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Taxation

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The 1997 Texas Legislative Session focused heavily on tax issues, and came far closer to massive property tax reform and a major expansion of the franchise tax to non-corporate entities than many observers had expected. In the end, the gap between the House plan to adopt 3.5 billion dollars in new taxes to fund property tax relief and the Senate plan to adopt 850 million dollars in new taxes to fund property tax relief proved too great a chasm to bridge, and—in a decision that benefited the Texas business community and the state’s efforts to draw additional business to the state—the Legislature adopted a plan that provided a billion dollars of property tax relief to Texans without changing the fundamental underpinnings of the franchise or sales tax.

I. SALES TAX

A. APPLICATION OF THE TAX

Taxpayers enjoyed considerable success at the courthouse during the Survey period, most notably with respect to cases focusing on manufacturing issues. In Texas Citrus Exchange v. Sharp a fruit juice manufacturer successfully challenged the Comptroller’s assessment of sales tax on the use of electricity to keep juice concentrate frozen until it was used to make juice. The issue the court faced was whether maintenance of the juice concentrate at a constant frozen temperature was an exempt use of electricity as part of the manufacturing process, or a taxable use of electricity for warehousing. Based on the definition of manufacturing, which includes every operation from the first stage of production until the prop-

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1. 955 S.W.2d 164 (Tex. App.—Austin 1997, no pet. h.). The Comptroller did not challenge the exemption of the electricity used to freeze the concentrate, only the electricity used to maintain the concentrate at below freezing temperatures. See id. at 166, 167.

2. Generally, electricity is exempt from sales tax unless it is used for commercial purposes. See Tex. Tax Code Ann. § 151.317(a), (c)(2) (Vernon 1992 & Supp. 1998). Commercial use is defined to include use in selling, warehousing, or distributing but does not include the processing of tangible personal property for sale. See id. § 151.317(c)(2)(A)(i) (Vernon Supp. 1998); see also 34 Tex. Admin. Code § 3.300(d)(1)(West 1997) (exempting electricity used directly in the manufacturing process).
eity is completed and packaged for sale, the court determined that “ware-
housing” refers to storage involving the final product, not incidental
storage that occurs during production of the product. Therefore, “only
electricity used to maintain or preserve completed property ready for sale . . . constitutes a commercial use subject to taxation.”3 In holding that the
use of electricity to keep the concentrate frozen was an exempt part of
the manufacturing process, the court stated that the “Comptroller’s un-
bending policy of exempting as noncommercial only electricity used to
change the physical characteristics of property” did not comport with the
statute or rules.4

Addressing a manufacturing issue currently being litigated in numerous
states, the court of appeals determined in Sharp v. Morton Buildings,
Inc.5 that manufactured components were distinct from their constituent
raw materials. The Comptroller assessed use tax on raw materials
purchased and manufactured outside the state into building components
that were subsequently brought into Texas and assembled into prefabric-
cated buildings.6 The court distinguished the building components from
their constituent raw materials and held that the raw materials were not
taxable because they were not used in Texas until after the materials had
been transformed into building components. Likewise, the building com-
ponents were not taxable because the taxpayer manufactured, rather than
purchased, the components.7 Furthermore, the storage of the building
components at the job sites in Texas did not subject the taxpayer to use
tax on the storage.8

3. Texas Citrus Exchange, 955 S.W.2d at 170; see 34 Tex. Admin. Code § 3.300(a)(9)
(West 1997); see also id. § 3.295(a)(7). The Tax Division argued that maintaining a concen-
trate at a frozen state cannot be exempt processing under rule 3.295 which excludes from
processing “any action taken to prolong the life of tangible personal property or to prevent
a deterioration of the tangible personal property being held for sale.” Id.; see Texas Citrus
Exchange, 955 S.W.2d at 168-69.

4. Id. at 170. The court states “[m]anufacturing is a broader term that includes
processing; manufacturing need not always cause a change in the physical characteristics of
the property.” Id.

5. 953 S.W.2d 300 (Tex. App.—Austin 1997, writ denied).

6. The state asserted that the taxpayer brought raw materials into the state that were
purchased for use in the state and the taxpayer’s incorporation of the materials into the
purchaser’s property was a consumption of the raw materials in Texas. See Morton Build-
ings, 953 S.W.2d at 302.

7. See id. at 303. Texas imposes a use tax “on the storage, use, or other consumption
in this state of a taxable item purchased from a retailer for storage, use, or other consump-
that use tax applies to items purchased out of state for use in Texas but does not apply to
items manufactured, rather than purchased, out of state. See Morton Buildings, 953
S.W.2d at 303. Further, the court noted that subsequent to manufacturing the building
components, the raw materials no longer exist and therefore could not be put to a taxable
use in Texas. See id.

8. See id. at 303-304. The court found that the stipulations of the parties indicated the
components were installed as expeditiously as possible after delivery at the jobsite. See id.
at 304; see also Bullock v. Shell Pipeline Corp., 671 S.W.2d 715 (Tex. App.—Austin 1984,
writ ref’d n.r.e.) (storage tax not imposed on items brought into state and kept at jobsite no
longer than necessary for incorporation into construction project).
In Sharp v. Cox Texas Publications, Inc., the court of appeals held that Comptroller's Rule 3.299, which concerns publications, impermissibly imposes a sales tax on advertising, a nontaxable service. The taxpayer published a city visitors' magazine that was distributed without charge and received revenue from advertisers who paid to have their advertisements published in the magazine. According to the court, Rule 3.299 impermissibly expanded the three-party sale concept set forth in Bullock v. Cordovan Corp. beyond the limited situation to which it applies, that is, when advertisers pay a premium price to have the publisher distribute the free magazine to a target audience. The publication at issue was not distributed to a targeted audience, and advertisers paid only the cost of ordinary advertising services—they paid no premium. Therefore the Comptroller's assessment of tax on the taxpayer's entire advertising revenues was the taxation of ordinary advertising services: a nontaxable service. Additionally, the court held that the essence of the transaction between the publisher and the advertisers was the sale of nontaxable advertising services, rather than a taxable sale of the magazines.

In Park 'N Fly of Texas, Inc. v. Sharp, the district court found Comptroller's Rule 3.315 concerning motor vehicle parking and storage to be invalid and an unconstitutional retroactive law. The taxpayer provided airport parking and shuttle transportation services. The Comptroller assessed tax on the entire charge as a taxable parking service. The taxpayer argued it was providing two services, one taxable and the other non-taxable. The court held in favor of the taxpayer, finding that Rule 3.315 unlawfully imposed sales tax on nontaxable transportation services.


10. 697 S.W.2d 432 (Tex. App.—Austin 1985, writ ref'd n.r.e.).

11. See Cox Publications, 943 S.W.2d at 209; 34 TEX. ADMIN. CODE § 3.299 (West 1997). In Cordovan, 697 S.W.2d at 436, the court of appeals held that a three-party sale occurred justifying the imposition of sales tax on the distribution of a free magazine under certain limited circumstances where advertisers paid a premium to have the publisher distribute the publications to specific industry groups. Sales tax on a three-party sale is assessable on the premium paid over and above the normal cost of the advertising services provided. See id.

12. The court noted the difficulty of an assessment under Cordovan "when the Comptroller must deduct the ordinary cost of advertising to determine the amount of the premium on which to assess the tax," but stated that the present decision will limit the circumstances in which that calculation will be necessary. Cox Publications, 943 S.W.2d at 210.

13. See id. The court held tax was due on the materials used in publishing the magazine. See id. at 211.

14. See No. 95-12285 (200th Dist. Ct., Travis County, Apr. 11, 1997) [hereinafter Park 'N Fly]; 34 TEX. ADMIN. CODE § 3.315 (West 1997). Indeed, the court held that the Comptroller's taxation of the taxpayer's transportation services violated the taxpayer's rights to equal protection and equal and uniform taxation under the United States and Texas constitutions by failing to tax other, similar transportation services. See Park 'N Fly.

15. The Comptroller viewed the shuttle transportation costs as "transportation incident to the performance of a taxable [parking] service" and therefore included in the sales price of the taxable service. TEX. TAX CODE ANN. § 151.007(a)(4) (Vernon 1992).
Although taxpayers may not have been as successful at the administrative level as they were at the courthouse during the Survey period, the Comptroller issued several interesting decisions (and a few surprising victories). In Decision 32,469 the Comptroller addressed the issue of when sufficient contacts are present to establish nexus and impose sales and use tax-collection responsibility.\footnote{16} An out-of-state corporation that sold toys, gifts, and home decorating items through a network of home parties, conducted with the assistance of a demonstrator, argued that its solicitation activities were not sufficient to establish constitutional nexus under Quill v. North Dakota.\footnote{17} The administrative law judge held that the demonstrators and hostesses were acting as representatives, agents, or salespersons soliciting orders in Texas under the taxpayer's authority, thereby obligating the taxpayer to collect the tax.\footnote{18}

In another decision examining the minimum level of contacts necessary to establish nexus for sales- and use-tax collection, the Comptroller determined that an out-of-state company conducting seminars in Texas had sufficient nexus to impose tax-collection responsibility on the company's mail-order sales to Texas residents.\footnote{19} The administrative law judge rejected the company's argument that a business must maintain a permanent location or representative in the state to establish nexus.\footnote{20} The company's in-state activities of conducting seminars, hiring faculty to speak at the seminars, hiring temporary employees to act as coordinators, and renting hotel space to conduct the seminars were sufficient to estab-

\footnotetext{17}{504 U.S. 298 (1992). In Quill, the United States Supreme Court held that a mail order vendor whose only connection with the taxing state was by common carrier or United States mail had sufficient contact to establish nexus for due process, but insufficient to establish nexus under the Commerce Clause, which requires physical presence in the taxing state. \textit{See id.} at 106.}  
\footnotetext{18}{See 1997 Tex. Tax LEXIS 184, at *5; \textit{Tex. Tax Code Ann.} § 151.107(a)(2) (Vernon 1992) (defining a retailer "engaged in business in this state" to include a retailer with a "representative, agent, salesman, canvasser or solicitor operating in this state under the authority of the retailer . . . for the purpose of selling or delivering or the taking of orders for a taxable item"); \textit{see also Tex. Tax Code Ann.} § 151.103 (Vernon Supp. 1998). The judge further determined that the goods were not purchased for resale, based in part upon the relationship between the hostesses and the taxpayer as principal and agent, not as seller and purchaser. \textit{See 1997 Tex. Tax LEXIS 184, at *19; see also Ltr. 9609L1438G12 (Sept. 18, 1996); But Where's the Food Court?, \textit{Tax Policy News}, Feb. 1997, at 5 (administrator of electronic mall, as agent for its Texas client retailers, is responsible for collection of sales taxes on transactions with client retailers' Texas customers); Ltr. 961127L (Nov. 8, 1996); Silence is Golden, \textit{Tax Policy News}, May 1997, at 4 (independent contractor established nexus for out-of-state company by participating in speeches before associations and clubs in Texas concerning the company's operations and services).}  
\footnotetext{20}{See \textit{id.} at *6; National Geographic Society v. California Board of Equalization, 430 U.S. 551 (1977)(holding that an out-of-state seller's duty to collect use tax is established by some minimum connection between the seller and the taxing state, and is not dependent on whether the duty to collect the use tax relates to the seller's activities carried on within the state).}
lish nexus with Texas.\textsuperscript{21}

In determining whether a taxable sale occurred, Decision 34,493 held that a lessor's contribution or reimbursement for an item purchased by the lessee is not a taxable transaction for the lessor.\textsuperscript{22} The administrative law judge held that the taxability of the transaction rests solely between the parties to the contract at issue, the lessee and the third-party vendor, the lessor was not a party to the contract. In another decision, determining when a taxable use has occurred, the Tax Division argued that the write-down of the value of a printing press that was purchased out of state and stored in Texas while being held for resale was a taxable use.\textsuperscript{23} The administrative law judge disagreed based on the fact that the taxpayer did not depreciate the press for federal income tax purposes and therefore the write-down did not constitute a taxable use since the taxpayer did not enjoy a federal tax benefit from the write-down.\textsuperscript{24} Additionally, the storage of the press was exempt because the press was held for resale. Although the taxpayer did not issue a resale certificate, the exemption was allowed based on the taxpayer's evidence of intent to resell.\textsuperscript{25}

Several recent favorable decisions have been issued interpreting sales and use tax exemptions.\textsuperscript{26} In Decisions 31,987 and 32,007, the Comptroller held that tangible personal property used in providing taxable services may constitute a sale for resale without the customer taking actual physical possession.\textsuperscript{27} The taxpayer argued successfully that although actual physical possession of the property had not transferred to the customer, the customer's restrictions on the taxpayer's use of the property were so


\textsuperscript{24} See id.

