coal removal,” so that the actual manufacturing as required by the statute, “occurs later when the coal is processed and made ready to be transformed.”\textsuperscript{17}

B. LEGISLATIVE DEVELOPMENTS

Although there was no sweeping overhaul of sales tax statutes during the Survey period, legislators enacted multiple changes, including several that impact exemptions or exclusions. For example, the 2007 legislative session excluded from “real property service[s]” certain services provided by a landman that are “necessary to negotiate or secure land or mineral rights.”\textsuperscript{18} The legislature also amended the definition of “[s]ale for resale” by inserting the phrase “in the normal course of business” to the resale requirements (which, according to the comptroller’s staff, merely confirms current policy) and added a new subsection (b) that provides that the transfer of a wireless voice communication device as an integral part of a taxable service is a sale for resale regardless of “whether there is a separate charge for the wireless voice communication device or whether the purchaser is the provider of the taxable service, if payment for the service is a condition for receiving the wireless voice communication device.”\textsuperscript{19} In a related change, the legislature amended section 151.0103 to exempt “a pay telephone coin sent-paid telephone call,” but the exemption only applies to the “portion of the sales price of the telecommunication service that is paid by coin.”\textsuperscript{20} The legislature also extended the sunset date for the Texas emissions reduction plan surcharge.\textsuperscript{21}

\begin{itemize}
\item \textsuperscript{13} Sharp v. Tyler Pipe Indus., Inc., 919 S.W.2d 157, 163 (Tex. App.—Austin 1996, writ denied) (holding for a pipe-manufacturing company which sought a tax exemption under section 151.318, as then in effect, for materials used to make molds which were then used to size and shape the pipes it sold).
\item \textsuperscript{14} Sharp v. Chevron Chem. Co., 924 S.W.2d 429, 433 (Tex. App.—Austin 1996, writ denied) (holding for producer of plastics which claimed pipes used to transport plastic-producing chemicals within a plastic factory were exempt because the transportation of the chemicals from one point to another was a stage in the manufacturing of plastic).
\item \textsuperscript{15} Sabine Mining, 2007 Tex. App. LEXIS 6766, at *9.
\item \textsuperscript{16} Id. at *11.
\item \textsuperscript{17} Id. at *14-16.
\item \textsuperscript{18} TEX. TAX CODE ANN. § 151.0048 (Vernon 2008).
\item \textsuperscript{19} § 151.006.
\item \textsuperscript{20} § 151.0103(a)(4)-(b).
\item \textsuperscript{21} § 151.0515(d) (the surcharge expires Aug. 31, 2013).
\end{itemize}
In a change that came about in part because of concerns presented to the comptroller, the legislature modified section 151.056 by adding a new subsection which defines "ready mix concrete contractor," provides specific rules for such contractors, and requires that the tax rate be applied to the price of materials based on the greater of fair market value or invoice price (except for invoices submitted for a public works project).²²

The legislature also revised section 151.313 dealing with FDA approved drugs,²³ modified section 151.318 regarding the manufacturing exemption as it applies to certain pharmaceutical biotechnology clean rooms and equipment,²⁴ changed the sales tax holiday for certain clothing and footwear,²⁵ and modified provisions regarding certain aircraft exemptions.²⁶ In addition, the legislature added new provisions regarding "energy-efficient" products sold over Memorial Day weekend,²⁷ added an exemption for "tangible personal property used to process, re-use or recycle waste water that will be used in fracturing work performed at an oil or gas well,"²⁸ and revised section 151.429 relating to tax refunds for enterprise projects.²⁹ The legislature also modified miscellaneous sections regarding the motor fuel,³⁰ and hotel occupancy taxes,³¹ among other Tax Code changes.

Although this Survey typically does not address telecommunications gross receipts cases, the Austin Court of Appeals decision in *Combs v. Evercom Systems, Inc.*,³² is notable because it examines the application of the Texas Public Utility Commission’s assessment on the gross receipts of all public utilities within the commission’s jurisdiction. The legislature initially adopted the assessment in 1975 in order to help cover the costs of the commission’s operations. In particular, Evercom argued that it should not be subject to the assessment because it was a non-dominant interexchange carrier, as opposed to a carrier determined by the commission to have sufficient market power to control prices, and thus did not meet the definition of a public utility.³³ The court rejected this argument, holding that Evercom’s reading of the statute was too narrow, and concluding instead that the assessment applies equally to non-dominant carriers and dominant carriers.³⁴

²². § 151.056(g).
²³. § 151.313.
²⁴. § 151.318(b)(3).
²⁵. § 151.326(a)(2).
²⁶. § 151.328(a)(4), (c)(3).
²⁷. § 151.333.
²⁸. § 151.355.
²⁹. § 151.429.
³⁰. § 162.104.
³¹. § 156.2512.
³². No. 03-06-00481-CV, 2007 WL 1295811, at *2-3 (Tex. App.—Austin May 1, 2007, no pet.) (mem. op.).
³³. Id. at *5.
³⁴. Id.
II. FRANCHISE TAX

Even before the 2006 legislative session adjourned, it was clear that technical corrections were necessary to address problems created by inconsistencies in the statutory language of the revised franchise tax. Thus, against the backdrop of the enactment of a substantially revised franchise tax, legislators, the comptroller’s office, and taxpayers worked to craft amendatory language. As with almost all technical corrections bills, the revisions include not only minor clean-up amendments but also more significant changes. In this discussion of the revised tax, it is worth noting that the revised tax is sometimes labeled “the margin tax.” This is an appropriate label since the tax is imposed on a business’s “margin,” as defined under the Tax Code. However, some argue that the tax is technically still the “franchise tax.”

