Taxation

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In Texas, as in other taxing jurisdictions, the rules are changing and the “game” is getting more expensive, as states seek to solve budgetary challenges by extending the reach of their taxing jurisdiction. The past year witnessed numerous administrative and judicial challenges to Texas’ authority to define more accurately the scope of services taxes, to extend the scope of “nexus,” and to subject in-transit goods to property tax.2 Franchise tax planning continued to attract significant attention...
from both taxpayers and the state, as taxpayers continued the struggle to minimize the impact of Texas' version of a corporate income tax.

I. SALES TAX

A. APPLICATION OF THE TAX

During the Survey period, the United States Supreme Court reviewed several Commerce Clause challenges to state tax laws as taxpayers continued to assert constitutional violations resulting from the application and enforcement of various state taxes. In *Oregon Waste Systems, Inc. v. Dept. of Environmental Quality* operators of solid waste disposal facilities successfully challenged the constitutionality of Oregon's imposition of a surcharge on the disposal of solid waste generated in other states that was almost three times higher than the fee imposed on the disposal of waste generated within Oregon. The Court held that the surcharge was facially invalid under the negative Commerce Clause and could not be sustained as a compensatory tax, or as resource protectionism designed to conserve space in landfills for waste generated in Oregon.

In *Associated Industries of Missouri v. Lohman* the Supreme Court held that Missouri's use tax scheme, under which the use tax did not correspond to a sales tax at the state level, was impermissibly discriminatory in violation of the Commerce Clause in localities in which the use tax exceeded the local sales tax. Missouri imposes a statewide sales tax on sales of goods within the state and an equivalent statewide use tax on goods brought into the state subsequent to an out-of-state purchase. The challenged tax was an additional use tax of one and a half percent imposed on the privilege of storing, using, or consuming within the state any article of personal property purchased outside the state. Though by its terms the additional use tax appeared to violate the Commerce Clause.

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4. Id. at 1355. See U.S. CONST. art. I, § 8, cl. 3. Although the Commerce Clause is stated as a grant of authority to Congress to regulate commerce among the states, it is well established that the Commerce Clause has a negative aspect that denies the states the right to discriminate against or burden the interstate flow of articles of commerce. See, e.g., Wyoming v. Oklahoma, 112 S. Ct. 789, 800 (1992); New Energy Co. of Indiana v. Limbach, 486 U.S. 269, 273 (1988).
5. Under the compensatory tax doctrine, the negative Commerce Clause is not violated if a tax, though facially discriminatory, imposes the equivalent of an identifiable and substantially similar tax on interstate commerce as that imposed on intrastate commerce. Maryland v. Louisiana, 451 U.S. 725, 758-59 (1981).
6. *Oregon Waste Sys.*, 114 S. Ct. at 1353-55. In a factually analogous case, the Supreme Court held that Alabama was prohibited by the negative Commerce Clause from imposing a higher fee on the disposal of hazardous waste from other states than on the disposal of identical waste from Alabama. Chemical Waste Management, Inc. v. Hunt, 112 S. Ct. 2009, 2012-14 (1992). However, the Court left open the possibility that such a surcharge might be valid if based on the cost of disposing of waste from other states. Id. at 2016, n.9.
8. U.S. Const. art. I, § 8, cl. 3.
prohibition against discrimination, the state argued that the tax was valid as a compensatory tax. Stating that the standard which must be met is a strict rule of equality, the Court held that under Missouri's use tax scheme, the discrepancy in those jurisdictions where the use tax exceeded the sales tax imposed a discriminatory burden on interstate commerce, because for a tax system to be compensatory the burdens on interstate and intrastate commerce must be equal.

Many of the cases and administrative decisions decided during the Survey period continued to interpret and define taxable services. The court of appeals addressed the telecommunications tax in Teleprofits of Texas, Inc. v. Sharp. Teleprofits, a regulated provider of telecommunications services, provided coin-operated telephone services. Teleprofits obtained access to a telephone network by purchasing customer-owned and coin-operated telephone lines through the local exchange company. Teleprofits then sold to individuals access to the telephone network from pay phones for charging twenty-five cents per local call.

Teleprofits brought suit claiming an exemption from sales tax under section 151.323(2) of the Tax Code, which exempts from sales tax the receipts from the sale, use, or other consumption of access to a local exchange telephone company's network by a regulated provider of telecommunications services. Teleprofits argued that since it is a regulated provider, the exemption should apply to all of its business transactions, thus providing a tax exemption both when Teleprofits bought access to a local network and when it sold that access to its customers. In denying the exemption, the court held that the exemption applies to Teleprofits' original purchase of access to a local network but does not exempt the subsequent sale of such access by Teleprofits to its customers. After engaging in a statutory construction analysis of the exemption, the court

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11. See supra note 4. See also Oregon Waste Sys., 114 S. Ct. at 1352.
14. The telecommunications tax was also addressed by the district court in Confidential Communications Corp. v. Sharp, No. 9201571 (167th Dist. Ct., Travis County, Tex., May 9, 1994) (holding that the provider of airtime for mobile phone and radio communications did not qualify for exemption under Tex. Tax Code Ann. §§ 151.323(2) or 151.323(3) (Vernon 1992)). See also Tex. Comp. Pub. Acc'ts, Hearing No. 30,273 (Feb. 28, 1994) (finding telegram and telegraph services are taxable telecommunications services); Tex. Comp. Pub. Acc'ts, Hearing No. 28,930 (June 15, 1993) (holding facsimile services are taxable telecommunications services).
15. 875 S.W.2d 748 (Tex. App.—Austin 1994, no writ).
17. Teleprofits, 875 S.W.2d at 750.
18. The court determined the statutory exemption was ambiguous in that the comptroller understood the exemption to apply only to the original sale of access to a regulated provider and Teleprofits understood the exemption to apply to all subsequent sales of access by a regulated provider; therefore, the court had to look to the standard rules of statutory construction to determine the meaning of the exemption. Id. at 750-751.
ultimately held the statute applies only when the local exchange carrier provides access to the regulated provider (Teleprofits in this case). 19

In Reuters Information Services, Inc. v. Sharp 20 the Austin Court of Appeals upheld the constitutionality of the sales tax as it applies to electronic information services, even though newspapers are specifically exempt from the sales tax. Reuters provided electronic news services to subscribers through satellite or telephone lines. The state argued that Reuters was providing taxable information services 21 to its customers, and despite Reuters' argument that the tax provisions are facially invalid because they are content based, the state maintained that the sole basis for the application of the tax to Reuters rested upon the format requirements of the newspaper exemption. 22