\textsuperscript{25} See id. at *11. Generally a sale of property for delivery in Texas is presumed to be a sale for storage, use or consumption in Texas, and all gross receipts received by the seller are presumed taxable, unless a resale certificate is accepted by the seller. See Tex. Tax Code Ann. § 151.104 (Vernon 1992), § 151.054 (Vernon 1992). The administrative law judge noted that these presumptions are concerned primarily with the seller, who can overcome the presumption only by accepting a resale certificate from the buyer, but with respect to a purchaser, the facts control the exemption availability, not the resale certificate. See Tex. Comp. Pub. Acc'ts, Hearing No. 34,937, 1997 Tex. Tax LEXIS 9, at *11 (Jan. 10, 1997).


\textsuperscript{27} See Tex. Comp. Pub. Acc'ts, Hearing Nos. 31,987, 32,007, 1997 Tex. Tax LEXIS 168 (Jan. 27, 1997); Tex. Tax Code Ann. § 151.302(b) (Vernon 1992) (to qualify as a sale for resale, the care, custody, and control of the property must be transferred to the purchaser of the service).
significant that the care, custody, and control had passed to the customer.\textsuperscript{28} Decision 35,448 held that the availability of the manufacturing exemption is not limited to the actual manufacturer; the use of third parties to perform the actual manufacturing on behalf of the party claiming the exemption is permitted.\textsuperscript{29} In determining that a women's clothing wholesaler who contracted independent companies to perform the processing of its garments qualified as a manufacturer, the administrative law judge found it irrelevant whether the taxpayer's employees or its subcontractors performed the manufacturing activities.\textsuperscript{30}

As technology continues to advance, the multitude of Comptroller decisions and taxability response letters evidence the challenge of the sales and use tax laws to keep up with the rapid pace of technology.\textsuperscript{31} Decision 33,164 addressed the taxability of services provided by a computer communications company that operated a network of protocol processors that provided interoperability among disparate computer devices by changing the form of the data.\textsuperscript{32} The taxpayer objected to the assessment of the services as taxable telecommunications services, arguing that its customers were purchasing interoperability among its computers, not point-to-point transmission or processing of information.\textsuperscript{33} The admin-

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\item See Tex. Tax Comp. Pub. Acc'ts, Hearing Nos. 31,987, 32,007, 1997 Tex. Tax LEXIS 168, at *10-11 (Jan. 27, 1997). The taxpayer's customer was the United States government whose significant control was evidenced by the following factors: the government controlled the actual purchase of the materials, title passed to the government upon delivery to taxpayer, the government set the terms and conditions for use and storage of the property, taxpayer was subject to an annual review, the government ensured the property was maintained and the government insured the property. See id.


\item See Tex. Comp. Pub. Acc'ts, Hearing No. 35,448, 1997 Tex. Tax LEXIS 84, at *8 (Jan. 30, 1997); see also Tex. Comp. Pub. Acc'ts, Hearing No. 33,524, 1995 WL 236046 (Apr. 3, 1995) (holding that tax was not due on materials used to repackate hospital kits when the kits were subject to a sterilization process (considered manufacturing or processing) performed by a third party).

\item Numerous Comptroller decisions and letters were issued during the Survey period interpreting the taxation of various Internet services. See Ltr. 9609L1435G13 (Sept. 13, 1996); Internet Posting, TAX POLICY NEWS, Jan. 1997, at 5 (submission to owners of websites and search engines of the name of and link to the customer's Internet sites is not a taxable service); Ltr. 9610L1436A02 (Oct. 8, 1996) (Internet dating service is taxable information service); Ltr. 9701L189L (Jan. 23, 1997); Casting the Net, TAX POLICY NEWS, Aug. 1997, at 4 (construction of web sites is data processing service, sale of domain names is not taxable); Ltr. 9703L157L (Mar. 24, 1997); Cyber Representative, TAX POLICY NEWS, Apr. 1997, at 4 (Texas tax due on registration fee when shareware is registered for use in Texas); Ltr. 9702L163L (Feb. 25, 1997); Processing Data, TAX POLICY NEWS, Aug. 1997, at 4 (Internet service providers cannot qualify for manufacturing exemption on equipment because such providers are not producing tangible personal property).


\item Tax Code section 151.0103 defines telecommunications services as "the electronic or electrical transmission, conveyance, routing, or reception of sounds, signals, data, or information utilizing wires, cable, radio waves, microwaves, satellites, fiber optics, or any other method now in existence or that may be devised, including but not limited to long-distance telephone service." TEX. TAX CODE ANN. § 151.0103 (Vernon Supp. 1998); see also 34 TEX. ADMIN. CODE § 3.344 (West 1997) (further defining telecommunications services). Numerous Comptroller decisions were issued during the Survey period addressing
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trative law judge found the services to be both protocol conversion and the transmission of information between the parties and therefore taxable.\textsuperscript{34}

The Comptroller is continually presented with cases attempting to distinguish nontaxable software creation from the taxable sale of a computer program.\textsuperscript{35} Decision 32,495 held that the exclusion from taxation for software creation applies to software created from scratch, and the customer must retain exclusive rights to the software.\textsuperscript{36} Creation of a program by using program strings ("recipes") was found to not qualify as the development of a program from scratch.\textsuperscript{37} In an issue of first impression, Decision 35,100 addressed when a computer program is modified in such a way as to constitute the creation of a new program for sales tax purposes.\textsuperscript{38} The administrative law judge held that changing the code used by the software was not sufficient to create a new program when the upgraded version performs the same function as the old version and is still covered by the same licensing agreement.\textsuperscript{39}

Numerous cases during the Survey period reflect the continuous struggle of both taxpayers and the Comptroller to clarify the distinction between nontaxable new construction and taxable repair and remodeling services. In Decision 34,340 the Comptroller confirmed that extensive construction in an existing building is not new construction if additional

\textsuperscript{34} See Tex. Comp. Pub. Acc'ts, Hearing No. 33,164, 1997 Tex. Tax LEXIS 104 at *13 (Mar. 17, 1997). The taxpayer argued its services were not data processing services because only the form of the information was changed, not the content of the information. See id. The protocol conversion was held to be data processing, and the administrative law judge noted that neither the Tax Code nor the rules distinguish between form and content changes to information. See id. at *15.

\textsuperscript{35} See Ltr. 9707626L (Revised July 23, 1997); Electronic Answers, TAX POLICY NEWS, Sept./Oct. 1997, at 8 (consultant's development of interactive software program for client concerning application of state and local taxes to client's business was taxable sale of computer program); Ltr. 9612054L (Dec. 3, 1996); Backup Computer, TAX POLICY NEWS, Apr. 1997, at 4 (computer backup services held taxable data processing service); see also Ltr. 9611839L (Nov. 5, 1996); Keep Those Phone Records, TAX POLICY NEWS, Mar. 1997, at 3 (bill of lading, federal express receipt, postal receipt, or invoice with out of state shipping address are acceptable proof of out of state sale. Sufficient proof for software sales sent to out of state customers via modem include phone records or computer logs showing out of state area code).


\textsuperscript{39} See id. at *5.
footage is not added.\textsuperscript{40} In holding that the construction at issue was remodeling, the decision noted that although the construction was extensive, involving the complete demolition of portions of the existing improvement, the construction was all located within, (and was an integral part of) the existing building and resulted not in additional square footage, but in a reallocation of the existing square footage.\textsuperscript{41}

Decision 33,034 held that the installation of a new system in existing real property does not qualify as new construction.\textsuperscript{42} A taxpayer who installed a cable television system and monitors at various places in an existing theme park argued that installation of the new cable system was new construction because there was no existing cable system in the park.\textsuperscript{43} The administrative law judge disagreed with the taxpayer and found the work was real property remodeling, explaining that, since the theme park existed before the system was added, the cable system merely upgraded or enhanced the park.\textsuperscript{44} Decision 34,706 recognized that when replacing an existing system, usage of an improvement while work is in progress should not be a factor disqualifying treatment as new construction.\textsuperscript{45} The replacement of a cable television system by taking the old system out, suspending it to allow the old system to continue to provide temporary service, building the new cable system underneath the existing system, and then tearing down the old system was new construction.\textsuperscript{46} In

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  \item \textsuperscript{40} See Tex. Comp. Pub. Acc'ts, Hearing No. 34,340, 1997 Tex. Tax LEXIS 62, at *5 (Feb. 18, 1997). The definition of new construction under rule 3.357 includes new improvements to real property, including the initial finish out work to the interior or exterior of the improvement and the addition of new footage to an existing structure. See 34 Tex. ADMIN. CODE § 3.357(a)(5) (West 1997).
  \item \textsuperscript{41} See Tex. Comp. Pub. Acc'ts, Hearing No. 34,340, 1997 Tex. Tax LEXIS 62, at *5, *8 (Feb. 18, 1997). The administrative law judge relied on Decision 34,112 which held that the term "demolition" refers to the complete destruction of an improvement to realty and does not encompass interior demolition or the demolition of a portion of a building. See Tex. Comp. Pub. Acc'ts, Hearing No. 34,112, 1995 WL 854656, at *2 (Jan. 1, 1996); see also Tex. Comp. Pub. Acc'ts, Hearing No. 35,748, 1997 Tex. Tax LEXIS 144, at *6 (Feb. 24, 1997) (finding that complete replacement of only the concrete portion of a race track that consisted of both concrete and asphalt portions was not new construction because the work did not result in a new complete structure or additional footage); Tex. Comp. Pub. Acc'ts, Hearing No. 34,530, 1996 WL 625196, at *3 (Oct. 31, 1996) (holding that taxpayer’s use of area, prior to finish out, for storage of building materials over multiple year period precluded later finish out of area from qualifying as new construction).
  \item \textsuperscript{43} See id. at *10.
  \item \textsuperscript{44} See id. at *10-11. This case also addressed services rendered for both demolition (not a taxable service) and debris removal (a taxable service) for a single charge. The administrative law judge held the entire charge was taxable real property services. See id. at *15.
  \item \textsuperscript{46} See Tex. Comp. Pub. Acc'ts, Hearing No. 34,706, 1997 WL 404636, at *10 (Feb. 20, 1997). In fact, the administrative law judge notes that in Decision 28,489, allowing golfers to use the cart paths on a particular hole prior to completion of the entire cart path system "would not seem to be a legitimate basis for precluding a complete replacement of the
addition, the judge held that overlashing new fiber optic cable alongside an existing coaxial cable system so that the existing coaxial cable was left in place and continued to transmit cable television signals to subscribers while the fiber optic cable was added to provide new and different functions qualified as new construction.\textsuperscript{47}

Decision 35,105 addressed whether an oral agreement to improve real property was a lump-sum or a separated contract.\textsuperscript{48} Pursuant to an understanding between the parties, the subcontractor was required to provide a written breakdown of the costs for materials and labor before a purchase order would be issued.\textsuperscript{49} Based upon the testimony and documentary evidence presented by the subcontractor, the administrative law judge concluded that the "breakdowns" of the materials and labor were a material part of the "contract" between the parties, and as such, the contract was a separated contract.\textsuperscript{50}

In an interesting decision, a taxpayer successfully challenged the comptroller’s long-standing policy regarding exempt food.\textsuperscript{51} The taxpayer prepared sandwiches and cold food plates for sale to airlines who in turned served the food to passengers during flight ("flight food").\textsuperscript{52} The Tax Code sets forth a two-part test under which food is exempt unless the food is served, prepared, or sold (1) ready for immediate consumption and (2) in or by restaurants, lunch counters, cafeterias, vending machines, hotels, or like places of business.\textsuperscript{53} The administrative law judge found that the first part of the test for taxability was met: the flight food was ready to be consumed immediately when sold.\textsuperscript{54} However, the flight food

\textsuperscript{47} Id. at *7; see Tex. Comp. Pub. Acc'ts, Hearing No. 28,489, 1993 WL 35270, at *3 (Jan. 6, 1993) (holding that replacement of only some of the cart paths on a golf course was remodeling).


\textsuperscript{49} See Tex. Comp. Pub. Acc'ts, Hearing No. 35,105, 1996 Tex. Tax LEXIS 819, at *5 (Nov. 15, 1996). The Tax Division argued that purchase orders and invoices should control the characterization the contract since there was no formal written agreement. See id. at *10.

\textsuperscript{50} See id. at *15. The judge noted that this decision should not have widespread application because the subcontractor's success was due to his ability to prove that in the numerous contracts between these specific parties, the requirement that material and labor breakdowns be submitted was a recurring pattern that was a condition of the contract. See id. at *16.