1. Combined reporting

As noted in last year’s Survey, the revised franchise tax marks a dramatic change from Texas’ long-time single-entity reporting methodology. One of the most significant changes made by the Technical Corrections bill was to modify the definition of “controlling interest” used to determine whether an entity should be included in an “affiliated group.” As revised in 2006, the franchise tax requires—for the first time in Texas history—certain affiliated entities to file combined returns if they are engaged in a unitary business. Prior to Technical Corrections, the ownership threshold had been eighty percent. However, the legislature changed the test to “more than 50 percent” for all entity forms subject to the tax. This change means that entities such as corporations, partnerships, and other taxable entities engaged in a unitary business are required to file a combined report based on a much lower common ownership threshold than under the original margin tax standards. The ownership criteria in both the original 2006 legislative language and in the new 2007 section regarding limited liability companies continues to be phrased in the disjunctive such that, for example, a controlling interest in

36. See Ohlenforst et al., supra note 35, at 1331-32.
38. See TEX. TAX CODE ANN. § 171.003(8) (Vernon 2008).
39. TEX. TAX CODE ANN. § 171.1014(a) (Vernon 2008).
40. Technical Corrections, supra note 37.
41. Technical Corrections also added a new subsection defining a controlling interest in an LLC as either more than fifty percent, owned directly or indirectly of the total membership interest of the LLC or more than fifty percent, owned directly or indirectly of the beneficial ownership interest in the membership of the LLC. Technical Corrections, supra note 37, at 2.
a partnership can be either more than fifty percent of the capital or more than fifty percent of the profits interest in the partnership. Thus, if one entity holds more than fifty percent of the profits, and a different entity holds more than fifty percent of the capital, the comptroller theoretically could have asserted that the partnership be deemed a member of two different combined groups. The comptroller has dealt with this situation—as well as with other similar situations in which an entity could be required to file in two separate groups—by adopting Rule 3.590, which provides that an entity that is a member of more than one affiliated group and has a "unitary relationship with more than one of those affiliated groups [may] elect to be treated as a member of only one group."42

This rule is one of several that the comptroller issued in draft form and, later, in proposed form during this Survey period.43 These rules were superseded by final rules that were adopted after the end of the Survey period.44 Therefore, although this article does not discuss the final rules in depth, they set forth several examples to demonstrate when an entity ("Parent") that owns a controlling interest in another entity ("Subsidiary") will be deemed to own one hundred percent of the Subsidiary's ownership interest in a third entity for purposes of determining whether the entities are commonly controlled. Essentially, these rules require that in any circumstance in which Parent controls Subsidiary by meeting the more-than-fifty-percent test, Parent will be treated as owning any interest controlled by Subsidiary.45 These rules apply not only to corporate entities, but also to other taxable entities such as trusts, partnerships, and limited liability companies, all of which could be included in a single combined return.46

In another change related to combined reporting, the legislature revised the definition of a "unitary business" to modify the list of specific factual criteria that the comptroller is to consider in assessing whether an affiliated group is unitary.47 Now the comptroller can argue that the legislature intended to make a meaningful change when it replaced the "and" with an "or" in the list of "any relevant factor" (so that the list now refers to whether activities of the group members are in the "same general line," "are steps in a vertically structured enterprise," or "whether the members are functionally integrated"). However, from a grammarian's standpoint, the list remains—as it was before Technical Corrections—a list of relevant factors to consider in making the unitary business determination. The comptroller further tackled the interpretation of the unitary business concept in Rule 3.590, which includes presumptions that

47. § 171.0001(17).
affiliated entities are unitary, and that an acquired business is unitary upon acquisition.48

Despite legislative changes, combined reporting issues continue to confuse and complicate compliance for Texas taxpayers who have spent years with strict single-entity, separate company reporting. Technical Corrections addressed some, but not all, of these issues. Section 171.1014(d), for example, has been amended to clarify that, regardless of a combined group's choice with respect to deductions (i.e., either cost of goods sold ("COGS") or compensation), the combined group's taxable margin cannot exceed seventy percent of the combined group's total revenue.49 This clarification resolves, in favor of higher taxes, an ambiguity in the pre-Tech Corrections legislation. Because all members of a combined group must use the same deduction approach, the group's total tax liability will drive the deduction election. Thus, some members may be required to use a disadvantageous method. For example, a service provider affiliate that is in a COGS combined group would effectively get no deduction because, on a stand-alone basis, it has no COGS deduction. The amendment to section 171.1014(d) makes clear that a member of a combined group cannot rely on the seventy percent cap otherwise applicable to single entities in calculating total revenue to be included in the group's total revenue. Thus, one hundred percent of such an affiliate's total revenue could be included in the tax base.

A tax change more favorable to taxpayers can be found in section 171.1014(d-1), which provides that a member of a combined group may claim as COGS the costs incurred for goods that are owned by another member of the combined group as a COGS deduction.50 This provision is designed to avoid the unintended consequence implied by H.B.3 of disallowing a COGS deduction simply because one member of a combined group incurred the cost while another member owned the goods.

Note that new section 171.1014(h) clarifies that a combined group must compute its tax with reference to business done during the same period for each group member.51 However, when group members have different accounting periods, it may not be clear which accounting period must be used by the group as a whole, so the comptroller's guidance becomes especially important.

New section 171.1014(i) has been the subject of much recent discussion, as it deems each member of a combined group jointly and severally liable for the combined group's margin tax liability.52 Although joint and several liability may not be unusual in some types of combined or consolidated reporting, the changes in the common control threshold from eighty to fifty percent, coupled with a renewed focus on a broad concept

48. 34 TEX. ADMIN. CODE § 3.590(b)(6). These presumptions which do not appear in the statute, may be over reaching.
49. TEX. TAX CODE ANN. § 171.1014(d) (Vernon 2008).
50. § 171.1014(d-1).
51. § 171.1014(h).
52. § 171.1014(i).
of unitary, makes this a troubling prospect for many entities, including partnerships.

2. Passive Entities

The revised franchise tax excludes from taxation those entities in which at least ninety percent of gross income as calculated under the federal tax code is derived from certain passive activities. As originally drafted, passive income included "gains from the sale of real property." Taxpayer elation at being able to treat all gains from the sale of real property as passive was short lived since the legislature quickly changed this provision to include only to "capital" gains.

The exclusion for passive entities requires both that an entity have no less than ninety percent passive income and no more than ten percent active income. Given the obvious fact that ninety percent plus ten percent equals one hundred percent, it is unclear whether there could ever be a circumstance in which an entity could meet the ninety percent test but fail the ten percent test. Therefore, the ten percent test is widely considered surplusage. Many practitioners and taxpayers had hoped that the legislature would repeal the ten percent active income test. The legislature's failure to repeal the ten percent test may tempt comptroller representatives to assert that income should be measured differently for the ninety percent test than for the ten percent test. However, early proposed guidance from the comptroller, which suggested that passive income could, in certain circumstances, be considered active income, was not carried over to the regulations.

Note also that the exclusion for passive entities is just that—an exclusion. Although it has sometimes been characterized as an exemption, it is in fact an exclusion. In view of the different burdens of proof associated with showing that a taxpayer is entitled to an exemption as opposed to an exclusion, this difference may be significant.