Reuters objected to the imposed tax on a variety of grounds. Reuters claimed that the tax violated its constitutional rights, including the free speech provisions and equal protection clauses of both the federal and state constitutions. 23 Additionally, Reuters argued that treating its news information services differently from print newspapers resulted in an unjustifiable tax on the press; Reuters argued it was an electronic newspaper and therefore part of the newspaper medium. The state responded that Reuters could not qualify for the newspaper exemption because the exemption rested upon the basis of how the message was conveyed, referring to the format distinctions with respect to price, newsprint, and frequency of distribution, rather than on the content of the message. The court agreed with the state, concluding that the service provided by Reuters, similar to the cable industry, presents information through a medium different from the print media. 24 The court concluded that the tax provisions were constitutional for three reasons: the tax was based on format requirements, not on the content of the speech; the tax was a generally applicable sales tax which did not single out the press or a small group thereof; and the newspaper exemption was rationally related to promoting literacy and administrative economy. 25

19. Id. at 752.
20. No. 3-93-124-CV (Tex. App.—Austin Dec. 7, 1994, n.w.h.) (slip op.).
21. The Tax Code defined “information service” as: (1) furnishing general or specialized news or other current information, including financial information, unless furnished to a newspaper of general circulation published at least as frequently as weekly or to a radio or television station licensed by the Federal Communications Commission; or (2) electronic data retrieval or research. Act of July 21, 1987, 70th Leg. 2d C.S., ch. 5, § 5, 1987 Tex. Gen. Laws 9, 11, amended by Act of May 15, 1991, 72d Leg., R.S., ch. 705, § 10, 1991 Tex. Gen. Laws 2521 (amended 1991) (current version at TEX. TAX CODE ANN. § 151.0038 (Vernon 1992)).
24. Reuters, No. 3-93-124-CV, slip. op. at 8-9. The United States Supreme Court has ruled that a sales tax on cable television services and on cable satellite services, while exempting the print media, does not violate the First Amendment. Leathers v. Medlock, 499 U.S. 439 (1991).
Direct Resources for Print, Inc. v. Sharp addressed the issue of whether the portion of a direct mail business which involved the printing of mailing addresses on envelopes by means of an ink jet machine was a taxable service pursuant to section 151.005(4) of the Tax Code, pertaining to printing or imprinting of tangible personal property, or pursuant to section 151.0101(a)(12), pertaining to data processing services. The comptroller argued both that the portion of the business which used the ink jet machine was a taxable printing or imprinting service and that such activity was a taxable data processing service, since the ink jet machine used computer components which allowed the machine to read addresses off magnetic tape and apply the addresses to envelopes. Direct Resources asserted that the addressing of envelopes was not a taxable activity and that the "essence of the transaction" was providing a non-taxable direct-mail service. Direct Resources also argued that its activities with respect to the addressing of envelopes by ink-jet machines did not meet the definition of printing, imprinting, or data processing. The district court granted summary judgment in favor of Direct Resources and the comptroller has filed an appeal.

Comptroller Hearing No. 29,507, holding that guided birdwatching trips are non-taxable, provided clarification of the exclusion from the definition of amusement services for "the provision of educational or health services if prescribed by a licensed practitioner of the healing arts for the primary purpose of educational or health maintenance or improvement." The tax division argued that the exemption language requires a person to obtain a doctor's prescription in order to engage in educational, primarily instructional activities. The administrative law judge disagreed with the tax division's reading of the exemption and held that pursuant to

27. TEX. TAX CODE ANN. § 151.005(4) (Vernon 1992).
29. Before services became subject to tax, taxpayers could avoid taxation by showing that the "essence of the transaction" was the transfer of a non-taxable service rather than the transfer of tangible personal property. See Bullock v. Statistical Tabulating Corp., 549 S.W.2d 166 (Tex. 1977). Under this test, "[i]f the object or essence of the sale is not tangible personal property, but instead concerns intangible property, such as a service, then the transaction is not taxable under any definition of sale." Comptroller v. Austin Multiple Listing Serv., Inc., 723 S.W.2d 163, 165 (Tex. App.—Austin 1986, no writ). See also First Nat'l Bank of Fort Worth v. Bullock, 584 S.W.2d 548 (Tex. Civ. App.—Austin 1979, writ ref'd n.r.e.).
30. See also Tex. Comp. Pub. Acc'ts, Hearing No. 31,134 (June 2, 1994), which held that the service of batching and paying freight bills was generally an accounts payable service achieved through the use of a computer and therefore was a taxable business accounting type of data processing.
31. Tex. Comp. Pub. Acc'ts, Hearing No. 29,507 (Feb. 9, 1994). Although guided birdwatching services may not be of widespread interest, the decision is noteworthy for its construction of a services tax.
Rule 3.298(a)(2), the services provided by taxpayer were not subject to tax because they were primarily instructional in nature.

The interpretation of the distinction between taxable remodeling and non-taxable new construction was the focus of several administrative decisions during the Survey period. Decision 31,904 involved press pits which were constructed by excavating fifteen feet below floor level and creating a room ten feet below ground level. Based upon the definition of new construction in Rule 3.357, which specifically includes the addition of new footage to an existing structure, the comptroller held that only new footage, not necessarily new floor footage, is required and therefore the addition was non-taxable new construction. In Decision 29,268 the comptroller allowed the taxpayer to use a bid proposal to prove non-taxable costs related to a lump-sum contract which involved both new construction and remodeling. The services involved constructing a new building beside an existing building and demolishing the wall between the two buildings to create one large building. The contract referenced a lump-sum price but also incorporated the bid proposal, which did not allocate costs between new construction and remodeling but separately stated a variety of charges. The comptroller held that the charges in the bid proposal that strictly related to the construction of the new building were not subject to tax, and those charges not sufficiently attributable to either new construction or remodeling were treated as taxable remodeling.

Decision 30,394 addressed the definition of real property services in connection with a taxpayer whose business included the demolition of buildings and the collection and removal of the demolished remains. The taxpayer’s customers were billed one tax-free lump-sum amount covering