\textsuperscript{52} In 1987 the Texas Legislature repealed the exemption for food and drinks purchased by common carriers for service to passengers. See Act of July 21, 1987, 70th Leg., 2d C.S., ch. 5, art. 1, pt. 4, § 23, sec. 151.314, 1987 Tex. Gen. Laws 8, 17 (repealing TEX. TAX CODE ANN. § 151.314(d)). The parties in this decision agreed that the effect of the repeal was that common carriers would be subject to the same statutes applicable to other taxpayers.

\textsuperscript{53} See TEX. TAX CODE ANN. §§ 151.314(a),(c) (Vernon 1992).

was not sold by a “like kind of business activity” to those businesses listed in the statute, and therefore the second part of the test was not met, and the flight food was not taxable.\(^5\) The judge found that the unambiguous two-step statutory test controlled over the Comptroller’s policy of disregarding the second-part of the test and assessing tax on all ready-to-eat foods, regardless of where the food was served.\(^6\)

### B. Legislative Developments

The Regular Session of the 75th Legislature began with sweeping proposals to subject numerous additional services to tax to help fund property tax relief, but the session ended with few substantive changes to the Tax Code and numerous “cleanup” provisions to the sales and use tax statues.

The definition of “sales price” or “receipts” was amended to require that a trade-in must be of the type of property regularly sold by the seller in order for the value of the trade-in to reduce the taxable sales price.\(^5\) Therefore, tangible personal property taken in trade when the property is not the type of property regularly sold by the seller will be included in the taxable sales price. Further, a retailer is liable for sales tax on an item purchased under a resale certificate if the purchaser uses the item as a trade-in that reduces the amount of tax due on another taxable item.\(^6\)

A new exemption was added for taxpayers working under contracts with or on behalf of the United States or foreign governments to exempt gas or electricity used in providing certain defense or national security-related taxable items.\(^5\) Also concerning exempt entities, the Legislature limited tax-free transactions to items sold for $5,000 or less for qualifying religious, educational, charitable organization or tax-exempt organizations that are permitted to hold two one-day tax-free sales or auctions.\(^6\)

In response to recent taxpayer victories at the courthouse, significant changes were made to the manufacturing exemption to limit the exemption to property used directly in the manufacturing process and to require a chemical or physical change in the product being manufactured or processed for sale, or in an intermediate or preliminary product that becomes a part of the product manufactured for sale.\(^6\) In addition, the list

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55. See id. at *37.
56. See id. at *39. The Comptroller has stated that rule 3.293 will be amended in accord with the decision in this case. See More Than Peanuts, TAX POLICY NEWS, Apr. 1997, at 2.
57. See TEX. TAX CODE ANN. § 151.007(c)(5) (Vernon Supp. 1998).
58. See id. § 151.154(f); see also Tex. Comp. Pub. Acc’ts, Hearing No. 35,583, 1997 WL 294489 (May 18, 1997) (holding that trade-in must be separately identified by invoice, billing, sales slip or ticket, or contract).
60. See id. § 151.310(c). The same provisions were extended to one-day tax-free sales by a student organization affiliated with an accredited Texas college or university. See id. § 151.321(a).
61. See id. § 151.318(a)(2); see also id. § 151.318(a)(4) (amendment exempting equipment used to power, supply, support, or control exempt equipment directly used in the
of items ineligible for the manufacturing exemption was expanded to specifically include (and thus make taxable) intraplant transportation equipment used to move a product or material, including piping and conveyor systems, as well as machinery and equipment or supplies used to maintain or store tangible personal property. The manufacturing exemption was further amended to provide that the taxpayer has the burden of proof that the exemption is applicable and that no statutory exclusion applies.

Each legislative session the Legislature continues to revise and refine the application of sales and use tax to taxable services. The Legislature clarified that the exemption for services performed for use both within and outside the state only applies to services that became taxable on or after September 1, 1987.

The staff-leasing rules were amended to exclude from taxation services performed by assigned employees of a staff-leasing company for a client under a written contract that provides for shared employment responsibilities. Exempt court reporting services were expanded to include services by a video photographer who videotapes or films a deposition, testimony, discovery document, or statement of fact prepared for use in the suit.

The exclusion from taxation of real property services purchased by a contractor in connection with the construction of a new home were clarified to include a speculative builder or developer within the term "contractor." A new provision was added to the exclusion from taxable manufacturing process or that generates electricity, chilled water, or steam for sale; § 151.318(a)(5) (amendment exempting certain pollution control equipment).

62. See id. § 151.318(c)(1). The restrictions and exclusions added to section 151.318(a)(2),(c)(1) and (c)(5) do not apply to exempt semiconductor fabrication cleanrooms and equipment. See id. § 151.318(s). Piping which is part of a single item of manufacturing or pollution control equipment may qualify for exemption. See id. § 151.318(c)(1). These amendments appear to be aimed at reversing the court decisions of Sharp v. Tyler Pipe Indus., Inc., 919 S.W.2d 157 (Tex. App.—Austin 1996, writ denied) and Sharp v. Chevron Chemical Co., 924 S.W.2d 429 (Tex. App.—Austin 1996, writ denied). See Cynthia M. Ohlenforst et al., Taxation, Annual Survey of Texas Law, 50 SMU L. REV. 1479, 1480-81 (1997) [hereinafter Ohlenforst, 1997 Annual Survey] for a complete discussion of these cases.

63. See TEX. TAX CODE ANN. § 151.318(r) (Vernon Supp. 1998). Note that after October 1, 1997, there will be two subsections (r) under Tax Code § 151.318. The Legislature added another provision, also designated as section 151.318(r), providing that computer software manufacturing begins with the design and writing of the program and includes testing or demonstration of the software. See id. § 151.318(r).

64. See TEX. TAX CODE ANN. § 151.0035 (Vernon Supp. 1998) (definition of data processing amended to include a totalisator service (a service used by race tracks to process wager information and calculate odds and pay-offs) and to exclude the transcription of medical dictation).

65. See id. § 151.330(f). Services that became taxable on or after September 1, 1987, include credit reporting, debt collection, insurance services, information services, real property services, data processing, real property repair and remodeling, security services, and telephone answering services. See id. § 151.0101 (Vernon 1992).

66. See id. § 151.057(3) (Vernon Supp. 1998).

67. See id. § 151.353(d). The Legislature provided that document preparation is a nontaxable court reporting service if performed by a licensed court reporter or a notary public. See id. § 151.353(a).

68. See id. § 151.0048(c).
repair and remodeling for improvements that provide increased capacity by producing additional products or services in a manufacturing production unit of petrochemical refineries to clarify that a "new product" is not a product derived from activities of straining or purifying an existing product or from cosmetic changes.\footnote{69}

The taxation of prepaid telephone calling cards was changed by providing such sales will be taxed as the sale of tangible personal property and not as a taxable service.\footnote{70} Retailers will be responsible for collecting and remitting sales and use tax when the cards are sold.\footnote{71}

The Legislature amended the Local Government Code to authorize voters in qualifying cities or counties to create sports or community venue districts and to impose a local sales and use tax to build, renovate, operate, or maintain a stadium or other facility for sports or community events, convention or civic center and related facilities, or any other economic development project authorized by law.\footnote{72}

C. REGULATORY DEVELOPMENTS

During the Survey period the Comptroller continued efforts to eliminate and consolidate rules dealing with similar subject matter.\footnote{73} Rules concerning multistate tax credits and the allowance of credit for tax paid to suppliers were consolidated, and the new rule clarifies that tax must be recovered from the seller and a credit may not be given for tax paid to a supplier for taxable items that are not resold but used for nontaxable purposes.\footnote{74} The Comptroller also consolidated rules concerning motor

\footnote{69. See id. § 151.0047(b)(3).}
\footnote{70. See id. §§ 151.009, 151.0103. Prior to September 1 1997, telephone prepaid calling cards were taxable telecommunications services. A seller could either include the tax in the price of the card and remit the tax as the card was used, or collect and remit the sales tax on the face value of the card at the time of sale. On or after September 1, 1997, sellers will no longer owe the telecommunications infrastructure fund assessment on the sale receipts. See 34 Tex. Admin. Code §§ 3.1101 - 3.1103 (West 1997).

71. A new section 151.0132 was added to define "telephone prepaid calling card" and specifically provide that the definition does not include calling cards sold through vending machines for one dollar or less. See Tex. Tax Code Ann. § 151.0132 (Vernon Supp. 1998).

72. See Act of May 20, 1997, 75th Leg., R.S., ch. 551, § 1, 1997 Tex. Gen. Laws 1929; Tex. Loc. Gov't Code Ann. chs. 334, 335 (Vernon Supp. 1998). The legislation also allows voters to approve the imposition of other taxes, including an admissions tax, a tax imposed on each motor vehicle in a parking facility of an approved venue project during an event, a local hotel occupancy tax, a facility use tax on members of professional sports teams, and a local sales tax on short term motor vehicle rentals. See id.

73. As a result of the consolidation process, numerous rules were repealed and new consolidated rules were adopted bearing the same rule number as one of the rules included in the consolidation. Therefore, although few substantive revisions were made during the consolidation process, the reader is cautioned to examine closely any existing rules to ensure there has not been a change to such rule.

74. See 21 Tex. Reg. 9149 (1996), adopted 21 Tex. Reg. 11505 (1996) (now codified at 34 Tex. Admin. Code § 3.338). In addition, rule 3.338 was further amended to provide that a purchaser may not claim a credit for tax paid on wrapping, packing, or packaging materials used by a manufacturer to expedite or further the sale of tangible personal property because such materials are not "resold" when the property is itself sold. See Tex. Admin. Code § 3.338(c)(3)(B) (West 1997).}
vehicles and added a provision clarifying the Comptroller's policy of allowing the sale for resale exemption for accessories and equipment attached to motor vehicles that are held for sale, lease or rental. 75

Some rules were amended during the Survey period to reflect changes made by the 1995 Legislature. Rule 3.294, concerning the rental and lease of tangible personal property, was amended to reflect 1995 legislative changes exempting sales for resale in Mexico. 76 The amendment allows the issuance of a resale certificate for the purchase of property to be held for lease within the United Mexican States and provides information concerning the acceptance of valid resale certificates from Mexican retailers. 77

II. FRANCHISE TAX

A. LIABILITY FOR TAX—DOING BUSINESS IN TEXAS

In Sharp v. Hobart Corp. 78 the taxpayer argued that it had no nexus or minimum contacts with Texas for the 1990 tax period because, prior to December 30, 1989, the taxpayer had stopped doing business in Texas, transferred all of its assets and liabilities to a new corporation, and become a holding company for the new corporation. The Comptroller argued that these facts were irrelevant because the company held a certificate of authority to do business in Texas during the tax period and therefore was subject to the tax. Although the appeals court was faced with conflicting evidence, it concluded as had the trial court, that the taxpayer had attempted to withdraw from the state before the tax period began. (The taxpayer asserted that the state failed to grant the taxpayer's application for withdrawal because of confusion created by the existence of two corporations associated with taxpayer's name.) The court of appeals therefore determined that the taxpayer had taken "affirmative acts to sever its last semblance of a nexus with the State of Texas by withdrawing its certificate of authority before the 1990 tax period began," so that "the requisite nexus was absent and the imposition of the franchise tax ... violated the commerce clause of the U.S. Constitution." 79

78. 957 S.W.2d 650 (Tex. App.—Austin 1997, no pet. h.). This case is included in this Survey Article because the district court decision was issued during the Survey period; however, after the Survey period, the court of appeals issued this opinion affirming the trial court judgment.
79. Id. at 653.
Several administrative decisions during the Survey period also focused on whether taxpayers are subject to the franchise tax. In Decision 35,026, the taxpayer argued that it was subject only to the taxable capital component of the Texas franchise tax, on the ground that it did not have "substantial nexus" with Texas sufficient to allow imposition of the earned surplus component of the tax. The taxpayer, a wholesale distributor of houseware products, provided financing for its sales and entered into agreements with distributors in Texas. Orders for the taxpayer's products were sent to the taxpayer's Wisconsin headquarters. After discussing the taxpayer's various contacts with Texas, the administrative law judge determined that the taxpayer's physical presence through its distributors in Texas "is more than that of just an out-of-state seller with no connection to the state other than through the U.S. mail or by common carrier," and determined that the contacts were sufficient to impose the franchise tax. Additionally, the Comptroller relied on an earlier decision, Decision 33,431, which determined that in-state solicitation by independent contractors constituted Texas nexus within the federal constitution for sales and use tax purposes; the administrative law judge concluded that the discussion in that decision also applied to franchise tax context.