Other changes related to passive entity classification include cleanup changes to make clear that the characterization of a passive entity is tied to a particular return period, so that the tax is not imposed on an entity if

53. The legislature did not extend the opportunity to qualify as a passive entity to entities other than partnerships and trusts that are not business trusts. Therefore, non-business trusts and partnerships remain preferred vehicles for businesses that would be subject to the tax but for the fact that their income could allow them to meet the passive entity test. The legislative decision to limit passive entity status to only trusts and partnerships is based on multiple factors, including these entities' utility as vehicles for bringing oil and gas real estate investors and other investors into the state, and the high cost—in terms of tax revenue that would be lost—of extending passive, nontaxable status to other entities.


55. Tex. Tax Code Ann. § 171.0003(a)(2)(C) (Vernon 2008). This change not only reduced the amount of gain on a transaction that could be counted as passive, but also gave rise to questions concerning federal tax recapture amounts (for example, depreciation, typically treated as ordinary income on the disposition of operating properties). In informal advice, comptroller staff has confirmed that I.R.C. § 1231 gain will be considered capital gain but also indicated that they will consider recapture amounts as ordinary (that is, non-passive) "active income" for purposes of this test.
the entity qualified as a passive entity during the reporting period.56

3. **Taxable Entities**

Technical Corrections also made other changes that impact which entities are subject to the margin tax. As noted in last year's Survey, there were several unintended "cliff rules" (that is, one misstep and your fall off a cliff, perhaps without ever having known the cliff was there) in the original enactment.57 For example, section 171.0002(c)(2) provided that a nontaxable general partnership comprised entirely of natural persons would be nontaxable but would become taxable if a partner died and the partner's interest were held by the partner's estate. Technical Corrections eliminated this particular cliff by redefining natural person to include the estate of the human being.58

Other changes:

- Section 171.0002(a) now specifically includes a limited liability partnership as a taxable entity,59 a change designed to conform statutory effect with legislative intent that lawyers, accountants, and others operating in limited liability partnerships (which are technically general partnerships) are subject to the tax.
- Section 171.0002(b) further confirms legislative intent that the general partnership exclusion does not apply to a general partnership with statutorily limited liability.60
- Section 171.0002(c)(4), which sets forth additional requirements for a family limited partnership to qualify as a passive entity, was repealed.61 This change, like many of those discussed in this Survey, is designed to eliminate drafting glitches. The correction confirms the legislative intent that a family limited partnership ("FLP") which meets the definition of a passive entity is not taxable, regardless of whether it meets the additional requirements set forth in this repealed section.62
- Section 171.0002 was further amended to repeal subsections that imposed additional requirements on passive investment partnerships in trusts.63
- The legislature confirmed that certain other entities are nontaxable by specifically providing that certain non-profit self-insurance

---

56. § 171.001(c).
58. TEX. TAX CODE ANN. § 171.0001(11-a) (Vernon 2008).
59. § 171.0002(a). See also 34 TEX. ADMIN. CODE § 3.582(c)(1)(c) (2008) (Comptroller of Pub. Accounts, Combined Reporting) (indicating, consistent with legislative intent, that a limited liability partnership may qualify for treatment as a passive entity).
60. TEX. TAX CODE ANN. § 171.0002(b) (Vernon 2008).
61. Technical Corrections, supra note 37.
62. The additional requirements were apparently a carry over from an earlier draft, designed to insure that FLP's could qualify as non-taxable entities. However, the additional requirements imposed by the section could have created confusion as well as the risk that the comptroller or a court would have concluded that an FLP must meet not only the passive entity test set forth for other taxpayers, but also the separate, additional requirements formerly included in this section.
63. See Technical Corrections, supra note 37 (repealing prior §§ 171.002(c)(5), (c)(6) and (c)(7)).
trusts and trusts qualified under Internal Revenue Code section 401(a) are not taxable.64

- Legislators also amended section 171.0002(d) to provide that sole proprietorships formed under the statutes of a foreign country that limit liability are subject to the tax.65 This amendment is designed to reach those forms of business whose individual owners are shielded from personal liability, consistent with the legislature's general intent that most limited liability entities are subject to the tax.

4. Definitions and Other Changes

Technical Corrections revised the definition of the Internal Revenue Code to provide that the Tax Code does not include changes made by federal law after January 1, 2007.66 Technical Corrections also broadened the definition of "lending institution" to include any entity that makes loans and: (1) is regulated by the Commodity Futures Trading Commission; (2) is regulated by the Office of Thrift Supervision; (3) "is licensed by, registered with, or otherwise regulated by the Department of Savings and Mortgage Lending; [(4)] is a "broker" or "dealer" as defined in the Securities Exchange Act of 1934 . . .; or [(5)] provides financing to unrelated parties solely for agricultural production."67

The definition of "security" is relevant in multiple places in the revised franchise tax code, including for purposes of determining revenue (in calculating the tax basis of securities and the basis of securities sold)69 and apportionment of gross proceeds arising from certain sales of securities.70 However, H.B.3 did not include a specific definition

64. See TEX. TAX CODE ANN. § 171.0002(c)(6) (Vernon 2008) (non-profit self insurance trusts created under TEX. INS. CODE ch. 2212 (Vernon 2007); § 171.0002(c)(7) (trusts qualified under I.R.C. § 401(a)). Many section 401(a) retirement plans may own assets through wholly owned subsidiaries or joint venture entities; these subsidiaries/joint ventures are not explicitly listed as nontaxable entities, and the Comptroller is working to determine the scope of this exclusion.

65. § 171.0002(d).

66. § 171.0001(9). This change is consistent with Texas' legislators' long-term practice of defining the Internal Revenue Code as of a stagnant point in time, generally to minimize concerns that they could be unconstitutionally delegating taxing powers to the federal government. The impact carries forward another of Texas' long-held traditions of creating a gap between the Internal Revenue Code as it applies to taxpayers' federal tax returns and the Internal Revenue Code as it applies to franchise tax calculations that are based on the Code.

67. § 171.0001(10). The subject of much debate and redrafting, this provision more specifically defines lending institutions, which are entitled to treat certain interest expenses as deductible costs of goods sold. The Tax Code provides that lending institutions, other than entities "primarily engaged in an activity described by category 5932 [used merchandise stores] of the 1987 Standard Industrial Classification Manual," may subtract interest expense. § 171.1012(k). Both industry-affiliated lenders (for example, seller financiers) and banks and other lenders had expressed concern with the definition of lending institution, and the language from the early versions of the Technical Corrections was changed in response to concerns that some lenders would be unable to claim the intended interest expense deductions.

68. § 171.1011(g)(2).

69. § 171.1011(g-2).