33. 34 TEX. ADMIN. CODE § 3.298(a)(2) (West 1994).
34. The taxpayer’s business was organizing, promoting and conducting trips for the observation and identification of different birds. The decision noted that the guide services conducted by taxpayer were primarily instructional and the participants in the trips included educators and serious students of ornithology.
36. 34 TEX. ADMIN. CODE § 3.357(a)(4) (West 1994).
37. The tax division interpreted the definition of new construction to require additional floor footage be created and argued that the construction at issue did not meet the definition of new construction because it did not add new floor space to the building, the building’s total square footage remained the same. The administrative law judge rejected the tax division’s restrictive reading of the exemption and concluded that “the Tax Division’s interpretation of Rule 3.357 misreads the Rule’s plain language”. Tex. Comp. Pub. Acc’ts, Hearing No. 31,904 (May 12, 1994).
38. See also Tex. Comp. Pub. Acc’ts, Hearing No. 29,296 (Dec. 20, 1993)(holding that the initial underground installation of a large scale for weighing rail cars created new footage, so the labor to install the scale was not taxable; also finding that the replacement of old equipment with new equipment was taxable remodeling and did not qualify as new construction); Tex. Comp. Pub. Acc’ts, Hearing No. 30,086 (July 18, 1994) (holding the construction and installation of a 20,000 gallon tank was new construction on the basis that the tank was an improvement to realty).
40. Id.
the demolition and the removal of the demolished materials. The taxpayer argued that its removal service was not a taxable real property service, because the plain and common meaning of the term garbage does not include the remnants from demolition. The comptroller disagreed with the taxpayer and held that demolished construction materials collected and removed clearly fall within the meaning of the term “rubbish.” The taxpayer’s services were held taxable pursuant to Rule 3.356(i)(2), which provides that where non-taxable and taxable services are sold for one lump-sum price, and the portion relating to taxable services represents more than five percent of total charge, the total charge is taxable. The decision also addressed the application of the essence of the transaction doctrine to a transaction which involves only services. The comptroller held that even if the essence of the transaction test were applicable, the taxpayer was hired to perform two services, one taxable and one non-taxable, and the test is therefore of no avail.

The exemption for sales to governmental entities was addressed in Decision 28,475, which involved the sale of office furniture and supplies to a construction manager under contract with the Department of Energy (DOE). In holding that the sale was not an exempt sale to the government, the decision focused on the following facts: the contractor had a cost-plus contract to furnish all materials and supplies necessary to perform the job; title to all materials and supplies passed directly from the seller to the DOE; the contractor contracted with the seller in its own name and was prohibited from binding the DOE; and the DOE was obligated to reimburse the contractor for the items purchased but was not bound by the contractor’s purchase contracts. The administrative law judge noted that if a taxpayer-purchaser made purchases for resale to the government and failed to issue a resale certificate, an exemption could still be claimed upon demonstration that the purchase was for purpose of resale. However, as in this case, a taxpayer-seller has a duty to collect

42. Tex. Tax Code Ann. § 151.0048 (Vernon 1992 & Supp. 1995) defines real property service to include the removal or collection of garbage, rubbish, or other solid waste, with the exception of certain enumerated exceptions relating to hazardous waste or sewage.

43. 34 Tex. Admin. Code § 3.356(i)(2) (West 1994).

44. Id. The taxpayer made an interesting argument that since the demolition services are not statutorily subject to tax, but were held taxable under Rule 3.356(i), the rule improperly taxes services outside the statutory authority and should therefore be invalid and unconstitutional on the basis that the comptroller does not have the power to expand the reach of the statute to tax services not established by the legislature to be subject to tax. The administrative law judge concluded that the rule is based on a grant of legislative power and is a reasonable and legitimate exercise of the comptroller’s authority. Tex. Comp. Pub. Acc’ts, Hearing No. 30,394 (Sept. 21, 1994).

45. Id. See also Tex. Comp. Pub. Acc’ts, Hearing No. 32,247 (Oct. 4, 1994) (holding that asbestos removal services are taxable as real property repair and remodeling).


47. Though not argued by either party, the administrative law judge addressed whether title could have passed from the seller to the contractor and then from the contractor to the DOE. The administrative law judge concluded that even if title had passed in such a manner, the sale to the contractor would not have been exempt because of the seller’s failure to obtain a resale certificate within the prescribed time limitations. Id.

48. Id.
and remit tax and must receive a properly completed resale certificate to avoid liability.49

Decision 29,34550 focused on software maintenance services performed on custom computer software, which were sold by the taxpayer to one of its affiliates. Section 151.346(c) of the Tax Code51 allows an exemption from tax services to certain affiliates, provided such services were not taxable prior to September 1, 1987.52 The administrative law judge correctly concluded that maintenance services on custom computer programs is a service that was not taxable on or prior to September 1, 1987,53 and that such services therefore may qualify for exemption.54

Following the 1992 United States Supreme Court decision in Quill Corp. v. North Dakota,55 out-of-state taxpayers continue to struggle to


51. TEX. TAX CODE ANN. § 151.346(c) (Vernon 1992).
52. E.g., data processing services and information services.
53. Id. The taxpayer argued successfully that maintenance of custom computer programs was not taxable prior to September 1, 1987 since the Tax Code definition of "tangible personal property" excluded custom computer programs until October 1987. In other words, prior to the relevant date, custom computer software was not considered tangible personal property; therefore, maintenance of the custom computer software was not a taxable service. See Act of July 13, 1984, 68th Leg., 2d C.S., ch. 31, art. 6, § 2, 1984 Tex. Gen. Laws 222 (amended 1987) (current version at TEX. TAX CODE ANN. § 151.009 (Vernon 1992)).
55. 112 S. Ct. 1904, 1912-13 (1992). In Quill, the United States Supreme Court held that a North Dakota use tax requiring certain out-of-state vendors to collect the state's use tax violated the Commerce Clause. Id.
understand when “nexus” is established for Texas sales and use tax purposes. Decision 30,661 involved a Louisiana mail-order company which did not have sales representatives, agents, or employees residing in Texas, did not service or repair any of its products in Texas, and did not publicly advertise in Texas. The corporation sent employees to participate in at least two trade shows in Texas to exhibit the corporation’s products. The decision held that sufficient nexus was established by sending representatives to Texas trade shows to market merchandise and generate Texas sales, and therefore the corporation was required to collect Texas use tax.57

Several administrative decisions addressed the issue of when a taxable sale has occurred. Decision 30,273 upheld the comptroller’s informal rule that a sale of cellular phones for less than twenty-five percent of the dealer’s cost is not a sale for sales tax purposes; therefore, the dealer’s purchase, according to this decision, does not qualify as an exempt sale for resale. Decision 30,303 involved a corporation that sold industrial machines, some of which were set up in a showroom in order to demonstrate the machines to potential customers. For financial accounting and federal income tax purposes, the corporation depreciated the showroom machines. All of the showroom machines were sold at full price with no discount, and upon sale the corporation recaptured the depreciation it had previously taken for federal tax purposes. The tax division argued that depreciation of the showroom machines for federal income tax purposes subjects the machines to tax, unless applicable returns are amended to reverse the depreciation. The comptroller held that sales tax was not applicable because the machines were sold for full list price and the depreciation previously taken was recaptured for tax purposes, resulting in the functional equivalent to an amendment of the corporation’s returns. However, in Decision 31,350, the comptroller held that when returns were not amended to reverse depreciation deductions, the depreciation of an asset for tax purposes constituted a taxable “use” and sales tax was due on the original purchase.