Wisconsin taxpayers were similarly unsuccessful in two cases involving companies that plan and conduct professional seminars throughout Texas and other states, selling materials and audio tapes related to its seminars. Decision 34,833 and consolidated Decisions 33,889 and 34,255 each involved taxpayers who argued that their activities in conducting seminars did not constitute substantial nexus under the United States Constitution, and asserted claims contesting the apportionment or calculation methodology for the franchise tax. Decision 34,833 concluded that the seminar activities did constitute nexus and were not protected under Public Law 86-272, given the finding of the administrative law judge that the taxpayer's activities related to conducting seminars were not ancillary to the solicitation of orders for tangible goods. The administrative law judge in Decisions 33,889 and 34,255 rested his decision in large part on his conclusion that the taxpayer had entered into a contract with Texas residents who accepted the offer to attend seminars in Texas and that,
because the seminars were held in Texas and conducted by speakers hired by the taxpayer, the taxpayer had performed its contracts in Texas and provided services in Texas.\textsuperscript{86} As in most of the franchise tax administrative decisions issued during the Survey period, the taxpayers in these cases were unsuccessful across the board, also failing in their efforts to contest the calculation methodology or to rely on Public Law 86,272 to shield them from the tax.

In another administrative hearing, Decision 36,485\textsuperscript{87} the administrative law judge refused to address the constitutional merits of the “exit tax” provided for in section 171.0011 of the Tax Code.\textsuperscript{88}

B. Calculation and Allocation to Taxable Capital and Earned Surplus

1. Additions to and Deductions from Surplus

Several taxpayers have contested the add-back to earned surplus of officer and director compensation required by the Tax Code;\textsuperscript{89} although both district court judges and administrative law judges\textsuperscript{90} are currently facing issues relating to the add-back, these issues have not yet been resolved. These cases address both multi-tiered corporations and the distinction between “real” officers and directors, and those individuals who have “bare title” of officer or director, but do not have the corporate authority characteristic of officers or directors.

Decision 26,549\textsuperscript{91} focused on a tax sharing agreement pursuant to which a taxpayer and its parent corporation agreed to an allocation of tax liability between the two companies. The parent would record an intercompany tax receivable if the taxpayer owed it an amount pursuant to the agreement, but recorded an intercompany tax liability if the taxpayer recorded the receivable for its tax benefit. The taxpayer argued that its intercompany tax receivable from its parent corporation should be excluded from surplus on the ground that the Comptroller did not allow the parent corporation to reduce its surplus by the corresponding intercompany tax payable. The taxpayer’s argument was thus similar in numerous


\textsuperscript{88} TEX. TAX CODE ANN. § 171.0011 (Vernon Supp. 1998); see also Tex. Comp. Pub. Acc’ts, Hearing No. 34,244, 1996 Tex. Tax LEXIS 584 (Oct. 14, 1996) (holding that a dissolved foreign corporation was subject to the tax imposed pursuant to TEX. TAX CODE ANN. § 171.0011(a) (Vernon Supp. 1998)); 3 Beall Brothers 3, Inc. v. Sharp, No. 97-05710 (Dist. Ct. of Travis County) (hearing on cross-motions for summary judgment on “exit tax” set for May 14, 1998); B&A Marketing Co. v. Sharp, No. 97-01522 (Dist. Ct. of Travis County)(pending case on whether taxpayer is subject to section 171.0011 surtax).

\textsuperscript{89} See TEX. TAX CODE ANN. § 171.110(a) (Vernon Supp. 1998).


respects to the argument that the comptroller has used against taxpayers in the operating lease cases (cases in which the Comptroller has argued that a company may not deduct operating lease payments as debt, relying in part on the fact that the offsetting asset is not reflected on the taxpayer's books). The administrative law judge noted that the taxpayer's most compelling argument was that the receivable and the payable should be treated consistently. However, notwithstanding the consistency argument (on which the Comptroller relies in the operating lease cases), the administrative law judge in this case concluded that "the statute's definition of debt overrides the Rule's requirement that these intercompany tax accounts be reported in a consistent fashion," holding that "again, the taxpayer loses."\footnote{92}

Decision 34,740\footnote{93} focused on whether dividends coming from foreign subsidiaries that did not transact substantial business or maintain a substantial portion of assets in the United States should be included in taxable earned surplus. The Tax Division argued that certain foreign dividend gross-up income pursuant to section 78 of the Internal Revenue Code\footnote{94} and certain foreign dividend gross-up income under Internal Revenue Code section 1248\footnote{95} that had been deferred by virtue of the federal consolidated return regulations until the 1993 franchise tax report year should be included in surplus for that year. The Tax Division therefore argued that the taxpayer should be required to include in federal taxable income over eighteen million dollars of income from foreign subsidiary corporations. The administrative law judge, after concluding that the Tax Division was clearly erroneous in its assertion that the amount at issue were foreign tax credits, concluded that, although the eighteen million dollars might or might not have been reportable in 1984 had there been an earned surplus tax in effect at the time, it could not be included in the earned surplus calculations at a later date, particularly taking into account the "single entity reporting" intent of the franchise tax law.

In another decision that follows the "single entity" approach, Decision 36,030\footnote{96} addressed the taxpayer's claim that it should be permitted to take into account its business loss carryover from its amended 1995 franchise tax report. Relying on Comptroller Rule 3.555(g)(3),\footnote{97} which provides that a corporation may not convey, assign, or transfer a business loss to another entity, including by merger, the Comptroller concluded that because the loss was originally incurred by a company that had merged out of existence, no business loss deduction was available.

Numerous administrative decisions also focused on what amounts may be deducted from surplus for franchise tax purposes, holding that taxpay-

\footnotesize{\begin{itemize}
\item \footnote{92}{\textit{Id.}}
\item \footnote{93}{Tex. Comp. Pub. Acc'ts, Hearing No. 34,740, 1997 WL 563404 (Jul. 21, 1997).}
\item \footnote{94}{26 U.S.C. § 78 (1994).}
\item \footnote{95}{\textit{Id.} § 1248.}
\item \footnote{97}{See id.}
\end{itemize}}
TAXATION

ers may not deduct various reserves and contingent obligations.\(^9\)

Decision 35,763\(^9\) addresses certain dismantling and removal costs for improvements from oil and gas production sites and costs to restore the sites in accordance with various binding agreements. The taxpayer treated these amounts as debts, properly deductible from surplus. However, the administrative law judge concluded that "since the costs are for future restoration, it is logical to conclude that such amounts are estimated,"\(^10\) and that the amounts were not payable in an ascertainable time period, so that they were not deductible. Although the taxpayer had argued that the costs constituted contra-asset accounts for depletion, depreciation or amortization, which would have been excludable from surplus under section 171.109(i)(2),\(^10\) the taxpayer failed to prove that these amounts were properly a part of the contra-asset account for depletion, depreciation or amortization.\(^10\)

As always, several cases focused on what constitutes debt for franchise tax purposes. Decision 30,826,\(^10\) for example, determined that the taxpayer had failed to prove that a note was a uncollectible note or that preferred stock was subject to a write-off for franchise tax purposes. Another decision that consolidated several different hearings determined that a guarantor's obligation did not constitute intercompany debt.\(^10\)

2. Allocating Gross Receipts

Several cases address the allocation of gross receipts as affected by the throw-back rule. In Decision 34,757,\(^10\) the taxpayer argued that certain of its sales receipts should not be thrown back to Texas because the tax-

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\(^10\) Id. at *6-7.


\(^10\) Cf. Tex. Comp. Pub. Acc'ts, Hearing No. 30,897, 1998 WL 46298 (Dec. 19, 1997). Although decided after the Survey period, this decision merits mention because of its holding that adjustments to a valuation impairment allowance of an oil and gas company could be excluded from surplus, because the impairment allowance was, consistent with Generally Accepted Accounting Principles (GAAP), included in the taxpayer's contra-asset account for depletion, depreciation and amortization.


payer had nexus in the destination states through its contract representatives. This case is an interesting contrast to the nexus case discussed earlier\(^\text{106}\) in that this judge decided that, despite the taxpayer's having contracted to construct and deliver barges to Washington and Virginia, the taxpayer's only contact with the destination states was that the barges had been shipped there by another entity, so there was no taxing nexus with the other states—meaning that receipts from these states should be thrown back to Texas. The case is also noteworthy because it looks to the nexus rule to be applied by the destination states at the time the vessels were delivered rather than to the standards set forth under Texas law.\(^\text{107}\)

Another rare taxpayer win among the reported franchise tax cases during the Survey period, Decision 34,052\(^\text{108}\) involved a taxpayer which asserted successfully that its delivery to oil and gas rigs located outside Texas waters did not subject the receipts for these sales to the throwback rule.\(^\text{109}\) The deliveries were outside the U.S. boundary, so the deliveries were into an area that is neither a federal land nor federal waters; the Tax Division nonetheless asserted that the sales receipts should be Texas receipts unless they were taxed by another state or delivered to a foreign country. The administrative law judge, relying on Rule 3.549,\(^\text{110}\) concluded that sales could be thrown back to Texas only if they were delivered to a purchaser “in another state,” and that the locations at issue did not constitute “another state.”

Other cases addressing receipts include Decision 34,401,\(^\text{111}\) in which the taxpayer was unable to convince the administrative law judge that delivery of its sales were to Japan,\(^\text{112}\) and Decision 33,037\(^\text{113}\) in which the administrative law judge determined that all receipts from inflight magazines should be sourced to Texas, relying on a Comptroller rule that treats all advertising revenue of a newspaper with its primary business activities in Texas as Texas receipts.\(^\text{114}\) The judge reached this decision notwithstanding the taxpayer's arguments that newspapers and magazines are fundamentally different and that its primary business activ-

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106. *See supra* text accompanying notes 80-82.
107. *See 34 Tex. Admin. Code § 3.554(f) (West 1997).*
109. *The “throwback rule,” found at Tex. Tax Code Ann. § 171.103(1) (Vernon Supp. 1998) requires sales that are made to a state with which the taxpayer had no taxing jurisdiction to be “thrown back” to Texas, in other words to be treated as Texas receipts for franchise tax purposes.*
112. *The facts were somewhat complicated because the taxpayer acquired computers at issue from its parent and made conflicting claims with respect to whether it or another party had delivered the computers to the customer.*
ities were not in Texas. In Decision 35,982, the administrative law judge held that receipts from repairs in Texas on equipment are apportioned to Texas regardless of the ultimate shipment destination of the merchandise being repaired.

Decision 35,520 focused on the interpretation of the franchise tax rule dealing with netting of gains and losses from capital assets and held that the taxpayer was not allowed to deduct its net loss from certain sales in Texas. The Comptroller also discussed (and dismissed) in a relatively lengthy opinion the argument that the taxpayer should be permitted to use less than a thirty-year life and zero salvage value for depreciation of its distribution system. The decision refers to several prior Comptroller decisions addressing circumstances in which taxpayers claimed a shorter amortization or depreciation period for assets than that used on audited financial statements, and reviewed the parties' various arguments concerning whether the proposed service life changes conformed to GAAP.

C. LEGISLATIVE DEVELOPMENTS

The 1997 Legislative Session produced significant draft legislation, including multiple versions of the key bill—House Bill 4—which began as the Governor's tax bill, then took new form as the House adopted a committee substitute for the bill. Although the Senate version of the draft legislation differs in many respects from the House version, the Senate carried the House version of franchise tax over into its own draft. However, several of the Senators most involved with drafting the tax language indicated their intent to use the Conference Committee version as a vehicle for further modifications to the franchise draft.

Among the conceptual problems the bill created were the mechanics of the tax on partnerships. As drafted, the committee substitute for House Bill 4 would have required some—but not all—partners' compensation to be added to the tax base. Such legislation would have effectively im-

115. The judge also dismissed taxpayer arguments concerning whether the receipts resulted from the sale of service, while focusing on whether the sale should be characterized as a sale of an intangible, of tangible personal property, or of a service.


118. 34 TEX. ADMIN. CODE § 3.549(e)(3) (West 1997).


120. See, e.g., id. at *11-14 (referencing Tex. Comp. Pub. Acc'ts, Hearing No. 30,118 (May 4, 1995)).

121. See id. at *9-20.


123. See id.

posed an income tax on the tax of some partners (e.g., lawyers, accountants, or other professionals holding a 0.1% or greater partnership interest) while allowing other similarly-employed partners to pay no tax. Thus, for example, five accountants with equal partnership interests would effectively pay tax on 4.5% of their income, but partners of a Big Six firm would not pay the tax.

The franchise tax amendments the Legislature adopted were far less dramatic. Some were merely conforming changes to update references to the Internal Revenue Code, and others were what the Comptroller labeled a clarification of existing law.

One of the few potentially significant franchise tax amendments addresses the allocation of gross receipts from patents, copyrights, trademarks, franchises; or licenses in Texas. As amended, section 171.103(4) provides explicitly that receipts from these sources are allocated to Texas, based on their use in Texas. (The Legislature indicated that it viewed this provision as "a clarification of existing law.") The Legislature also adopted a corresponding change to section 171.1032, which applies to taxable earned surplus.