70. § 171.106(f).
of “security.” After considering multiple alternative definitions, legislators elected in Technical Corrections to tie the definition of securities to the Internal Revenue Code, but “only” for purposes of the three sections above.  

Technical Corrections does not state the definition of securities will apply in other franchise tax contexts, such as for purposes of the section 171.003(a)(2)(c) passive entity test, leaving room for both interpretation and argument.

Another securities-related provision is new section 171.106(f), which provides that if a loan or security is treated as inventory of the seller for federal income tax purposes, then the gross proceeds of a sale of such loan or security are gross receipts for apportionment purposes. This Technical Correction change followed much discussion of the legislative intent underlying H.B.3 to maintain pre-margin tax apportionment rules for lenders. Indeed, the industry had suggested to the comptroller’s office could make the change by regulation without a Technical Correction, although the legislative resolution is a much cleaner fix.

Technical Corrections also made several changes that were just that—technical corrections—including revisions to the mechanics of consumer price index adjustments. Section 171.203 has been modified to clarify that the section 171.203 public information report requirements are imposed on limited liability companies as well as corporations. Section 171.002, as originally drafted, would have based the tax rate on each year of the privilege period, arguably resulting in a higher tax than the stated rates. Changes to this section corrected this drafting error by tying the rate to the privilege period. Other changes to section 171.002 make tax rates subject to section 171.003 (increase in rate requires voter approval) and section 171.1016 “E-Z Computation and Rate.” The relevant rate period is now the “per 12-month period on which the margin is based.”

In several places, legislators changed the starting point of gross revenue as it appears on the federal tax return from the amounts “entered” to amounts “reportable as income.” Section 171.1011(b) refers to reportable income as “the amount entered to the extent the amount entered complies with federal income tax law.” These changes reflect the legislators’ concern that taxpayers might be able to play games with the mar-

71. Technical Corrections, supra note 37.
72. Id. See also 34 TEX. ADMIN. CODE § 3.582(b)(10) (2008) (Comptroller of Pub. Accounts, Passive Entities) (defining security for purposes of the passive income calculation as being limited to securities in which the holder has an interest that is less than or equal to fifty percent). Taxpayers may well challenge this section as it does not appear to have statutory support. Id.
73. See TEX. TAX CODE ANN. § 171.006 (Vernon 2008).
74. § 171.203.
75. § 171.002.
76. § 171.003.
77. § 171.1016.
78. § 171.002.
79. See, e.g., § 171.1011(c)(1)(A)(i).
80. § 171.1011(b).
gin tax by "entering" amounts on a federal tax return that would not impact the taxpayer's federal tax liability but might be artificially low enough to reduce margin tax and result in inaccurate underreporting.

Legislators also revised section 171.1015, which addresses reporting for certain partnerships in tiered partnership arrangements. While the revisions fixed the confusing language by which lower-tier referred to upper-tier, and vice versa, multiple questions about tiered reporting still remain.\(^81\) Additional amendments to section 171.1015(b) provide that an upper-tier entity may include its allocable share of the total revenue of a lower-tier entity in determining its own taxable margin, and that a lower-tier entity is liable for its own margin tax to the extent a related upper tier entity is not subject to the tax.\(^82\)

New section 171.1015(d) provides that the minimum $1,000 tax or $300,000 total revenue requirements for application of the tax do not apply to an upper-tier entity if a lower-tier entity attributing total revenue to it does not satisfy one of the minimum requirements.\(^83\) The comptroller could argue that this provision disallows the small business exemption to any small taxable entity that owns an interest of any size in a flow-through entity with tax or revenues that exceed the exemption thresholds, irrespective of whether the small upper-tier entity actually reports allocable total revenue from the larger lower-tier entity. Such an interpretation, however, would appear contrary to the legislative intent to reduce the tax burden on small businesses.

Legislators considered, but did not adopt, proposed amendments to section 171.1011 that would have allowed taxable entities to exclude from revenue net distributed income from exempt passive entities. This concept was abandoned late in the legislative process. The resulting passive entity treatment is, in some ways, an exception to the margin tax's antipyramiding principle, which generally allows upper-tier entities to exclude from revenue net distributed income from lower-tier flow-through entities.

Other changes to section 171.1011 include changes designed to correct two significant drafting glitches in H.B.3 relating to federal tax partnerships.\(^84\) Prior to Technical Corrections, "revenue" included certain net income from rental real property instead of gross income, and double

---

\(^81\) § 171.1015. See also § 171.1011(c)(1)(B) (a more concise provision relating to corporations' ability to deduct net distributed income from federal tax partnerships and S Corporations).

\(^82\) Tex. H.B. 3, 79th Leg., 3d C.S. (2006). H.B.3 had provided that upper-tier entities could report allocable shares of "taxable margin" of lower-tier entities (for example, after deductions and apportionment at the lower-tier), while Technical Corrections provides that upper-tier entities can report allocable shares of "total revenue." Id. The section does not explicitly provide a corresponding right for an upper-tier entity to report its allocable share of a lower-tier entity's COGS or compensation deduction, nor does it explicitly address apportionment issues.

\(^83\) Tex. Tax Code Ann. § 171.1015(d) (Vernon 2008).

\(^84\) See § 171.1011(c)(2).
Modifying the tax base to include gross rentals rather than net rentals created additional fiscal note revenue, which legislators used to fund other legislative changes, including the additional relief for small businesses.

Under revised section 171.1011(d), any taxable entity that is part of a federal consolidated group must compute its total revenue under section 171.1011(c) as if it had filed a separate return for federal income tax purposes.

New section 171.0021 provides a discount for certain small businesses. One of the most popular changes in Technical Corrections, this section—added in the Senate Committee substitute—effectively extends partial relief from the margin tax rates to taxpayers with revenues of up to $900,000.

Section 171.1013(b-1), one of the relatively few margin tax incentives directly intended to influence taxpayers' behavior, allows small employers as defined by section 1501.002 of the Insurance Code that have not previously provided healthcare benefits to any of their employees to gross up their compensation deductions for such benefits in the first two years they begin providing health care benefits by fifty percent and twenty-five percent, respectively.

5. **Deductions for Costs of Goods Sold and Compensation**

Revised section 171.101(d) no longer explicitly provides that taxable entities may change their COGS/Compensation election by filing an amended return, and requires instead that a taxable entity notify the comptroller of its deduction choice no later than the due date of its annual report. However, it is not clear whether this change means that a taxpayer who files a return based on one method (COGS or Compensation) will be unable to change its return, even if subsequent interpretation of the law or change in circumstances make the original election less favorable. Several other legislative changes address the calculation of the deductions.