57. Id. The corporation argued that its representatives that visit Texas are not salesmen and are not sent to Texas to take orders; however, the administrative law judge found such distinction without merit. Id.
58. Id. In another decision addressing nexus, the comptroller held that independent contractor distributors located in Texas that sell or take orders for products of an out-of-state corporation imposed sufficient presence to establish nexus for use tax collection purposes. Tex. Comp. Pub. Acc’ts, Hearing No. 30,495 (May 5, 1994).
61. The corporation’s parent company was a foreign corporation whose applicable tax law allows demonstration inventory items to be depreciated.
64. Id.
In Decision 30,151\textsuperscript{65} the comptroller was faced with a situation not previously addressed. The taxpayer performed testing services for a corporation. The corporation leased to the taxpayer testing equipment used to perform some of the tests on the corporation's products; however, the lease agreement was silent as to consideration. Generally, the taxpayer charged the corporation a discounted price for tests performed using the equipment from the corporation. The taxpayer took the position that sales tax was not applicable to the transfer of the equipment from the corporation to the taxpayer because there was no payment and no consideration in connection with the transfer. The comptroller, however, concluded that a taxable sale occurred, that sales tax was applicable to the consideration for the sale, and that the consideration should be measured by the differential favoring use of the corporation's equipment (\textit{i.e.}, the savings experienced by the corporation and the loss suffered by the taxpayer).\textsuperscript{66}

Decision 30,984\textsuperscript{67} upheld the comptroller’s recent change of policy regarding the prior contract rule\textsuperscript{68} and found that the prior contract exemption applies only to third-party contracts.\textsuperscript{69} The decision acknowledged that the comptroller had adopted Rule 3.319\textsuperscript{70}, which extended the prior contract exemption to two-party contracts. Further, the comptroller’s policy had been to allow two-party contracts to qualify for the exemption. However, in 1992 the comptroller instituted a policy change and, as a result, only third-party contracts could qualify for exemption as a prior contract. The taxpayer argued that Rule 3.319\textsuperscript{71} should be afforded the full force and effect of legislation and that the comptroller cannot simply change his mind. The administrative law judge held that the comptroller’s rule cannot be accorded any weight and does not have the full force and effect of legislation because the comptroller was without authority to adopt a rule that was contrary to the laws of the state.\textsuperscript{72} According to the

\textsuperscript{66.} Id.
\textsuperscript{67.} Id.
\textsuperscript{70.} 34 Tex. Admin. Code § 3.319(b) (West 1994). In adopting an amendment to Rule 3.319(b), the comptroller specifically stated in the preamble that such amendment was made to clarify the application of the rule to two-party contracts. See 13 Tex. Reg. 1340 (1988) (prop. amend. to 34 Tex. Admin. Code § 3.319).
\textsuperscript{71.} 34 Tex. Admin. Code § 3.319 (West 1994).
\textsuperscript{72.} Tex. Comp. Pub. Acc'ts, Hearing No. 30,984 (Aug. 12, 1994). This decision is based upon Calvert v. British-American Oil Producing Co., 397 S.W.2d 839 (Tex. 1965), which interpreted some earlier prior contract statutory exemption as applying to third-party contracts only. The comptroller agrees, however, that the three-party contract requirement does not apply to services that first became taxable in 1987.
decision, the fact that Rule 3.319(b)\footnote{34 Tex. Admin. Code § 3.319(b) (West 1994).} has yet to be formally amended has no bearing on the fact that such portion of the rule is void and unenforceable because of the conflict with the Texas Supreme Court’s interpretation of the prior contract rule.\footnote{See British-American, 397 S.W.2d at 839. Since at least one prior contract case has already been filed at the courthouse, taxpayers will have another opportunity to point out the comptroller’s inconsistent view on this issue and to argue that this inconsistency results in treating similarly situated taxpayers differently.}

Decision 30,768\footnote{Tex. Comp. Pub. Acc’ts, Hearing No. 30,137 (Jan. 24, 1994).} held that resale certificates which did not contain descriptions of the taxable items generally sold by the purchasers were not accepted by the seller in good faith and the sales were thus taxable. In Decision 29,692\footnote{Id.} the taxpayer accepted a properly completed resale certificate from a related company with respect to items the tax division claimed were not purchased for resale. The tax division argued that the taxpayer could not accept a resale certificate in good faith from a related company because the taxpayer is charged with knowledge as to the use of the purchased items by the related company.\footnote{Id.} The administrative law judge found the resale certificate sufficient and held that the tax division failed to prove that the taxpayer knew of any divergent or improper use.\footnote{Id.} The decision also noted that if tax resulted from a divergent use, the liability for such tax would be on the buyer.\footnote{Id.}

Numerous procedural issues applicable to sales and use taxes were decided by the courts as well as at the administrative level. These issues included burden of proof with respect to taxable services, successor liability, refund sampling and prepayment as a prerequisite to judicial review.\footnote{Discussed \textit{infra} at notes 203-48 and accompanying text.}

The comptroller, working with representatives of the broadcast industry to formulate guidelines, also confirmed, informally, that broadcasters who produce television and radio programs for consideration qualify for the manufacturing exemption\footnote{Tex. Tax Code Ann. § 151.31(p) (Vernon 1992 & Supp. 1995).} for purchases of materials necessary, essential to, and used directly in the production of the programs, and for machinery, equipment, and accessories used directly in the production of the programs. The exemption is also applicable to rented or leased machinery and equipment used in the production.\footnote{Id.}
B. Regulatory Developments

The comptroller proposed revisions to Rule 3.319 in 1993 to reflect the policy change that the prior contract exemption would only be applicable to third-party contracts; however, those revisions lapsed without being adopted. Therefore, during the Survey period, the rule continued to contain language previously held to be applicable to two-party contracts.

To bring the rules into conformity with the 1993 amendments to the Tax Code adopted by the Seventy-Third Legislature, the comptroller amended several rules during the Survey period. Rule 3.316, which sets forth the criteria for a qualifying sale of a business or an identifiable segment of a business, was revised to refer specifically to tangible personal property in the definition of operating assets. To conform the rule to the 1993 amendment to section 151.304 of the Tax Code, subsection (i) was added to specifically require a purchaser who holds a tax permit to accrue and remit tax on a transaction in which the seller qualifies for an occasional sale exemption. Rule 3.329 was also amended to reflect changes to section 151.429 of the Tax Code, which allows a sales tax refund for jobs retained, as well as jobs created, by an enterprise project.