The Legislature "clarified" section 171.109 by providing that consolidated reporting "of surplus" (rather than "the surplus of related corporations") is prohibited. Similarly, the Legislature added a new subsection to section 171.110 to "clarify" that a corporation shall report its net taxable earned surplus based solely on its own financial condition, and that "[c]onsolidated reporting is prohibited." The Legislature also amended similar no-consolidation language to sections 171.112 and 171.1121.

A new section 171.212 requires a corporation to file an amended

125. See id.
127. See id., e.g., TEX. TAX CODE ANN. § 171.001(b)(3)(C) (Vernon Supp. 1998) (adding "banking corporation" to the list of entities included in the term "corporation"); See also id. § 171.002(d).
128. See id. § 171.103.
129. Id. § 171.103(4).
130. See Act of May 30, 1997, 75th Leg., R.S., ch. 1185, § 16(2) sec. 171.103(5), 1997 Tex. Gen. Laws 4569, 4573. See Franchise Tax supra note 126. The Legislature discussed, and considered seriously, repealing the long-established "location of payor" rule for interest and dividends, but—to the benefit of Texas-based businesses and the Texas economy—retained the rule as it applies to interest and dividends.
132. See id. §§ 8 & 16(5), sec. 171.109(d), at 4570, 4573.
133. Id. § 16(6) & 9, sec. 171.110, at 4571, 4573; TEX. TAX CODE ANN. § 171.110(h) (Vernon Supp. 1998). (Note that unlike section 171.109, this provision says only "consolidated reporting," without further elaboration).
134. Id. § 171.112(d) (gross receipts for taxable capital).
135. Id. § 171.112(c) (gross receipts for taxable earned surplus).
136. Id. § 171.212.
franchise tax report if the corporation’s net taxable earned surplus is changed as the result of an Internal Revenue Service ("or another competent authority")\textsuperscript{137} audit or adjustment, or if “the corporation files an amended federal income tax return or other return that changes the corporation’s net taxable earned surplus.”\textsuperscript{138} Although prior law had a mechanism for amending franchise returns following certain “final determination[s]” by federal agencies,\textsuperscript{139} this provision imposes a broader requirement to file amended franchise tax returns and, in the view of some Comptroller representatives, is (together with amendments to section 111.206), the first indication that an Internal Revenue Service audit qualifies as an investigation by a federal agency.\textsuperscript{140} The penalty for failure to file the amended report is a penalty of ten percent of the tax that should have been, but was not previously, reported to the Comptroller.\textsuperscript{141}

In other changes, the Legislature provided that the section 171.102 provision addressing taxable capital of a liquidating corporation applies only to the computation of taxable capital under section 17.101;\textsuperscript{142} amended the law concerning apportionment of taxable capital and earned surplus for certain entities selling management, administration or investment services to an employee retirement plan;\textsuperscript{143} and changed the requirements for getting a extension of time to file an annual report.\textsuperscript{144}

The Legislature also amended certain provisions dealing with exempt non-profit corporations\textsuperscript{145} and added section 171.1016, dealing with “defense readjustment projects.”\textsuperscript{146} The new section 171.1016 provides that a corporation that has been designated as a defense readjustment project under the Government Code may deduct fifty percent of its capital investment in the aggregate from its apportioned taxable capital, or deduct five percent from its apportioned taxable earned surplus.\textsuperscript{147}

D. Regulatory Developments

The Comptroller adopted or amended several regulations during the Survey period to reflect amendments to the Tax Code made by the 1995

\textsuperscript{137} Id. § 171.212(a)(1).
\textsuperscript{138} Id. § 171.212(a)(2).
\textsuperscript{139} Id. 111.206 (Vernon 1992).
\textsuperscript{140} This section is likely to create confusion not only as to deadlines (and determining when “all administrative appeals” have been exhausted), but also as to the statute of limitations. See infra notes 273-288 and accompanying text.
\textsuperscript{141} See Tex. Tax. Code Ann. § 171.212(d) (Vernon Supp. 1998). Note that the penalty does not include the amount of the underreported tax. See id.
\textsuperscript{142} Id. § 171.102 (Vernon 1992 & Supp. 1998).
\textsuperscript{143} See id. § 171.106(d)-(g) (Vernon Supp. 1998). In a provision that indicates the nature of the legislative process, section 171.106(g) provides that if another act of the 75th Legislature’s Regular Session makes the same substantive changes, but differs in text, the cited version prevails regardless of enactment dates. See id. § 171.106(g).
\textsuperscript{145} See id. § 171.063.
\textsuperscript{146} Id. § 171.1016 (Vernon Supp. 1998).
\textsuperscript{147} See id.
Legislature. For example, Rule 3.541,148 a new rule effective December 10, 1996,149 reflects the Comptroller’s changes with respect to franchise tax exemptions. This rule also conforms the definition of corporations that qualify for franchise tax exemption with the Comptroller’s policy.150

The Comptroller also proposed, but did not adopt an amendment to Rule 3.545.151 to conform with 1997 legislative changes concerning extension payments made by taxpayers requesting an extension for the time in which to file an annual franchise tax report.

In December 1997, the Comptroller circulated three draft franchise tax rules: Rule 3.549 (taxable capital: apportionment),152 Rule 3.556 (earned surplus: S corporations),153 and Rule 3.562 (limited liability companies),154 to reflect changes made by the 1997 Legislature. Changes to Rule 3.549 include a provision to reflect the legislative statement that revenues from trademarks, franchises, and licenses for reports due on or after January 1, 1998, are “included in Texas receipts to the extent used in Texas,”155 and to provide that if “services are performed inside and outside Texas, [the] receipts are Texas receipts on the basis of the fair value of the services rendered in Texas.”156 In December 1997, the Comptroller also proposed amendments to Rule 3.556 concerning the earned surplus of S corporations;157 these changes deal primarily with computation for a qualified subchapter S subsidiary.158

Interestingly, the Comptroller did not amend Rule 3.557 (earned surplus apportionment)159 although a draft version of the rule has been circulating since mid-1996 that would reflect the Comptroller’s change of policies as a result of the Pennzoil Co. v. Sharp160 decision and other changes in agency policy, particularly concerning receipts from trusts and partnerships.

The Comptroller has also considered amending Rule 3.558, which deals with officer and director compensation as included in earned surplus

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148. See 34 TEX. ADMIN. CODE § 3.541 (West 1997).
150. See 34 TEX. ADMIN. CODE § 3.541(c) (West 1997).
156. Id. § 3.549(e)(38).
158. See id.
159. See 34 TEX. ADMIN. CODE § 3.557 (West 1997).
160. See No. 94-00974 (200th Dist. Ct., Travis County, Tex., Mar. 3, 1995).
computation.\textsuperscript{161} A draft version of the rule provides that officer and director compensation does not include any amount reported to an officer/director which is disallowed as a reduction to federal taxable income for any taxable period for federal income tax purposes.\textsuperscript{162} As noted earlier, several cases are pending with respect to the constitutionality of the compensation add-back, and it is possible that the next Survey period may see a policy or judicial modification of the officer and director add-back.

The Comptroller also proposed an amendment to Rule 3.562, concerning limited liability companies\textsuperscript{163} to reflect additional changes enacted by the 1997 Legislature, as well as to acknowledge the “check the box” regulations issued by the Internal Revenue Service.\textsuperscript{164} The proposed franchise tax amendments reflect Comptroller policy on the computation of reportable federal taxable income for limited liability companies that are treated as sole proprietorships, divisions or branches of corporations, or corporations. For example, the rule provides that a single member of a limited liability company which is treated as a divisional branch of a corporation for federal tax purposes, will compute its “reportable federal taxable income” for franchise tax purposes as though the limited liability company were a separate corporation for federal income tax purposes.\textsuperscript{165} Thus, a single member limited liability company that is treated as a corporate division or branch for federal income tax purposes will compute its reportable federal taxable income for franchise tax purposes in the same manner as a limited liability company that is treated as a corporation for federal tax purposes.\textsuperscript{166}

Proposed changes to Rule 3.568\textsuperscript{167} would add a new subsection to provide that an “entity that was subject to franchise tax prior to conversion and that continues to be subject to franchise tax after conversion will not have a new beginning date for franchise tax;” and to make other changes to acknowledge the possibility of conversion from one entity to another.\textsuperscript{168}

The Comptroller also drafted proposed or adopted amendments to several other rules.\textsuperscript{169}

\begin{itemize}
\item \textsuperscript{161} See 34 Tex. Admin. Code § 3.558 (West 1997).
\item \textsuperscript{162} Draft rule circulated Oct. 27, 1997.
\item \textsuperscript{164} See Treas. Reg. § 301.7701-3 (as amended in 1997).
\item \textsuperscript{166} See id. § 3.562(h).
\item \textsuperscript{167} 34 Tex. Admin. Code § 3.568 (West 1997).
III. PROPERTY TAX

A. APPLICATION OF TAX/EXEMPTIONS

During the Survey period, Texas courts continued to struggle in defining the circumstances under which goods involved in international commerce are taxable. In a five-four decision, the Texas Supreme Court held in Vinmar, Inc. v. Harris County Appraisal District\(^{(170)}\) that the imposition of property taxes on goods brought into Texas and which were awaiting export was unconstitutional because the tax violated the Commerce Clause of the United States Constitution.\(^{(171)}\) Vinmar's business was to purchase plastic resin for foreign customers and to export the resin to the customer's country, and its practice was to obtain orders and then seek to locate the goods necessary to fill the order.\(^{(172)}\) Once goods were purchased, they were shipped to a Houston warehouse and remained there to await finalization of import clearance, currency control procedures and letters of credit.\(^{(173)}\) Vinmar's profit margin was small, and apparently the imposition of the property tax would render Vinmar's transactions profitless.\(^{(174)}\) The Supreme Court ruled that the property tax on Vinmar's goods failed the requirement in the Commerce Clause that the tax must not prevent the federal government from speaking with one voice in its regulation of commercial relations with foreign governments,\(^{(175)}\) relying on the conclusion in other cases that property taxes assessed against goods awaiting export under similar circumstances violated the one-voice prong of the Import-Export Clause of the United States Constitution, which is the same test employed under the Commerce Clause.\(^{(176)}\)

This case appears to further narrow circumstances in which property taxes may be imposed on properties destined for foreign locations. Although the Supreme Court concluded that the facts of Vinmar are similar to those in Virginia Indonesia Co. v. Harris County Appraisal District,\(^{(177)}\) there are some important differences that would have made it easier for a court to conclude that property tax could be imposed on Vinmar when it could not be imposed on Virginia Indonesia. These dif-

\(^{(170)}\) 947 S.W.2d 554 (Tex. 1997).
\(^{(171)}\) See U.S. Const. art. I, § 8, cl. 3. In Complete Auto Trans Inc. v. Brady, 430 U.S. 274, 279-87 (1977), the United States Supreme Court set forth four factors used to evaluate whether a state tax complies with the Commerce Clause. In order for the state tax to be valid, a tax must: (i) apply to an activity having a substantial nexus with taxing state; (ii) be fairly apportioned; (iii) not discriminate against interstate commerce; and (iv) be fairly related to the services provided by the state. See id. If the taxes are on foreign commerce, in addition to the criteria set forth above, the tax must not (1) create a substantial risk of international multiple taxation or (2) prevent the federal government from speaking with one voice in its regulation of commercial relations with foreign governments. See Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434, 451 (1979).
\(^{(172)}\) See Vinmar, 947 S.W.2d at 554.
\(^{(173)}\) See id.
\(^{(174)}\) See id. at 556 (Hecht, J., dissenting).
\(^{(175)}\) See id. at 555.
\(^{(176)}\) See id.
ferences include that Vinmar's principal place of business was in Harris County, whereas Virginia Indonesia had no place of business in Texas; that Vinmar held the goods in Texas until payment was made, which generally was a lengthy period, whereas Virginia Indonesia's goods usually remained in Texas for no more than forty-five days; and that Vinmar purchased goods to fill orders for customers whereas Virginia Indonesia never bought goods from which to supply its principal and was merely reimbursed for its costs (at no profit to Virginia Indonesia). The dissent forcefully concludes that if Vinmar's property cannot be taxed, it is difficult to envision how any exporter's goods can be taxed.

In *Deer Park v. Harris County Appraisal District*, it was held that the federal statute granting a property tax exemption for tangible personal property imported from outside the United States into a foreign trade zone for specified purposes and for property held in the foreign trade zone for exportation does not violate the United States Constitution. In this case, three school districts sued companies in foreign trade zones for property taxes that would be due but for the federal foreign trade zone exemption, claiming that the exemption unconstitutionally intruded on their authority as components of the federal system of divided power and extended unconstitutionally national authority over foreign trade. In rejecting the school districts' claims, the court reasoned that the federal government had exercised its constitutional authority in the facts at hand over international commerce in a manner complying within the limits of its power and the limit on federal intrusion on the states' partial autonomy.