The section 171.1012(a)(3)(A) definition of "tangible personal property" now explicitly includes live and prerecorded television and radio.

---

85. Id.
86. §§ 171.1011(c)-(d). See also § 171.1011(g-3)(3) (revising the exclusion from revenue for attorneys providing pro bono services from actual out-of-pocket costs capped at $500 per case to a flat deduction of $500 per case—at a one percent rate, the provision offers five dollars tax relief per case.); § 171.1011(g-4) ("A taxable entity that is a pharmacy cooperative shall exclude from its total revenue . . . [any applicable] flow-through funds from rebates from pharmacy wholesalers that are distributed to the pharmacy cooperative's shareholders.").
87. § 171.0021. Taxpayers with revenues of $300,000 - $400,000 are entitled to an eighty percent tax rate discount; revenue of 400,000 - $500,000 merit a sixty percent discount; revenues of $500,000 - $700,000 merit a forty percent discount and revenues of $700,000 - $900,000 merit a twenty percent discount. Id.
88. § 171.1013(b-1).
89. § 171.101(d).
programs, books, and other similar property embodying ideas, "without regard to the means or methods of distribution or the medium in which the property is embodied." This confirms that such property can qualify for COGS deductions.\(^9\) New section 171.1012(o) contains special instructions for the subtraction of COGS for any entity whose principal business activity is film or television production or broadcasting or the distribution of films, TV, and radio programs, as well as for other subsection (a)(3)(A)(ii) taxable personal property. Like the changes to the definition of tangible personal property, these changes confirm the original legislative intent and earlier comptroller rulings regarding the deductions available in the context of the film and broadcast industries.

The legislature also revised section 171.1012(c)(6) to provide that depreciation, depletion, and amortization deductible under this subsection as a COGS must be calculated as reported on the federal income tax return on which the franchise tax report is based.\(^9\) As noted above, significant discussion during the legislative session focused on the interplay between federal income tax reporting and the franchise tax.

Section 171.1012(g) also now provides that an entity may expense or capitalize COGS to the same extent as can be done on its federal income tax return.\(^9\) Subsection (g) contains detailed instructions about the capitalization of costs. Although this section also reflects the legislators' concerns with the link between federal and state tax reporting, the provision also allows taxpayers more flexibility in determining whether to capitalize or to deduct certain costs. Legislators also introduced new language to subsection (g) which was designed to prevent taxpayers from switching back and forth between capitalizing and expensing certain amounts in order to "double-dip" on deductions.

The section 171.1013(a) definition of "wages and cash compensation" has been modified to refer to net distributive income from all taxable entities treated as partnerships for federal income tax purposes or net distributive income from limited liability companies treated as sole proprietorships for federal income tax purposes, but in each case, only if the person receiving the distribution is a natural person.\(^9\) Several unadopted proposals would have allowed a broader compensation deduction for amounts paid to a single member LLC, single-shareholder professional corporation, or professional association, in order to provide relief to professionals who practice through these entities.

Amendments to section 171.1013(b)(2) clarify that taxable entities electing the compensation deduction may deduct the costs of all benefits provided to officers, directors, owners, partners, and employees, but only to the extent they are deductible for federal income tax purposes.\(^9\) This

\(^9\) § 171.1012(o).

\(^9\) § 171.1012(c)(6).

\(^9\) § 171.1012(g).

\(^9\) § 171.1013(a).

\(^9\) § 171.1013(b)(2).
clarification eliminated an ambiguity in H.B.3 regarding whether taxpayers could claim margin tax deductions for benefits that may not have been deductible for federal income tax purposes.

Section 171.1013(c) provides that, notwithstanding the actual amount of wages and cash compensation paid by a taxable entity to its officers, directors, owners, partners, and employees, a taxable entity may not include more than $300,000 or the amount determined under section 171.006 for each twelve-month period upon which the margin is based. The amended version of section 171.1014(f)(1) clarifies that the $300,000 compensation deduction per employee ceiling applies at a combined group level, rather than at the group member level. Comptroller staff had expressed concern that taxpayers would spread salaries across multiple entities in an effort to circumvent the $300,000 cap.

Technical Corrections also address staff-leasing and management company situations by treating workers assigned by such companies to an operating business, as if the individuals were employed by the operating business, for purposes of computing revenue and related compensation deductions. The bill amendment to these provisions thus places short-term employment arrangements on the same footing as long-term staff leasing arrangements by treating the client company as the recipient of the compensation deduction.

6. Business Loss Carryover

Technical Corrections also fixed the business loss carryover provisions. Section 171.111(b)(1) now provides that the basis for determining this credit is the business loss amount determined under section 171.110(e), and not exhausted on a report originally due prior to January 1, 2008. This language fixes the confusing language from H.B.3 which had referred to net operating loss carryforwards and temporary accounting differences. Section 171.111(b) also changed the percentage of the loss credit that a taxable entity may take in each of the twenty years across which the loss credit is spread (2.25% in each of the first ten years; 7.75% in each of the last ten) and provides that the credit be measured by reference to the 4.5% tax rate—the rate in effect when the losses were incurred. Section 171.111(d) now provides that a taxable entity that

95. § 171.1014(f)(1).
96. Query whether members of an affiliated group that are not engaged in a unitary business—and therefore are not a combined group—may each deduct up to $300,000 for compensation paid to a common employee.
97. TEX. TAX CODE ANN. § 171.0001(6) (Vernon Supp. 2008). The amendment modifies the definition of temporary employment service by incorporating a reference to TEX. LABOR CODE ANN. § 93.001(2) (Vernon Supp. 2008), which defines temporary employment service as “a person who employs individuals for the purpose of assigning those individuals to the clients of the service to support or supplement the client’s workforce in a special work situation, including: (A) an employee absence; (B) a temporary skill shortage; (C) a seasonal workload; or (D) a special assignment or project.”
98. TEX. TAX CODE ANN. § 171.111(b) (Vernon 2008).
changes combined groups after June 30, 2007 loses its right to the credit. 99 This section is intended to prevent selling off companies with a loss, not to penalize companies within a group that changes composition over time. Although the comptroller's initial guidance on the loss carryover appeared unduly restrictive, the comptroller subsequently provided some helpful confirmation. For example, a merger of two combined group members does not trigger a loss of the credit. Nonetheless, the comptroller and taxpayers may still face questions and disagreements about this provision.