The comptroller has amended various rules to conform with the addition of section 151.350 of the Tax Code during the 1993 legislative session, in which the legislature adopted an exemption for labor used to repair tangible personal property damaged within a disaster area. Rules 3.292 and 3.310 were amended to exempt labor used to repair tangible personal property in a disaster area if the amount of the charge for labor is separately itemized, and the repair is to property damaged within a disaster area by the condition that caused the area to be declared a disas-

85. 34 Tex. Admin. Code § 3.319(b) (West 1994).
86. For a discussion of the significant 1993 legislative changes affecting Texas sales tax, see 1994 Tax Survey, at 1654-57. In addition, many of the amendments that became effective during the Survey period were adopted without changes from the proposed form discussed supra note 74.
88. Prior to the 1994 revision, the definition of operating assets did not include the reference to tangible personal property, although former Rule 3.316(d)(4) made clear that intangibles and real property were excluded from the definition. See 34 Tex. Admin. Code § 3.316(d)(4) (West 1994).
90. 19 Tex. Reg. 2959 (1994) (codified at 34 Tex. Admin. Code § 3.316(i)).
93. Id.
94. Id. § 151.350 (Vernon Supp. 1995).
The comptroller proposed revisions to Rules 3.330, 3.333, 3.342, 3.343, 3.354, 3.355, 3.356 and 3.357, concerning data processing services, security services, information services, credit reporting services, debt collection services, insurance services, real property services, and labor relating to nonresidential real property repair, remodeling, restoration, new construction, and residential property. The revisions modify the existing five percent rule and allow for the separation of non-taxable charges for unrelated services subsequent to the execution of a contract that includes taxable services. The service provider will be able to establish, after the transaction occurs, the percentage of the total charge that relates to non-taxable unrelated services and tax will be due only on the portion of the charge that relates to taxable services. Most importantly, the proposed rules state these revisions will be applied retroactively.

II. FRANCHISE TAX

A. LIABILITY FOR TAX — DOING BUSINESS IN TEXAS

Four years after the enactment of legislation that effectively subjected Texas taxpayers to a corporate income tax, taxpayers continue to restructure businesses in an effort to mitigate the effects of a four and a half percent tax that, many taxpayers claim, has the effect of taxing income earned prior to enactment of the statute.

Much speculation occurred during the Survey period as to whether the comptroller intended to assert that limited partners or holders of a beneficial interest in a trust have nexus with Texas for franchise tax purposes, merely by virtue of such interests, if the underlying partnership or trust is doing business in Texas. To place this speculation in context, it is important to note that some taxpayers have sought to escape franchise tax by converting from an entity that, by its nature, is subject to the tax (i.e., a

99. Under the current rule, when non-taxable unrelated services and taxable services are sold or purchased for a single charge and the taxable services are greater than five percent of the total charge, the entire single charge is presumed taxable. See, e.g., 34 Tex. Admin. Code §§ 3.330(d)(2), 3.333(h)(2), 3.342(f)(2) (West 1994).
103. See infra note 116 and accompanying text.
corporation\textsuperscript{104} to an entity that, by its nature, is not subject to tax (e.g., a partnership or a trust). Since business reasons often demand limited liability, these restructurings often involve using a partnership or trust in conjunction with a corporation. One alternative involves doing business in a limited partnership; a corporation may become a partner in a partnership to which it contributes its business assets and activities. Because the comptroller treats a general partner as doing business in Texas if the partnership is doing business in Texas,\textsuperscript{105} the general partner will be subject to franchise tax and therefore is normally allocated only a minimal interest (as in one percent) in the partnership. The other partner(s) in the partnership are generally limited partners that are intended to have no nexus with Texas.\textsuperscript{106} When this structure is properly implemented, neither the partnership nor the limited partner is subject to franchise tax; rather, only the general partner's small share of income is subject to the earned surplus component of the franchise tax.

A second alternative adopted by some taxpayers involves moving their business assets and activities into a business trust designed to be treated as a corporation for federal income tax purposes. Since trusts are not subject to the franchise tax,\textsuperscript{107} the trust's income should not be subject to the franchise tax. Distributions from the trust are designed to be dividends for federal tax purposes, and therefore excludable from the income of the trust's corporate parent.

Because of widespread publicity about the partnership plan, many speculated that the comptroller would assert that a corporation holding a limited partnership interest in a partnership which does business in Texas is, by virtue of that interest, doing business in Texas. However, as of the end of the Survey period, the comptroller had indicated that he does not intend (for now, at least) to adopt that position. If the comptroller changed his mind, he would likely propose legislation to extend the tax to limited partners. However, in view of the well-established regulation stating explicitly that limited partners are not subject to franchise tax solely as a result of their partnership interest,\textsuperscript{108} it is likely that the comptroller does not have the regulatory authority to change this interpretation.\textsuperscript{109}

\textsuperscript{104} See \textit{Tex. Tax Code Ann.} § 171.001 (Vernon 1992 & Supp. 1995), which imposes franchise tax on corporations, as defined therein, doing business in Texas.

\textsuperscript{105} See 34 \textit{Tex. Admin. Code} §§ 3.546(c)(12)(A) (West 1994) (acting as a general partner in a general partnership which is doing business in Texas listed as an example of doing business) and 3.554(d)(20) (conducting activity listed as doing business in § 3.546 is doing business) (see 18 Tex. Reg. 5652-54 (Aug. 24, 1993) for text of Rule 3.554).

\textsuperscript{106} See 34 \textit{Tex. Admin. Code} § 3.546(c)(12)(B) (holding a limited partnership interest is not sufficient, without more, to constitute doing business in Texas).

\textsuperscript{107} As noted at text accompanying \textit{supra} note 104, only corporations, as defined in the Texas Tax Code, are subject to the tax. Texas has long recognized that an unincorporated trust under state law is a trust for franchise tax purposes, regardless of its characterization for federal income tax purposes.

\textsuperscript{108} See \textit{supra} note 106 and accompanying text.

\textsuperscript{109} Although there was widespread speculation in early 1994 that the comptroller would seek legislation in the 1995 session to treat such a limited partner as subject to the
In response to the business trust plan, the comptroller has asserted that the trust's beneficiary (generally the corporate parent or other affiliate of the trust for federal income tax purposes) has nexus with Texas if it controls the trust. However, this response meets the comptroller's goal (of taxing the trust's income) only if the comptroller can also succeed in arguing that the trust's income should be included in the corporate beneficiary's income for franchise tax purposes, notwithstanding the fact that the income is distributed as a dividend.

The comptroller's Preliminary Legislative Proposals for the 1995 regular session did not include legislation to extend the tax to limited partners, or to tax trusts and partnerships. Thus, although there is no guarantee that the legislature will not adopt such changes, most state tax practitioners do not expect dramatic franchise tax changes from the 1995 Legislature. Nonetheless, some of the proposed "clean-up" changes are noteworthy. The plan to follow the most current Internal Revenue Code (rather than the 1990 version required by the current statute) means, for example, that taxpayers will no longer be required to compute separately for federal and state purposes the deductions for amortization of intangible assets and for business entertainment. On the other hand, since some of the differences between the former and current Internal Revenue Codes reduce the deductions available to taxpayers, this change will effectively increase franchise tax burden for some taxpayers.