Indeed, tax exemptions have long been a tool used by the federal government to build a national economy.

There were two important cases during the Survey period addressing the constitutionality of methods of valuation prescribed in the Tax Code. The Austin Court of Appeals held in *Travis Central Appraisal District v. FM Properties Operating Co.* that section 23.12(a) of the Tax Code, which requires that certain residential real property held for sale in the ordinary course of a trade or business be treated as inventory and valued

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178. See Vinmar, 947 S.W.2d at 557-58 (Hecht, J., dissenting).
179. See id. at 559.
181. See id. at 609. The foreign trade zone exemption provides that the following tangible personal property is exempt from property tax:
- property imported from outside the United States and held in a zone for the purpose of storage, sale, exhibition, repackaging, assembly, distribution, sorting, grading, cleaning, display, manufacturing, or processing, and tangible personal property produced in the United States and held in a zone for exportation, either in its original form or as altered by any of the . . . processes [described above].
182. See Deer Park, 963 F. Supp. at 605.
183. See id. at 609.
184. See id. at 608.
185. 947 S.W.2d 724 (Tex. App.—Austin 1997, n.w.h.).
as a single unit,\textsuperscript{187} does not violate the Texas Constitution.\textsuperscript{188} The appraisal district argued that the valuation method violated the requirement in the Texas Constitution that taxation be equal and uniform and that property be taxed in proportion to its value,\textsuperscript{189} and that nothing in the Texas Constitution created a property tax exemption for residential real property inventory.\textsuperscript{190} The court reasoned that the valuation method did not violate the equal and uniform requirement because the valuation method mandated by the Texas Legislature was not unreasonable, arbitrary or capricious given that the method was supported by generally accepted appraisal techniques.\textsuperscript{191} The court also rejected the appraisal district's claim that section 23.12(a) prevented property from being taxed in proportion to its value.\textsuperscript{192} This requirement merely means that assessed valuations must be based on reasonable cash market value, and section 23.12(a) prescribes a method of valuation that produces a reasonable estimate of market value.\textsuperscript{193} As the Texas Supreme Court concluded in \textit{Enron Corp. v. Spring Independent School District},\textsuperscript{194} a statute fixing a valuation method does not create a tax exemption;\textsuperscript{195} therefore, the appraisal district's position that section 23.12(a) created a constitutionally impermissible exemption is wrong.\textsuperscript{196}

In another case in which an appraisal district challenged the constitutionality of a method of valuation set forth in the Tax Code, the Houston [14th Dist.] Court of Appeals held in \textit{Tex-Air Helicopters, Inc. v. Appraisal Review Board of Galveston County, Texas},\textsuperscript{197} that section 21.05 of the Tax Code,\textsuperscript{198} which sets forth the method appraisal districts must employ in allocating to Texas the portion of the value of commercial aircraft used in interstate commerce, is constitutional.\textsuperscript{199} Section 21.05(2) provides that if a commercial aircraft is used both in and outside of Texas, the appraisal district is required to allocate to Texas the portion of the

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\item \textsuperscript{187} See \textit{id}.
\item \textsuperscript{188} See \textit{FM Properties}, 947 S.W.2d at 735.
\item \textsuperscript{189} See \textit{id} at 728-33. The appraisal district's primary position was that section 23.12(a) violated the "equal and uniform" requirement of article VIII, section 1(a) of the Texas Constitution by treating some owners of real property, i.e., those whose property is inventory, differently from other owners of real property. See \textit{id} at 728; \textit{TEX. CONST} art. VIII, § 1(a). By valuing the property as a single unit as opposed to valuing each parcel separately, a lower value per acre will generally result because under the development approach, the appraiser will subtract from the gross retail value of the lots development costs, opportunity costs, and other expenses. See \textit{FM Properties}, 947 S.W.2d at 729. In valuing a single unit of inventory as opposed to individual lots, the retail price at which the individual lots are sold is only one of several factors to be considered. See \textit{id}.
\item \textsuperscript{190} See \textit{id} at 734.
\item \textsuperscript{191} See \textit{id} at 732.
\item \textsuperscript{192} See \textit{id} at 734.
\item \textsuperscript{193} See \textit{id}.
\item \textsuperscript{194} 922 S.W.2d 931 (Tex. 1996).
\item \textsuperscript{195} See \textit{id} at 940-41.
\item \textsuperscript{196} See \textit{FM Properties}, 947 S.W.2d at 735.
\item \textsuperscript{197} 940 S.W.2d 299 (Tex. App.—Houston [14th Dist.] 1997, writ granted).
\item \textsuperscript{198} See \textit{TEX. TAX CODE ANN}. § 21.05 (Vernon 1992).
\item \textsuperscript{199} See \textit{Tex-Air Helicopters}, 940 S.W.2d at 303.
\end{itemize}
value of the aircraft that fairly reflects its use in Texas.\textsuperscript{200} The appraisal district asserted that the statute is effectively an exemption which is not permitted by the Texas Constitution,\textsuperscript{201} and relied on \textit{Aransas County Appraisal Review Board v. Texas Gulf Shrimp Co.},\textsuperscript{202} in which the Corpus Christi Court of Appeals held that section 21.03,\textsuperscript{203} a very similar statute to section 21.05, is an unconstitutional exemption.\textsuperscript{204} Section 21.03(a) provides that if personal property is used continually outside Texas, then the appraisal district must allocate to Texas the portion of the value of the property that fairly reflects its use Texas.\textsuperscript{205} In concluding that section 21.03(a) is unconstitutional, the court in \textit{Aransas} reasoned that section 21.03(a) did not require that the portion of the value of the property not allocated to Texas be taxed elsewhere, thus effectively creating an exemption.\textsuperscript{206} The Houston Court of Appeals in \textit{Tex-Air}, however, rejected the rationale in \textit{Aransas}, instead following two more recent cases in which courts concluded that similar statutes were constitutional because they provided a method of determining taxable value rather than granting an exemption.\textsuperscript{207}

In \textit{Quantum Chemical Corp. v. Harris County Appraisal District},\textsuperscript{208} the Houston First District Court of Appeals interpreted the terms of a tax abatement agreement. The agreement was entered into in 1988, and provided that the tax abatement would be effective on the January 1 date immediately following the date the agreement was executed.\textsuperscript{209} The agreement further provided that the abatement would not exceed five years.\textsuperscript{210} Quantum delayed the commencement of construction until 1990 and claimed an abatement for 1994, arguing that it was entitled to a five-year abatement which should not have started until after construction commenced.\textsuperscript{211} The court disagreed, reasoning that the agreement was clear in providing that the abatement started in 1989 and that its

\begin{footnotesize}
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\item 201. See \textit{Tex. Const.} art. VIII, § 2(a) (amended 1995).
\item 202. 707 S.W.2d 186 (Tex. App.—Corpus Christi 1986, writ ref'd n.r.e.).
\item 204. See \textit{Aransas County}, 707 S.W.2d at 188, 196.
\item 205. See \textit{Tex. Tax Code Ann.} § 21.03(a).
\item 206. See \textit{Aransas County}, 907 S.W.2d at 189-91. The appraisal district also argued that section 21.05 is not a valuation statute because it is not placed in chapter 23 of the Tax Code, which is entitled “Appraisals Methods and Procedures.” However, the court rejected this argument, concluding that if section 21.05 were intended to be an exemption, it would be included in chapter 11 of the Tax Code, “Taxable Property and Exemptions.” See \textit{Tex-Air Helicopter}, 940 S.W.2d at 303.
\item 207. See id. at 302-03. The two cases followed by the court in \textit{Tex-Air Helicopter} are \textit{Tarrant Appraisal District v. Colonial Country Club}, 767 S.W.2d 230 (Tex. App.—Fort Worth 1989, writ denied), and \textit{Enron Corp. v. Spring Indep. Sch. Dist.}, 922 S.W.2d 931 (Tex. 1996).
\item 208. See 962 S.W.2d 50 (Tex. App.—Houston [1st Dist.] May 1, 1997, n.w.h.) (motion for rehearing granted).
\item 209. See id. at 51.
\item 210. See id.
\item 211. See id. at 51-52.
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maximum five-year term would end after the 1993 tax year.

B. Procedure

In *Henderson County Appraisal District v. HL Farm Corp.*, the Eastland Court of Appeals declined to follow a Houston Fourteenth District Court of Appeals decision concerning whether a taxpayer which is in litigation concerning a property tax issue for a particular year is required to exhaust its administrative remedies before amending the lawsuit to include later years in the lawsuit. In the case, the taxpayer was in litigation with the appraisal district for the 1988 tax year concerning the constitutionality of section 23.56(3) of the Tax Code, which denied open-space land designation to foreign entities. In 1993, the Texas Supreme Court held in another case that section 23.56(3) was unconstitutional. Thereafter, the taxpayer amended its petition to include tax years 1989 through 1993 in the litigation. However, the taxpayer had failed to exhaust its administrative remedies for years 1990, 1991, and 1993. The court held that it lacked jurisdiction to grant relief for years 1990, 1991, and 1993 because the taxpayer had not exhausted its administrative remedies for those years. The court stated that the decision by the Houston Fourteenth District Court of Appeals in *Harris County Appraisal District v. Bradford Realty, Ltd.* was in error. In a very similar situation, the court held in *Bradford* that the exhaustion of administrative remedies for the year initially included in the lawsuit, together with the amendment of the petition to include later years, were sufficient to put the appraisal district on notice, and thus the taxpayer did not have to repeat the administrative and protest process for the later tax years. The *Henderson County* court further concluded that the Texas Supreme Court’s decision that section 23.56(3) is unconstitutional should be applied retroactively, thereby allowing the taxpayer a recovery for the years...

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212. *See id.* This case makes it clear that the abatement agreement for any abatement intended to begin later than the year following the year in which the agreement is executed must clearly and expressly provide when the abatement is to begin. For example, it is common for abatements to begin in the first year after which a certificate of occupancy with respect to the facility is issued.

213. 956 S.W.2d 672 (Tex. App.—Eastland 1997, no writ).

214. *See id.* at 674.


216. *See id.*


218. *See Henderson County*, 956 S.W.2d at 674.

219. *See id.* at 674, 675.

220. *See id.* at 675.

221. 919 S.W.2d 131 (Tex. App.—Houston [14th Dist.] 1994, no writ).

222. *See id.* at 134. The *Henderson County* court further concluded the Texas Supreme Court decision that section 23.56(3) is unconstitutional should be applied retroactively, thereby allowing the taxpayer a recovery for the years in the litigation in which it had exhausted its administrative remedies. *Henderson County*, 877 S.W.2d at 675. The court based its conclusion on its belief that the retroactive application of the *Self* decision would not produce inequitable results. *See id.*
in the litigation in which it had exhausted its administrative remedies.\textsuperscript{223}

In \textit{Harris County Appraisal District v. Duncan},\textsuperscript{224} the Houston Fourteenth District Court of Appeals addressed the calculation of the appraisal ratio of a taxpayer's property for purposes of determining whether the taxpayer was entitled to relief for unequal appraisal. Pursuant to section 41.41(a)(2) of the Tax Code,\textsuperscript{225} a property owner may protest an "unequal appraisal" of his property as compared to other properties in the district.\textsuperscript{226} The property owner will prevail unless the appraisal district can establish that the ratio of his property's appraised value to his property's market value (the appraisal ratio) is not greater than the median level of appraisal of a sample of other properties in the district.\textsuperscript{227} If the property owner is dissatisfied with the appraisal review board's determination on the "unequal appraisal" issue, then he may appeal to the district court.\textsuperscript{228} However, the district court may grant relief only if it determines that the appraisal ratio of the property at issue exceeds the median level of appraisal by ten percent or more.\textsuperscript{229} The issue in \textit{Duncan} was the calculation of the property owner's appraisal ratio. The median level of appraisal for the district was 92.45\% (i.e., the average property's appraised value equaled 92.45\% of its market value).\textsuperscript{230} Therefore, the appraisal ratio of the property owner's property needed to be equal to or in excess of 102.45\% in order for the property owner to prevail under the "unequal appraisal" argument. In determining the appraisal ratio of the property owner's property, the district court used the original appraised value asserted by the appraisal district as the numerator rather than the appraised value as determined after the protest hearing by the appraisal review board.\textsuperscript{231} Based on the original appraised value, the appraisal ratio of the subject property exceeded the median level of appraisal by more than ten percent.\textsuperscript{232} Had the value determined by the appraisal review board been used, however, the appraisal ratio of the subject property would not have exceeded the median level of appraisal by more than ten percent.\textsuperscript{233} The court of appeals disagreed with the trial court, relying largely on section 1.12(b) of the Tax Code,\textsuperscript{234} which provides that the appraised value used in the appraisal ratio is that "determined by the