Consistent with legislative intent to make the credit available to companies subject to the pre-margin franchise tax, new section 171.111(d-1) grants were subject to the tax as of May 1, 2006. 100 Combined groups may claim the credit for each member entity that was subject to the tax on May 1, 2006. 101

New section 171.111(d-2) further provides that the credit may not result in a refund when it is greater than the amount of franchise tax due for a report, since neither the legislature nor the comptroller intended the credit as a refund mechanism. 102

7. Transition Rules, Apportionment and E-Z Reporting

The comptroller worked hard to provide written, informal guidance to taxpayers and to circulate draft rules before the year's end. The online guidance posted by the comptroller earlier in the year confirmed, to the taxpayer's pleasure, that certain pre-July 1, 2007 mergers by which partnerships merged out of existence could still enable taxpayers to reduce their otherwise higher tax burden.

The legislature considered, but did not adopt, plans to change the apportionment formula from the Joyce to the Finnegan method. 103 Instead, the legislature enacted new section 171.103(c), which requires that a combined group disclose, for informational purposes only, on its initial and annual reports the Texas gross receipts (including the amount of Texas gross receipts that are taxable in another state pursuant to a throwback rule) of each non-nexus group member. 104 This controversial, requirement is designed to allow Texas to quantify the additional tax revenue that could be gained by switching from the Joyce to the Finnegan method.

99. § 171.111(d).
100. § 171.111(d-1).
101. Id.
102. § 171.111(d-2).
103. As enacted, the revised franchise tax utilizes the "Joyce rule" instead of the "Finnegan rule." Compare Joyce, Inc., No. 66-SBE-070 (Cal. State Bd. of Equalization, Nov. 23, 1966) (all gross receipts of non-nexus combined group members are deemed non-Texas for purposes of computing the group's apportionment factor, irrespective of the normal sourcing rules), with Finnegan, Corp., No. 88-SBE-022-A (Cal. State Bd. of Equalization, Jan. 24, 1990) (gross receipts of non-nexus group members are sourced for apportionment purpose under the state's regular apportionment rules).
104. TEX. TAX CODE ANN. § 171.103(c) (Vernon 2008).
Taxpayers were pleased, by contrast, with the legislature’s repeal of the unpopular requirement that taxpayers file a proforma (“pretend”) margin tax report on February 15, 2008.

Another controversial provision enacted during the legislative session provides for an “E-Z method” of calculating the tax owed by smaller taxpayers. Specifically, new section 171.1016 provides that a taxable entity with up to ten million dollars in total revenue may elect to pay margin tax on 0.575 percent of the entity’s total revenue that is apportioned to Texas, and further recognized the availability of the new section 171.0021 step discounts to such electing taxable entities. This provision, which creates a new, simplified calculation for taxpayers with receipts of less than ten million dollars, was added late in the day by a Senate amendment to the Senate Committee Substitute. While many applauded the simplified calculation, others worried that the E-Z calculation paves the way for an almost-always-unpopular gross receipts tax.

III. PROPERTY TAX

A. LEGISLATIVE UPDATE

The long-awaited reduction in property taxes again dominated news during this Survey period. Perhaps the most significant evidence of legislative intent in a reduction was the House’s appropriation of nearly seven billion dollars each for years 2008 and 2009 to the Texas Education Agency to fund a reduction in school district property tax rates. The legislature also proposed a constitutional amendment capping the amount by which a property’s appraised value could be raised from one year to the next to ten percent. Among other legislative changes during the period were the criminalization of communications by appraisal district board members about property appraisals outside of public hearings, an exemption from property tax for certain goods in transit (excluding oil, natural gas, petroleum products, aircraft, dealer’s motor vehicle inventories, dealer’s vessel and outboard motor inventories, heavy equipment inventories, and retail manufactured housing inventories), and a new requirement that taxing units wishing to increase their tax rates hold two public hearings and make several pieces of information publicly available prior to such an increase.

B. JUDICIAL DECISIONS AND ATTORNEY GENERAL OPINIONS

Several cases during the review period addressed valuation and procedural issues of interest in the property tax context, and one attorney gen-

105. § 171.1016.
106. § 171.0021.
eral opinion focused on ex parte communications between an appraisal district and its appraisal review board. Numerous other property tax cases during the Survey period addressed issues such as the sovereign immunity of a taxing municipal corporation absent a claim of fraud, mutual mistake of fact, or duress, and the taxability of refined petroleum products stored in tanks and awaiting transfer into streams of interstate commerce. An additional attorney general opinion of interest concluded that property held by a charitable organization should not lose its exemption solely as the result of the property’s being unoccupied (for instance, following a fire).

**MHCB (USA) Leasing and Finance Corp. v. Galveston Central Appraisal District** was a hybrid procedure/valuation case during the review period that addressed which party has standing to protest an appraisal review board’s valuation and the validity of an appraisal agreement between a taxpayer and an appraisal district. MHCB (USA) Leasing and Finance Corp. (“MHCB”) owned a refinery unit that it leased to Valero during 2003, which is the valuation period in dispute. As part of this contractual relationship, Valero was obligated to pay property taxes on the refinery unit. In December of 2003, Valero began working with the district’s appraiser to arrive at a value for the property, and ultimately executed an appraisal agreement with the appraiser which determined that the refinery unit be valued at roughly sixty million dollars. Later in March 2004, MHCB sold the unit to Valero.

Following the district’s first appraisal notice at sixty million dollars, the district and the appraiser felt political pressure to justify the appraisal, which some parties considered to be too low. Over Valero’s objections, the district issued a revised appraisal of roughly 193 million dollars. Valero and MHCB filed a joint protest of this appraisal with the review board, which was denied, and then filed suit in district court following the district’s reappraisal of the unit to 240 million dollars, pursuant to a board order.

In their district court petition, MHCB and Valero argued that the district should be held to the initial appraisal agreement, and alternatively, that the reappraisal value was excessive and unequal. The district and the board answered that they were immune from suit as governmental

---

116. Id.
117. Id.
118. Id. at 72-73.
119. Id. at 72.
120. Id. at 73.
121. Id.
122. Id.
123. Id. at 72-74.
agencies and that the protest of their appraisal was improper because only the property owner of record—and not the property owner and another party jointly—has standing to protest an appraisal.\textsuperscript{124} The district’s and board’s standing argument rested in part on the premise that the entire protest was invalid because Valero had joined the dispute even though it was only a lessee during the relevant period and not a properly designated property tax agent of MHCB.\textsuperscript{125}

The district court granted the district’s and board’s plea with respect to the taxpayers’ primary allegations dealing with the appraisal agreement, but denied it with respect to the unfairness of the reappraised value.\textsuperscript{126} Both sides appealed.