In the controversial arena of extending jurisdiction to taxpayers who sell intangibles in the state, Texas, like other states, continues to grapple with the impact of Geoffrey, Inc. v. South Carolina Tax Commission. As of the end of the Survey period, Texas, recognizing the difficulty (both from a practical and legal standpoint) of structuring a set of rules to address the taxation of companies licensing intangibles in the state, had not adopted regulations or proposed legislation to change Texas law in this arena. Moreover, comptroller representatives consistently confirmed franchise tax, as of the end of the Survey period, the comptroller was not planning to propose such legislation.

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110. See, e.g., Letter: Franchise Tax, TAX POLICY NEWS, Dec. 1994, at 3 (summarizing a ruling in which the comptroller concluded that a Pennsylvania Business Trust doing business in Texas is not subject to Texas franchise tax since it is not a corporation, limited liability company, bank, or savings and loan under Pennsylvania law. However, the comptroller also concluded that a corporation that has direct or indirect control over such a trust (including control over the trustee) is subject to tax (summarizing microfiche 1315G09)).

111. These draft proposals are dated June 24, 1994.


114. The comptroller has prepared a sample worksheet for C corporations reversing the effects of the Revenue Reconciliation Act of 1993 that lists the differences between the 1990 Internal Revenue Code and the current Code.


116. While many taxpayers are worried that Texas' adopting the Geoffrey test would increase taxes, some companies might benefit from the adoption. Under TEX. TAX CODE ANN. §§ 171.103(1) (Vernon 1992) and 171.1032(a)(1) (Vernon 1992 & Supp. 1995) (the
that the comptroller did not intend to assert that franchise tax is owed by corporations whose sole connection to Texas during 1994 was the licensing of intangibles into the state.\textsuperscript{117} Nonetheless, in other areas, taxpayers and the comptroller disagreed as to the reach of the state’s taxing authority. \textit{Lawrence Industries, Inc. v. Sharp},\textsuperscript{118} for example, focused on the degree of activity required to constitute doing business in Texas for franchise tax purposes. Although there was conflicting testimony as to some of the facts,\textsuperscript{119} the lower court held that the corporation’s principal place of business was in Texas and that it managed and directed at least some of the affairs of its subsidiaries from Texas.\textsuperscript{120} The court concluded that these activities easily fell within the doing business standards, and that Lawrence therefore had nexus with Texas.

\section*{B. Calculation and Allocation of Taxable Capital and Earned Surplus}

Judicial and administrative cases continue to focus on how to calculate taxable capital for franchise tax purposes. In \textit{Browning-Ferris Industries v. Bullock},\textsuperscript{121} the district court held that intercompany payables are receipts to the parent corporation. \textit{Tandy Corporation v. Sharp}\textsuperscript{122} addressed the proper computation of receipts for the survivor of a merger

\textsuperscript{117}This position is decidedly more advantageous to taxpayers than the comptroller’s November 1993 announcement that a corporation licensing intangibles into the state would, effective January 1, 1994, be considered “doing business” in Texas and therefore have nexus for franchise tax purposes. \textit{Tax Policy News}, Nov. 1993, at 6.

\textsuperscript{118}890 S.W.2d 886 (Tex. App.—Austin 1994, writ requested). \textit{See also} Tex. Comp. Pub. Acc’ts, Hearing No. 29,608 (June 3, 1994) (acknowledging that “this is a close case,” the administrative law judge held that petitioner had provided some services and that petitioner’s employees had “occasionally made trips to Texas to facilitate some portion of Petitioner’s business”; although the petitioner disputed the tax division’s characterization of facts, the taxpayer could not produce proof to rebut the tax division’s assertions).

\textsuperscript{119}The court of appeals focused in part on whether the issues presented on appeal were issues of fact or law, and determined that the finding that Lawrence was doing business in Texas was the “ultimate finding of fact.” 890 S.W.2d at 888-89.

\textsuperscript{120}Particularly damning, in the court’s view, was the fact that Lawrence’s Delaware franchise tax return for the year had listed Conroe, Texas as Lawrence’s “principal place of business outside of Delaware.” \textit{Id.} at 890.

\textsuperscript{121}No. 392,894 (353d Dist. Ct., Travis County, Tex., Apr. 6, 1994) (judge ruled for state following Sept. 27, 1993 bench trial).

\textsuperscript{122}872 S.W.2d 814 (Tex. App.—Austin 1994, writ denied).
under section 171.153(c) as then in effect. The rules on calculating franchise taxes following a merger in section 171.153(c) required Tandy to calculate its receipts for both its 1986 report year and its 1987 report year by reference to periods that included an overlapping period of time (and receipts). The effect was to require Tandy to include an extraordinarily large Texas receipt ($100,000,000) in both years’ calculations of receipts. Effectively, Tandy argued, it was taxed twice on the same receipts. According to Tandy, the comptroller’s interpretation of section 171.153(c), providing an alternate reporting period for the period following certain mergers, was not based on determining “business done” during the preceding year, and was therefore an incorrect interpretation of the law. The court refused to accept Tandy’s argument that “business done” is distinct from “financial condition” in the statute and held that “[d]espite the hardship imposed on this taxpayer under these circumstances,” the comptroller’s interpretation is correct.

General Dynamics Corp. v. Sharp, which challenges the 1991 enactment of the earned surplus component of the franchise tax, was still pending at the end of the Survey period, although cross-motions for summary judgment were set for hearing in January 1995. General Dynamics has argued that, by modifying the franchise tax in 1991, the legislature enacted a retroactive income tax, in violation of both the Texas and United States Constitutions. General Dynamics had entered into a contract with the United States in 1984, and elected to report its income for federal income tax purposes on the “completed contract” method, so that most of its income on the contract was not reported until the contract was complete. General Dynamics’ first tax return to be filed after the 1991 enactment of the earned surplus tax was based on the company’s 1991 income. Unfortunately for General Dynamics, 1991 was the year in which the company accrued its net income on the 1984 contract — $974 million. Thus, the timing of the franchise tax effective date proved very expensive for General Dynamics. Recognizing that Texas courts have not addressed the precise question raised by its challenge to the franchise tax, General Dynamics’ briefs rely heavily on several Ohio cases. In briefs

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124. 872 S.W.2d at 817.
125. Id.
126. Id. at 818. The parties agreed that the § 171.153 provision at issue had been designed to thwart taxpayers who were trying to take advantage of a previously-existing tax loophole. It was, for Tandy, a loophole closing that proved to have unanticipated costs. Id.
129. See, e.g., Lakengren, Inc. v. Kosydar, 339 N.E. 2d 814 (Ohio 1975). This reliance on Ohio law is not without basis, since the Texas Legislature borrowed from Ohio’s statutes in enacting Texas franchise law and since the states have similar constitutional restraints on retroactive laws. Cf. Tex. Const. art. I, § 16 (“[N]o . . . retroactive law or any
in another franchise tax case, the comptroller has stated that *General Dynamics* implicates most of the franchise tax revenue for the 1992 report year. In addressing General Dynamics' arguments, the court may ultimately focus not only on the retroactive nature of the tax, but also on the extent to which taxpayers had remedies available to mitigate the impact of the new tax.