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\item\textsuperscript{223} See id.
\item\textsuperscript{224} 944 S.W.2d 706 (Tex. App.—Houston [14th Dist.] 1997, writ denied).
\item\textsuperscript{225} See TX. TAX CODE ANN. § 41.41(a)(2) (Vernon Supp. 1998).
\item\textsuperscript{226} Id.
\item\textsuperscript{227} See id. § 41.43.
\item\textsuperscript{228} See id. § 42.01 (Vernon Supp. 1998).
\item\textsuperscript{229} See id. § 42.26(a) (Vernon 1992). The ten percent threshold applies only to "unequal appraisal" issues addressed by the district court, and does not apply at the appraisal review board level. Compare TX. TAX CODE ANN. § 41.43 (Vernon Supp. 1998) with id. § 42.26(a) (Vernon 1992).
\item\textsuperscript{230} See Duncan, 944 S.W.2d at 707.
\item\textsuperscript{231} See id.
\item\textsuperscript{232} See id.
\item\textsuperscript{233} See id. at 709.
\item\textsuperscript{234} See TX. TAX CODE ANN. § 1.12(b) (Vernon 1992).
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appraisal office or appraisal review board, as applicable. . . .” 235 The court reasoned that if a court were precluded from using the value determined by the appraisal review board in circumstances such as this one in which the appraisal review board had agreed that the market value of the property was lower than the original value determined by the appraisal district, then the words “or appraisal review board, as applicable,” would be meaningless because the value determined by the appraisal review board would never be used.236

In *Sweetwater Independent School District v. ReCor, Inc.*,237 the Eastland Court of Appeals held that property owned by a county and used for public purposes is exempt even though the exemption was not timely urged during the appraisal review proceedings.238 Although section 42.09 of the Tax Code239 provides that a property owner may not raise an exemption in a defense to enforce collection of delinquent taxes unless the ground was raised during the appraisal process,240 the court reasoned that this statutory provision does not bar the exemption granted political subdivisions under article XI, section 9 of the Texas Constitution,241 which provides that property owned by counties and held for public purposes is exempt from taxation.242 Thus, the exemption is automatic.243

C. Legislation

Although the focus of the 1997 Texas Legislature was squarely on the subject of revamping Texas' system of school finance, the effort died in Conference Committee. However, the Texas Legislature did pass many significant property tax bills during its 1997 term. Many of these bills created new exemptions; others modified existing exemptions. The Texas Constitution was amended to increase the school district homestead ex-

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235. Id.; see *Duncan*, 944 S.W.2d at 708.
236. Id. The taxpayer also argued that the trial court cannot consider the appraisal review board's findings of a lower appraised value under the de novo standard of review that applies to property tax trials at district court. See id. at 709. Section 42.23 of the Tax Code provides that review by the district court of property tax matters is by trial de novo. See *Tex. Tax Code Ann.* § 42.23 (Vernon 1992). The court rejected this argument, relying on section 1.12 of the Tax Code, which provides that the district court is required to use the revised appraisal review board value of the property at issue in calculating the appraisal ratio. See *Duncan*, 944 F.2d at 709.
237. 955 S.W.2d 703 (Tex. App.—Eastland 1997, pet. filed).
238. See id. at 704.
240. See id. § 42.09(a).
242. See id.
243. See *Sweetwater*, 955 S.W.2d at 704. In another decision involving the property tax exemption for government-owned property used for a public purpose, the Attorney General ruled that a court could reasonably conclude that a state-owned university would be entitled to the public purpose exemption on property used temporarily as a public family entertainment center. The university was in the process of converting the use of the property to a public purpose use, that being educational activities. Indeed, some of those activities were already taking place. See Op. Tex. Att'y Gen. No. DM-429 (1996).
emption from $5,000 to $15,000. Amended section 23.23 of the Tax Code provides that the appraised value of a residence homestead may not increase more than ten percent per year (plus the value of all new improvements). Section 11.13(h) was amended to provide that a person may not receive a residence homestead, over-65 or disability exemption for more than one residence homestead in the same year. Section 11.42(c) was amended to provide that the cemetery, charitable organization, youth development association, religious organization, school, disabled veteran and the nonprofit water supply corporation exemption, and certain other miscellaneous exemptions set forth in section 11.23, are now effective immediately upon these entities' acquisition of eligible property. The charitable organization exemption was expanded to provide that qualifying charitable organizations are exempt if they provide housing and related services to individuals who are age sixty-two and older in a retirement community if the community provides independent living services, assisted living services and nursing services without regard to ability to pay if certain other conditions are met.

There were also several important procedural changes relating to protests and appeals to district court. One of the most important changes is that section 41.43 of the Tax Code was amended to provide that in a protest concerning market value or unequal appraisal, the appraisal district has the burden of proof. Section 42.08(b) was amended to make more

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244. See Tex. Const. art. VIII, § 1-b(c) (amended 1997). This exemption is implemented by an amendment to section 11.13(b) of the Tax Code. See Tex. Tax Code Ann. § 11.13(b) (Vernon Supp. 1998). Texas voters also approved an amendment to the Texas Constitution to allow the Texas Legislature to enact a law allowing the transfer of all or part of the over-65 property tax freeze to another homestead. See Tex. Const. art. VIII, §§ 1-b(c), (d).

245. See Tex. Tax Code Ann. § 23.23(a) (Vernon Supp. 1998). This amendment was made possible by an amendment to the Texas Constitution that allows the Texas Legislature to limit annual increases in the appraised value of residence homesteads for property tax purposes to ten percent or a greater percentage for each year since the most recent tax appraisal. See Tex. Const. art. VIII, § 1(i).

246. See Tex. Tax Code Ann. § 11.13(h) (Vernon Supp. 1998). The over-65 and disability exemption provide that in addition to the residence homestead exemption, an adult who is disabled or is age 65 or older is entitled to an exemption from school district property taxes of $10,000 of the appraised value of his residence homestead. See id. § 11.13(c) (Vernon 1992). In addition, if approved by the voters of the taxing unit, an individual who is disabled or age 65 or older is entitled to an additional property tax exemption. See id. § 11.13(d) (Vernon Supp. 1998).

247. See id. § 11.42(c). Prior to this amendment, the exemption was applicable effective for the next preceding year following such entities' acquisition of the relevant property.

248. See id. § 11.18(d)(19).

249. See id. § 41.43. This change in burden of proof will almost certainly make it more likely for a taxpayer to protest based on unequal appraisal, given that the appraisal district will require to at least establish a prima facia case of there not being unequal appraisal with respect to the property at issue. The legislation also provides that before a hearing on a protest or immediately after the hearing begins, the appraisal district and the property owner or its agent are required to provide the other with a copy of any written material that the person intends to offer and submit to the appraisal review board at the hearing. See id. § 41.45(h). However, if the information is provided immediately after the hearing begins, it is difficult to believe that the transfer of the information will be helpful to the other party.
straightforward the amount a taxpayer is required to pay to taxing jurisdictions in order to preserve its right to appeal, and now provides that taxpayers are required to pay the lesser of the amount of taxes due on the portion of the taxable value of the property in dispute or the amount of taxes due on the property under the order being appealed.\textsuperscript{250} Section 42.08(c) was amended to provide that the maximum award for the taxpayer’s attorneys fees in a property tax controversy is $100,000.\textsuperscript{251} Section 42.06 was amended to eliminate the requirement that certain property owners desiring to file suit challenging an appraisal review board decision are required to file a notice of appeal.\textsuperscript{252}

Section 6.025 of the Tax Code was amended to provide that if a property lies within the boundaries of more than one appraisal district, and if those appraisal districts have not reached an agreement by May 1 of the relevant year concerning the appraised value of the property, then the appraised value of the property in each such appraisal district shall be the mean of the appraisal districts’ asserted values.\textsuperscript{253} In addition, the owner of property lying within the boundaries of more than one appraisal district is entitled to file a protest concerning the property in any of such appraisal districts, and the appraisal review board or court’s determination on the issue protested is binding on all such appraisal districts.\textsuperscript{254} The legislation further provides that if a residence is subject to the jurisdiction of more than one appraisal district, then the granting of a residence homestead exemption or an over-65 or disability exemption by one such appraisal district is binding on the other appraisal districts.\textsuperscript{255}

Section 33.01 was amended to provide that penalties and interest accrue at the rates provided in the Tax Code even after a judgment has been entered into.\textsuperscript{256} Section 33.01 was also amended to provide harsh

\textsuperscript{250} See id. \textsection 42.08(b). Prior to this amendment, the property owner was required to pay (i) the amount of taxes due on the portion of the taxable value of the property that is not in dispute or the amount the taxes imposed on the property in the preceding year, whichever is greater, or (ii) the amount of taxes due on the property under the appraisal review board order. See id. \textsection 42.08(b) (amended 1997).

\textsuperscript{251} See id. \textsection 42.08(c) (Vernon Supp. 1998).

\textsuperscript{252} See id. \textsection 42.06. Under prior law, failure to file a notice of appeal when required was not a jurisdictional prerequisite to a lawsuit; however, any property owner who failed to deliver a timely notice of appeal in a circumstance in which it was required to pay a penalty to each taxing unit in which the property is taxable in an amount equal to five percent of the taxes finally determined to be due on the property.

\textsuperscript{253} See id. \textsection 6.025(e).

\textsuperscript{254} Id. \textsection 6.025(f). This provision appears to give the property owners a distinct advantage in circumstances in which property lies within the boundaries of one or more appraisal district and the appraisal districts differ concerning the value of the property. For example, if Blackacre lies within both Appraisal District X and Appraisal District Y, and Appraisal District X believes the property is worth $200, it seems axiomatic that the taxpayer would file its protest in Appraisal District X, which would have little reason to dispute any value over $100. In other words, query who will be doing the lobbying on behalf of Appraisal District Y in the protest filed with Appraisal Review Board with jurisdiction under Appraisal District X.

\textsuperscript{255} See id. \textsection 6.025(d).

\textsuperscript{256} See id. \textsection 33.01(a). In addition, a delinquent tax continues to accrue interest as long as the tax remains unpaid, irrespective of whether a judgment for the delinquent taxes has been rendered. See id. \textsection 33.01(c).
penalties to property owners who improperly received the residence homestead exemption, the over-65 exemption and the disability exemption in certain circumstances.\textsuperscript{257} The penalty is fifty percent of the amount of tax.\textsuperscript{258} New section 33.065 enables individuals to defer a delinquent tax suit on the portion of the debt which exceeds the sum of 105% of the property's value for the prior year plus the value of all new improvements to the property.\textsuperscript{259} Once deferred, a taxing unit may not sue to collect until the individual no longer owner and occupies the property as a residence homestead.\textsuperscript{260}

Section 33.52 of the Tax Code was amended by House Bill 2587\textsuperscript{261} (and also by House Bill 3306)\textsuperscript{262} to make the consequences of failing to pay property taxes even more onerous. Prior law provided that if there is a foreclosure sale of real property, the judgment shall provide, on the motion of the taxing unit, that the taxing unit recover from the sale proceeds the property taxes on the property for the current year, prorated to the day of judgment.\textsuperscript{263} Pursuant to House Bill 2587, the law has been changed to enable taxing units to recover the current year's taxes in full \textit{(i.e., not prorated)}.\textsuperscript{264} However, House Bill 2622 amended section 33.52 to provide that the taxing unit may recover from the proceeds of the foreclosure sale taxes for the year of sale prorated to the date of sale.\textsuperscript{265} Thus, it is unclear what portion of the current year’s taxes on property sold at a foreclosure sale a taxing unit may recover from the proceeds of the foreclosure sale.

In legislation that creates an expensive trap for the unwary, section 5.010 of the Property Code was added to provide that, subject to certain exceptions, a seller of vacant land must include in the sales contract specific statutory language notifying the buyer that if the land qualifies for special appraisal for property tax purposes, the buyer may not qualify for special appraisal and may owe rollback taxes on the property.\textsuperscript{266} The consequence of the seller's failure to include the statutory language in the contract is fairly draconian—essentially, the seller becomes liable for the payment of rollback taxes on the property if the rollback taxes are triggered before the fifth anniversary of the date of the transfer of the property.