The First Court of Appeals in Houston considered first the claim that the taxpayers did not have standing to challenge the reappraisal values because they filed jointly.\textsuperscript{127} The court rejected this argument, concluding that the appeal before them was really two arguments, one by each of MHCB and Valero. Since Valero acquired the refinery prior to the deadline to challenge an appraisal, the court held that it had standing to make the protest.\textsuperscript{128} However, the court found that to the extent that MHCB could have made a separate protest, it did not have standing, and therefore its protest would not be considered.\textsuperscript{129}

The court next addressed whether the appraisal agreement between the district and Valero was binding on the district.\textsuperscript{130} On this point, the court concluded that Texas Tax Code section 1.111(e) which allows final agreements as to property value between a property owner and an appraisal district, does not permit a district to rescind an agreement.\textsuperscript{131} Therefore, the court determined that the taxpayers’ suit was not one for breach of contract which would have been barred by the affirmative defense of sovereign immunity but was one to construe the meaning of section 1.111(e) and to determine whether the district and board exceeded their statutory authority in rescinding that agreement.\textsuperscript{132} The court ultimately reversed and remanded to the trial court for further proceedings to address the taxpayers’ claims regarding the appraisal agreement.\textsuperscript{133}

In two other cases, the Houston First and Fourteenth District Courts of Appeals also considered the question of when an appraisal agreement is binding on the appraisal district and on the taxpayer.\textsuperscript{134} In each case, the

\textsuperscript{124} Id. at 74–75.
\textsuperscript{125} Id.
\textsuperscript{126} Id.
\textsuperscript{127} Id. at 77–79.
\textsuperscript{128} Id. at 78–79.
\textsuperscript{129} Id.
\textsuperscript{130} Id. at 79.
\textsuperscript{131} Id. at 82–84 (interpreting TEX. TAX CODE ANN. § 1.111(e) (Vernon 2008)).
\textsuperscript{132} Id. at 83–84.
\textsuperscript{133} Id. at 90.
\textsuperscript{134} Hartman v. Harris County Appraisal Dist., 251 S.W.3d 595 (Tex. App.—Houston [1st Dist.] 2007, pet. denied); Sondock v. Harris County Appraisal Dist., 231 S.W.3d 65 (Tex. App.—Houston [14th Dist.] 2007, no pet.).
court held that a taxpayer’s presentation at an appraisal review board hearing of an agreed-upon property value and the district’s subsequent drafting of an appraisal agreement such renders an agreement as binding and unappealable to district court.\textsuperscript{135}

In another valuation case, \textit{Western AH 406 Ltd. v. Central Appraisal District of Taylor County}, the Eastland Court of Appeals considered an appraisal protest by the owner of an apartment complex that provided housing for military personnel and their families under a contractual arrangement with the Air Force.\textsuperscript{136} Western had lost on its arguments at trial that properties that were similarly encumbered by contractual arrangements such as the one it had with the Air Force should be considered by the district in determining its valuation for the tax year.\textsuperscript{137} In reversing the trial court, the court of appeals held that section 23.01\textsuperscript{138} requires a property’s market value to be determined in accordance with generally accepted appraisal methods, and pointed to the Uniform Standards of Appraisal Practice Rule 1-2(e)(iv), which states that such contracts are individual characteristics of a property, and therefore should be considered in valuing the property.\textsuperscript{139}

The San Antonio and Houston First District Courts of Appeals considered two similar cases involving a limited partnership’s argument that it was entitled to the section 11.182 property tax exemption for community housing development organizations\textsuperscript{140} because its general partner was a Community Housing Development Corporation ("CHDO"); in both instances, the court of appeals ruled against the taxpayers.\textsuperscript{141} In rendering their decisions, the courts relied on the requirements that tax exemptions are to be strictly construed and doubts resolved against exemptions.\textsuperscript{142} The courts held that the section 11.182(e) requirement that a CHDO “‘control 100 percent of the interest in the general partner if the [housing development] project is owned by a limited partnership,’” was to be construed as additional to—and not in place of—the section 11.182(b) requirement that the entity seeking the exemption must itself be a CHDO.\textsuperscript{143}

These opinions appear contrary to a prior decision on similar facts in \textit{TRQ Captain’s Landing, L.P. v. Galveston Central Appraisal District} by the First Houston Court of Appeals—the same court that decided \textit{Primrose Houston 7 Housing, L.P. v. Primrose Houston 7 Housing, L.P.}, on which the court below relied. However, the trial court did not explain its reasoning or provide a rationale for its decision, which makes it more difficult to assess whether the court was in fact relying on the Uniform Standards of Appraisal Practice Rule 1-2(e)(iv). It is possible that the trial court was incorrect in its application of the rule, and that the court of appeals was correct in its interpretation of the rule.

\textsuperscript{135} See Hartman, 251 S.W.3d at 60; Sondock, 231 S.W.3d at 69.
\textsuperscript{136} 213 S.W.3d 544, 545 (Tex. App.—Eastland 2007, pet. denied).
\textsuperscript{137} Id.
\textsuperscript{138} \textit{W. AH 406}, 213 S.W.3d at 546–47.
\textsuperscript{139} \textit{TEX. TAX CODE ANN.} \textsuperscript{140} § 23.01 (Vernon 2008).
\textsuperscript{141} \textit{TEX. TAX CODE ANN.} \textsuperscript{142} § 11.182 (Vernon 2008).
\textsuperscript{142} Cameron, 238 S.W.3d at 772; \textit{Primrose}, 238 S.W.3d at 786.
\textsuperscript{143} Cameron, 238 S.W.3d at 781; \textit{Primrose}, 238 S.W.3d at 786.
rose against the taxpayer.\textsuperscript{144} The Houston court drew a distinction between the facts in the two cases by reasoning that, unlike TRQ, the taxpayer in Primrose did not have equitable title to the property at issue because it did not have the present right to compel legal title.\textsuperscript{145} The opinions are also interesting in light of the point made by the taxpayers and the dissent in Cameron, is, that the court's strict reading of the statutory language arguably renders a portion of section 11.182(e) meaningless.\textsuperscript{146} Expect further appeals and a possible supreme court opinion to settle this issue.