*Texas Utilities Electric Co. v. Sharp* is one of several cases still pending in which taxpayers have challenged the comptroller's assertion that operating lease obligations are not "debt" within the meaning of section 171.109(a)(3), and therefore may not be deducted from surplus. Other pending cases focus on the deductibility from surplus of pension and other post-retirement benefits as debts, as taxpayers argue that section 171.109(j)(1) is effectively a substantive law change applied retroactively.

In *Harken Oil & Gas, Inc. v. Sharp*, the Austin Court of Appeals affirmed the district court's holding that the pre-acquisition earnings of a second-tier subsidiary may not be deducted from surplus. Although the appellate court did not overrule *State v. Sun Refining & Marketing, Inc.*, on which the taxpayer had relied, the court so limited *Sun Refining* to its facts that, on this issue, the case will likely not be relied on again unless the Texas Supreme Court holds differently from *Harken*.

While many franchise tax cases are pending, several of the numerous administrative hearing decisions issued during the Survey period focused...
on the same issues,139 such as debt versus equity characterizations,140 push-down accounting,141 and the need to declare dividends formally in order to reduce the declaring corporation's surplus.142

In addition, several administrative decisions focus on the types of accounting changes the comptroller will permit.143 In one decision, for example, the comptroller correctly held as acceptable a pre-planned conversion from the double declining balance method of depreciation to the straight line method in accordance with the depreciation rules under the Internal Revenue Code. The tax division had argued that this automatic change somehow constituted choosing a different method of accounting, so that a corporation could not make such a change more than once every four years without the comptroller's consent.144


140. See, e.g., Tex. Comp. Pub. Acc'ts, Hearing No. 29,990 (Feb. 16, 1994) (intercorporate advances from corporate family members should not be reclassified as surplus; taxpayer had consistently treated the intercompany advances as debts on its books, tax returns, and financial statements; taxpayer's debt-to-equity ratios were at least as good as the ratios set forth in other cited comptroller decisions; decision reviews comptroller's debt-equity criteria); see also Tex. Comp. Pub. Acc'ts, Hearing No. 30,444 (Feb. 8, 1994) (preferred stock not debt for franchise tax purposes); TAX POLICY NEWS, Aug. 1994, at 5 (noting that dividends are excluded from taxable capital as of the date of declaration if they are declared in accordance with the state of incorporation law and are paid within one year).


142. Tex. Comp. Pub. Acc'ts, Hearing No. 32,584 (Dec. 29, 1994) (dividend not excluded from surplus until date of formal declaration by board, although book entries and intent to declare dividend were earlier).


As noted above, 1995 legislative changes are likely to impact calculation of the earned surplus tax to the extent the franchise tax is calculated by reference to the 1990 Internal Revenue Code. Also, as Texas tax principles become more tied to unitary issues and to constitutional challenges, non-Texas cases take on increased significance to Texas taxpayers.

C. Regulatory Developments

The comptroller revised only a handful of franchise tax rules during the Survey period. The rule on nexus for earned surplus purposes was adopted without changes from the version proposed in August 1993. This rule, which reflects much of the Multistate Tax Commission's analysis of Public Law 86-272, adopts the "constitutional limit standard" for nexus, and provides numerous specific examples of activities that may be protected from state tax by Public Law 86-272.

Three other rules became effective in February 1994: the rules on officer and director compensation for earned surplus purposes, limited liability companies, and provisional exemptions (dealing with exemptions for corporations that have applied to the Internal Revenue Service for an exemption from federal income tax). The limited liability company rule states that such entities will generally be taxed as though they were a C corporation, and provides some rules for determining

145. The Texas Tax Code was tied to the 1990 Internal Revenue Code because the Texas drafters were concerned that allowing the franchise tax to be based on federal legislation would be treated as an improper delegation of Texas legislative power to the federal government; by contrast, however, Texas legislators provided that the franchise tax would be based on GAAP. In view of this contrast, it is not too surprising that the state's reliance on GAAP has been challenged as an unconstitutional delegation of power to the Financial Accounting Standards Board. See supra note 99 and accompanying text.

146. In Barclays Bank P.L.C. v. Franchise Tax Board of California, 114 S. Ct. 2268, 2276-77 (1994), one of the most eagerly-awaited Supreme Court state tax cases in years, the Court held that worldwide combined reporting for unitary business groups with a foreign parent did not violate Commerce Clause or Due Process Clause of the United States Constitution. In the companion case, Colgate-Palmolive Co., id., the Court confirmed that worldwide combined reporting was constitutional as applied to worldwide unitary group with a United States-based parent.


150. 19 Tex. Reg. 633 (1994) (codified at 34 Tex. Admin. Code § 3.558). The preliminary budget estimates that accompanied the 1991 enactment of the earned surplus component of the franchise tax had projected that as much as half of the revenue to be generated by the franchise tax revisions would result from theTex. Tax Code Ann. § 171.110(b) (Vernon 1992) add-back of officer and director compensation; however, the actual tax increase attributed to the add-back has been much lower than those revenue estimates. See also 1994 Tax Survey at 1662-63 and accompanying text for discussion.


III. PROPERTY TAX

A. Application of the Tax

In a case of first impression, a Harris County Court of Appeals in Spring Indep. Sch. Dist. v. Harris County Appraisal Dist. held that Sections 23.12(f) and (g) of the Tax Code are unconstitutional. These sections allow owners of inventory to elect to have their inventory appraised as of September 1 of the year preceding the tax year rather than January 1 of the tax year. In this case, Enron elected to have its natural gas inventory appraised as of September 1, 1989, instead of January 1, 1990. On September 1, the inventory was valued at approximately $78.3 million versus the approximately $93.2 value that would have been placed on the inventory had it been valued as of January 1, 1990 (because a larger amount of gas was stored on January 1). As a result of Enron’s ability to elect to value the inventory on September 1 instead of January 1, Spring I.S.D. asserted that it lost over $220,000 in tax revenue for the 1990 tax year.