\textsuperscript{257} See id. § 33.01(d).
\textsuperscript{258} See id.
\textsuperscript{259} See id. § 33.065(a).
\textsuperscript{260} See id. § 33.065(c).
\textsuperscript{263} See TEX. TAX CODE ANN. § 33.52(a) (amended 1997).
\textsuperscript{266} See TEX. PROP. CODE ANN. § 5.010 (Vernon Supp. 1998).
Section 23.121 of the Tax Code, which provides specific rules concerning the valuation for property tax purposes of inventory held by motor vehicle dealers, was amended to expand the definition of the term "motor vehicle dealer" to include businesses recognized as motor vehicle dealers under the laws of another state. New sections 23.127 and 23.128 were added to provide that the inventory of manufactured home retailers shall be determined pursuant to procedures very similar to those used for motor vehicle dealers, and new sections 23.1241 and 23.1242 were added to provide that essentially the same procedures apply to dealers of heavy equipment.

Several important amendments were made to section 25.25, which addresses the correction of appraisal rolls. Section 25.25(l) was added to provide that a motion to correct the appraisal roll under section 25.25(c) (correction for clerical errors, multiple appraisals of the same property, or inclusion of property that did not exist in the form or at the location described in the roll) may be filed irrespective of whether the property owner protested the value of the property that is the subject of the motion. In addition, a party bringing a motion under section 25.25(c) or (d) is entitled to a hearing and determination thereon if the chief appraiser and the property owner have not reached an agreement with respect to the proposed correction within fifteen days after the date the motion is filed.

IV. OTHER DEVELOPMENTS, INCLUDING STATUTES OF LIMITATIONS AND PERSONAL LIABILITY

A. Jurisdiction

The Texas Supreme Court addressed the issue of whether the failure to raise a constitutional challenge at the administrative level is a bar to jurisdiction of the district court and held the constitutional challenge was within the trial court's jurisdiction. In Central Power and Light v.

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267. See id. § 5.010(e). The statute appears to even allow the purchaser to recover rollback taxes for years after the date of sale in which property receives special valuation as long as the change in use occurred before the fifth anniversary of the date of transfer. This seems especially unfair, given that the purchaser enjoyed the benefits of the special valuation during years after transfer.

268. See id. § 23.121. The Department of Transportation was also given the power to initiate termination proceedings with respect to motor vehicle dealers failing to file the declaration required by section 23.121 of the Tax Code, or which had fewer than five sales in the prior year. See id.

269. See id. §§ 23.127, 23.128.

270. See id. §§ 23.1241, 23.1242.

271. See id. § 25.25.

272. See id. § 25.25(1).

273. See id. § 25.25(e). Hearings on motions under sections 25.25(c) and (d) are now expressly required to be conducted in the same manner as appraisal review board hearings under chapter 41 of the Tax Code. See id. § 25.25(m).

Sharp the taxpayer sought to bring a constitutional challenge to a Tax Code provision in the district court, without having raised the constitutional issue at the administrative level in its motion for rehearing. The Comptroller argued that failure to raise the constitutional issue at the administrative level precluded raising the issue for the first time at the trial court, based on the limitation set forth in Tax Code section 112.1252(a) restricting the issues that may be raised in a suit seeking a tax refund to the grounds of error contained in the motion for rehearing of the administrative case. The Court noted that this statutory limitation implicitly assumes that the agency has the authority to decide the issues presented in the motion for rehearing. It is well settled that the agency lacks the authority to decide constitutional challenges, therefore the Court found that failure to raise the constitutional issue at the administrative level did not preclude jurisdiction of the trial court.

B. Statute of Limitations

The court of appeals reviewed the statute of limitations applicable to taxpayers seeking a refund of sales and use tax based on vendor assignments and held that refund claims may be barred by the statute of limitations where the Comptroller and the vendors have not entered into a waiver of the statute. In Fleming Foods v. Sharp, the taxpayer and the Comptroller entered into an agreement extending the time period for the taxpayer to file tax refund claims. The Comptroller denied the refunds which were outside the original limitations period, reasoning that the original statute of limitations was not extended without a waiver agreement between the Comptroller and the vendors. The taxpayer argued that an assignee, attorney or successor of any person who paid the taxes has standing to file a refund claim under the Tax Code. Under the court’s analysis, the Tax Code provision that authorizes a refund must be read in conjunction with the provision that allows agreements to extend the limitations period applicable to refunds, and the term “taxpayer” as used in each of these statues refers to the same person—the person who paid the tax directly to the state. Therefore, the court held that

275. See id.
276. See id. at *1; TEX. TAX CODE ANN. § 112.152(a) (Vernon 1992).
278. See id. at *21; Birdville Indep. Sch. Dist. v. First Baptist Church, 788 S.W.2d 26 (Tex. App.—Fort Worth 1988, writ denied); Texas State Bd. of Pharmacy v. Walgreen Tex. Co., 520 S.W.2d 845 (Tex. Civ. App.—Austin 1975, writ ref’d n.r.e.).
280. See id.
281. See id. at 280. Generally the statute of limitations for refund claims under Tax Code section 111.104 is four years. See TEX. TAX CODE ANN. §§ 111.104(c); 111.107; 111.207 (Vernon 1992).
283. See Fleming Foods, 951 S.W.2d at 282; TEX. TAX CODE ANN. § 111.104 (Vernon 1992) (refund provisions); id. § 111.203 (agreements to extend period of limitations).
the failure of the vendors to enter into extension agreements with the Comptroller precluded the taxpayer's refund requests from being timely filed.\textsuperscript{284}

In another case released on the same date as Fleming Foods, the court of appeals similarly upheld the denial of refund claims, based on assignments of refunds obtained from the vendors, as being barred by the statute of limitations.\textsuperscript{285} In S\&H Marketing Group, Inc. v. Sharp the taxpayer challenged the constitutionality of Tax Code section 111.104 and Rule 3.325 as a violation of state and federal due process and equal protection guarantees.\textsuperscript{286} The taxpayer argued that an unconstitutional disparity of treatment among taxpayers existed by allowing taxpayers who directly pay taxes to the state to seek a refund directly from the Comptroller and requiring taxpayers who pay taxes to the seller of goods and services to seek a refund from the seller, rather than the Comptroller.\textsuperscript{287} The court held that taxpayers were not treated differently and that, through the vendor assignment provisions, refunds may be sought directly from the Comptroller by both categories of taxpayers.\textsuperscript{288} The taxpayer also argued that the statute of limitations was tolled due to the taxpayer's reliance on incorrect advice received from the Comptroller's office.\textsuperscript{289} Generally, unauthorized or negligent acts of an official or agent will not estop a governmental unit exercising its public or governmental functions.\textsuperscript{290} The court held that the Comptroller's collection of taxes was a governmental function and therefore the statute of limitations was not tolled due to incorrect information from the Comptroller's office and the Comptroller was not estopped from asserting a defense based on the statute of limitations.\textsuperscript{291}

C. Burden of Proof

Numerous Comptroller decisions during the Survey period examined the requisite burden of proof with respect to taxable services. Decision 32,141 summarized the Tax Division's burden as requiring prima facie proof that the service at issue is a taxable service enumerated in the Tax

\begin{itemize}
  \item \textsuperscript{284} See Fleming Foods, 951 S.W.2d at 282.
  \item \textsuperscript{285} See S\&H Marketing Group, Inc. v. Sharp, 951 S.W.2d 265 (Tex. App.—Austin, 1997, n.w.h.).
  \item \textsuperscript{286} See S\&H Marketing, 1951 S.W.2d at 267; Tex. Tax Code Ann. § 111.104 (Vernon 1992); 34 Tex. Admin. Code § 3.325 (West 1997).
  \item \textsuperscript{287} See S\&H Markets, 951 S.W.2d at 264.
  \item \textsuperscript{288} See id. The court cited its holding in Fleming Foods that both taxpayers who pay the tax directly to the state, and those who obtain a refund request and an assignment of refund rights from the taxpayer who remitted the tax directly to the state, have standing to file a refund claim under Tax Code section 111.104. See Fleming Foods, 951 S.W.2d at 282.
  \item \textsuperscript{289} See S\&H Marketing, 951 S.W.2d at 266.
  \item \textsuperscript{290} See id. The taxpayer argued that an exception to the general rule applies where equity and justice require estoppel. The court responded that the exception created in City of Hutchins v. Prasifka, 450 S.W.2d 829 (Tex. 1970), was not applicable in the present case because the exception is limited to municipalities. See S\&H Marketing, 951 S.W.2d at 266.
  \item \textsuperscript{291} See id. at 267.
\end{itemize}
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Code and that the service was purchased or sold tax free.\(^2\) If the Tax Division presents sufficient proof, the burden shifts to the taxpayer to prove by a preponderance of the evidence that the Tax Division is wrong, or to prove by clear and convincing evidence that the service is exempt from taxation. If the taxpayer alleges the service is not taxable because it is within an exclusion (rather than an exemption), and there is no indication that inadequate records are available to determine whether the exclusion applies, the burden is on the Tax Division to establish, on its face, not only that the service in question is included among the type enumerated in the statute, but also that the service is not the type intended to be excluded.\(^3\)

\section*{D. Personal Liability}

Several administrative decisions were issued during the Survey period applying the guidelines regarding assessment of personal liability set forth in a series of related comptroller decisions issued in 1996.\(^4\) In Decisions 32,467 and 32,468 the administrative law judge found that, under the guidelines, to carry its prima facie burden of proof for imposing personal liability with respect to an accrual basis corporate taxpayer, the Tax Division must show, by clear and convincing evidence, that an actual amount of taxes were collected and not remitted, and that the office or director exercised sufficient financial control over the corporation to properly remit the taxes or divert them from other purposes.\(^5\) The decision held that the Tax Division failed to prove that the day-to-day manager and majority stockholder, or the president and majority stockholder, both with sufficient financial control over the corporation, were personally liable because the Tax Division failed to show how much, if any, sales tax was actually collected but not remitted.\(^6\) The Comptroller also addressed numerous cases of taxpayers seeking penalty waivers.\(^7\)


\(^3\) See Tex. Comp. Pub. Acc'ts, Hearing No. 32,141, 1996 WL 875034, at *4-*5 (Dec. 11, 1996); see also Tex. Comp. Pub. Acc'ts, Hearing No. 32,354, 1997 WL 450692 (Mar. 3, 1997) (setting forth Tax Division's burden of proof when exclusionary issue raised). In a related decision, Tex. Comp. Pub. Acc'ts, Hearing No. 35,645, 1997 WL 617900 (Sept. 9, 1997), the administrative law judge held that the taxpayer's evidence of statutory exclusion that was submitted in the taxpayer's exceptions to the administrative law judge's proposed decision was sufficient to satisfy the taxpayer's burden by a preponderance of the evidence.

\(^4\) See Ohlenforst, 1997 Annual Survey supra note 62, at 1509-11. This article contains a complete discussion of the guidelines enumerated in these cases.

\(^5\) See id. at *3; see also Tex. Comp. Pub. Acc'ts, Hearing No. 34,098, 1996 WL 661132 (Oct. 2, 1996) (personal liability not established against president and majority shareholder with financial control over corporate funds based on Tax Division's failure to prove knowledge that taxes were collected but not remitted).

\(^6\) See Tex. Comp. Pub. Acc'ts, Hearing No. 35,714, 1996 Tex. Tax LEXIS 849 (Dec. 11, 1996) (holding that reliance on a Big Six accounting firm was not a factor to be consid-
E. LEGISLATIVE AND REGULATORY DEVELOPMENTS

The Legislature expanded the fifty percent penalty imposed on the failure to pay the tax or file a report due to fraud or intent to evade the tax to apply to a taxpayer who alters, destroys, or conceals items or otherwise engages in fraudulent conduct for the apparent purpose of affecting the course or outcome of an audit, investigation, redetermination or other proceeding before the Comptroller.\textsuperscript{298} Additionally, Tax Code section 111.206, providing an exception to the statute of limitations for final determinations resulting from an administrative proceeding of a local, state, or federal regulatory agency, was amended to specifically provide that an "administrative proceeding" includes an audit by the Internal Revenue Service.\textsuperscript{299}

The Comptroller amended Rule 1.39 to allow the dismissal of a case in which specific grounds for relief have not been raised or in which the only grounds raised cannot be ruled upon at the administrative level, for example, the constitutionality of a statute.\textsuperscript{300}

V. CONCLUSION

The 1997 legislative session proved that significant tax reform may one day become a reality. A special House committee has been appointed and asked to prepare recommended changes for consideration by the House when it meets again in January, 1999. Until the Legislature meets again, Texas tax law will continue to develop at the courthouse and through the administrative process.

\textsuperscript{298} See \textit{Tex. Tax Code Ann.} § 111.061(b) (Vernon Supp. 1998).

\textsuperscript{299} See \textit{id.} § 111.206 (Vernon 1992 & Supp. 1998). In 1995 the Legislature amended Tax Code section 111.206 to provide that the term "federal regulatory agency" includes the Internal Revenue Service. See \textit{id.}