The Attorney General's office issued an interesting opinion considering whether an appraisal district's use of its in-house counsel to advise the district's appraisal review board—which hears protests against district appraisals brought by taxpayers—should be barred as ex parte communications between the review board and the district.\textsuperscript{147} The opinion looks first to section 41.66(f), which prohibits appraisal review board members from communicating the facts or evidence related to a property owner's protest, or the property that is the subject of a protest with any person—including a district employee—outside a public hearing.\textsuperscript{148} It also notes that section 6.411 criminalizes such ex parte communications, though it excepts communications between a review board and its legal counsel.\textsuperscript{149} A provision in section 6.43 allows a review board to use an appraisal district's clerical staff when the board's budget does not allow for such support separately.\textsuperscript{150} The opinion nonetheless concludes that a review board's quasi-judicial function, combined with the clear statutory codification of the traditional ban on judicial ex parte communications, requires a finding that an appraisal review board's own use of a district's in-house counsel is banned as prohibited ex parte communications.\textsuperscript{151}

IV. PROCEDURE

A. LEGISLATIVE DEVELOPMENTS

The 2007 legislative session added a new section to the Tax Code to effect the transfer of contested cases to the State Office of Administrative Hearings.\textsuperscript{152} In addition, a section was added to confer exclusive jurisdiction to the district court of Travis County for suits that challenge a collection action.\textsuperscript{153} New provisions also address payment and collection of taxes, circumstances in which a person is presumed to have received or

\textsuperscript{144} 212 S.W.3d 726, 728–30 (Tex. App.—Houston [1st Dist.] 2006, pet. granted).
\textsuperscript{145} Primrose, 238 S.W.3d at 787.
\textsuperscript{146} Cameron, 238 S.W.3d at 775, 781.
\textsuperscript{148} Id. (interpreting TEX. TAX CODE ANN. § 41.66(f) (Vernon 2008)).
\textsuperscript{149} Id. (interpreting TEX. TAX CODE ANN. § 6.411 (Vernon 2008)).
\textsuperscript{150} See TEX. TAX CODE ANN. § 6.43 (Vernon 2008).
\textsuperscript{152} TEX. TAX CODE ANN. § 111.00455 (Vernon 2008).
\textsuperscript{153} § 111.0102.
collected a tax, and the tolling of the statute of limitations. Another change concerns the seizure and sale of property, specifically providing that certain activities constitute interference with the comptroller’s seizure of the property and consequently are misdemeanors. The legislature also added a section regarding tax evasion, which details when an officer, manager, director, or partner will be held personally liable in connection with a fraudulent “scheme” or “plan” to evade taxes. Other sections were enacted to tighten the comptroller’s authority to address the electronic transfer of certain payments, the electronic filing of certain reports, and actions to determine the validity of a state tax lien.

B. Judicial Decisions

In *Neely v. West Orange-Cove Consolidated Independent School District*, the Austin Court of Appeals agreed that the trial court’s granting of attorneys’ fees was equitable and just, and that the state had waived its argument regarding the attorney’s fees by not asserting it on direct appeal to the Texas Supreme Court. The state claimed that the school districts were ineligible for attorneys’ fees because under the Uniform Declaratory Judgments Act a declaratory judgment may not be used solely as a vehicle to obtain attorneys’ fees, and that the trial court abused its discretion in awarding fees to parties that did not prevail on its claims. The court of appeals reviewed the case although the State waived its argument because it may review the trial court’s award to ensure it was equitable and just. The court affirmed and found no abuse of discretion.

The Austin Court of Appeals in *Levy v. OfficeMax, Inc.* reversed and remanded the trial court’s decision granting a plea seeking to compel an assignment of the right to receive a tax refund via a class action suit. The issue was whether customers who receive a rebate on a retail purchase could pursue a class action against the retailer to obtain an assignment of refund rights in order to file a tax refund claim with the State. The court found that “district courts in Texas are courts of general jurisdiction with the power to ‘hear and determine any cause . . . ’ and to ‘grant any relief . . . ’”; therefore, at least according to this decision, the district court had jurisdiction to consider claims against the retailers for

154. § 111.016 (a-1), (b-1).
155. § 111.017.
156. § 111.0611.
157. § 111.0625.
158. § 111.0626.
159. § 113.106.
160. 228 S.W. 864, 869 (Tex. App.—Austin 2007, pet. denied). See also Cynthia M. Ohlenforst et al., *Taxation*, 58 SMU L. Rev. 1159, 1172 (2005); Ohlenforst et al., supra note 35, at 1316 (discussing this case as it impacted school funding and influenced 2006 legislative changes to both property and franchise tax provisions).
161. *Neely*, 228 S.W.3d at 867–68.
162. *Id.*
164. *Id.* at 848.
assignment of refund rights.\textsuperscript{165} Similarly, the court found that the comptroller had no jurisdiction to compel an assignment from the retailer.

In \textit{Bashaw v. State}, the court determined that the statute of limitations did not toll for filing a petition for bill of review in a motor vehicles sales tax collection suit.\textsuperscript{166} An automatic stay which prevented Bashaw from filing his bill of review while his bankruptcy proceeding was pending did not toll the filing deadline for a bill of review. Bashaw's filing therefore was untimely.\textsuperscript{167} The court concluded that regardless of whether the automatic stay provision applies, Bashaw's petition for bill of review was untimely under two theories: (1) if treated as bill of review, it would not toll for the length of the automatic stay; and (2) if treated like a commencement of a new action against the comptroller, the automatic stay would not apply and consequently the four-year statute of limitations passed.\textsuperscript{168}

The Fifth Circuit affirmed a district court holding under the Texas Unclaimed Property Law.\textsuperscript{169} In \textit{Arnett v. Combs}, the court dismissed Arnett's claims alleging that the comptroller's practice of retaining revenue generated from unclaimed property held by the State constitutes a taking without just compensation on Eleventh Amendment immunity grounds. The court also dismissed his motion for class certification on the grounds that Arnett was not an adequate class representative and class certification would serve no useful purpose. In addition, the court found that Arnett lacked standing to seek declaratory or injunctive relief regarding return of the revenue generated from the unclaimed property.\textsuperscript{170}

\textbf{V. CONCLUSION}

As in virtually every Survey period, the number of cases, rules, and legislative changes exceeds the scope of a relatively short survey article. Moreover, the changes discussed in this article are likely to trigger more cases and—with the legislature's next session beginning in January 2009—more legislative changes as well.

\begin{footnotesize}
\begin{itemize}
  \item 165. \textit{Id.} at 851.
  \item 167. \textit{Id.} at *4.
  \item 168. \textit{Id.} at *8–9.
  \item 169. Arnett v. Combs, 508 F.3d 1134, 1134 (5th Cir. 2007).
  \item 170. \textit{Id.}
\end{itemize}
\end{footnotesize}