The court ruled that the statutes violate three distinct principles set forth in the Texas Constitution: (i) taxation must be equal and uniform; (ii) all property must be taxed in proportion to its value; and (iii) the Texas Legislature may not exempt property without constitutional authorization. In concluding that sections 23.12(f) and (g) violate principles of equality and uniformity, the court reasoned that the statutes treat inventory differently from non-inventory and that there is not a rational basis for the disparate treatment, given that the sole purpose of enabling

154. Id. (codified at 34 Tex. Admin. Code § 3.562(h)(2)(A)).
155. 889 S.W.2d 562 (Tex. App.—Houston [14th Dist.] 1994, n.w.h.).
157. Spring I.S.D., 889 S.W.2d at 567.
158. Tex. Tax Code Ann. § 23.12(f) (Vernon Supp. 1995). Section 23.12(f) allows the owners of inventory other than motor vehicles to elect to have their inventory appraised at market value of September 1 of the year preceding the relevant tax year by filing an application with the chief appraiser requesting such valuation. The application applies to tax years beginning after the next August 1 following the date the application is filed unless the owner later revokes the election before September 1 of the following year. Id.
159. Tex. Const. art. VIII, § 1(a).
160. Id. art. VIII, § 1(b).
161. Id. art. VIII, § 2.
inventory owners to choose what the court views as an arbitrary valuation date is to lower inventory owners' tax burden.\textsuperscript{162}

With respect to the conclusion that sections 23.12(f) and (g) cause property not to be taxed in proportion to value, the court noted that Enron's natural gas was located in the same reservoir as other natural gas that was valued as of January 1 (because not all other gas owners made the election to value the gas as of September 1), and reasoned that using two different values for the same property creates an ambiguity concerning the natural gas' value and results in the property not being taxed in proportion to value.\textsuperscript{163} Finally, the court reasoned that by allowing a September 1 valuation date, inventory added after September 1 and before January 1 is effectively exempted from tax for the year. The Texas Constitution provides that the Texas Legislature cannot expand the property tax exemptions required or permitted by the Texas Constitution. Given that the Texas Constitution does not permit a special exemption for inventory,\textsuperscript{164} the court concluded that sections 23.12(f) and (g) unconstitutionally exempt property from taxation.\textsuperscript{165}

Several cases during the Survey period addressed the constitutionality of taxation of in-transit personal property. These cases are an indication that Texas courts narrowly interpret, in the context of property taxation, the Commerce Clause\textsuperscript{166} and the Import-Export Clause\textsuperscript{167} of the United States Constitution. In \textit{Harris County Appraisal Dist. v. Virginia Indonesia Co.},\textsuperscript{168} a Houston Court of Appeals reversed the lower court's summary judgment in favor of the taxpayer, Virginia Indonesia Company (VICO), that the appraisal district's assessment of property taxes against

\textsuperscript{162} \textit{Spring I.S.D.}, 889 S.W.2d at 566. If this opinion is upheld on appeal, it may offer taxing authorities an additional argument for setting aside the inventory valuations of businesses that have established related corporations, with different valuation dates, to own inventory at different times of the year.

\textsuperscript{163} \textit{id.} at 568.

\textsuperscript{164} In another decision addressing whether a property tax exemption violates article VIII, § 2 of the Texas Constitution, the Attorney General in Opinion No. DM-301 ruled that the property tax exemption under § 11.29 of the Tax Code, providing that land dedicated by easement as a disposal site for materials dredged from the Gulf Intracoastal Waterway is exempt from tax, is unconstitutional. Op. Tex. Att'y Gen. No. DM-301 (1994). The Attorney General reasoned that disposal sites for material dredged from the Gulf Intracoastal Waterway are not included within the Texas Constitution's list of permissive statutory exemptions. \textit{id.}

\textsuperscript{165} \textit{Spring I.S.D.}, 889 S.W.2d at 568. Query whether the special valuation methods used for motor vehicle dealers under TEX. TAX CODE ANN. §§ 23.12A and 23.12B (Vernon Supp. 1995), are constitutional given that a January 1 valuation date is not used. These sections require motor vehicle dealers to pay property taxes on inventory based on the average inventory over the prior twelve-month period, and to make monthly deposits based on vehicles sold during the months. \textit{id.} In Chicago Pac. Corp. v. Limbach, 605 N.E.2d 8 (Ohio 1992), the Ohio Supreme Court held a that a daily average method of valuation was constitutional because it avoided the "inequality of fluctuating inventories." \textit{id.} at 12. The valuation methods required by § 23.12A have similarities to a daily average method of valuation.

\textsuperscript{166} U.S. Const. art. I, § 8, cl. 3.

\textsuperscript{167} Id. art. I, § 10, cl. 2.

\textsuperscript{168} 871 S.W.2d 864 (Tex. App.—Houston [14th Dist.] 1994, writ granted).
VICO’s in-transit goods, destined for Indonesia, was unconstitutional.\textsuperscript{169} VICO purchased goods and equipment for use by a related joint venture. The goods and equipment were shipped to VICO in Texas, were then inspected and packaged in Texas and finally were sent to Indonesia. The taxing unit imposed property taxes on these goods and equipment which were located in Harris County on January 1, 1991. VICO challenged the tax on its in-transit goods, claiming that the tax violated the Commerce Clause and the Import-Export Clause.\textsuperscript{170} In addressing the Commerce Clause, the court applied the six prongs of the Commerce Clause test established by Complete Auto Transit, Inc. v. Brady\textsuperscript{171} and Japan Line, Ltd. v. County of Los Angeles.\textsuperscript{172} The primary issue with respect to the Commerce Clause was whether the tax violated the requirement under Japan Line that the tax not enhance the risk of multiple international taxation. Although the goods were clearly destined for Indonesia, the court concluded that VICO did not prove as a matter of law that the multiple taxation test was violated, reasoning that the mere potential for multiple taxation is not sufficient; rather, the court indicated that the taxpayer must provide evidence of multiple taxation.\textsuperscript{173}

The court also rejected VICO’s position that the tax on its goods violated, as a matter of law, the Import-Export Clause.\textsuperscript{174} The court applied the three factor test used in Intel Containers Int’l Corp. v. Huddleston\textsuperscript{175} and concluded VICO did not prove as a matter of law that any of the three factors were met.\textsuperscript{176} The court focused on the third prong on the Huddleston test, which asks whether the tax diverts import-derived reve-

\textsuperscript{169} Id. at 866.
\textsuperscript{170} Id. at 867.
\textsuperscript{171} 430 U.S. 274 (1977).
\textsuperscript{172} 441 U.S. 434 (1979). The tests applied by Complete Auto Transit and Japan Line are whether the tax:
\begin{itemize}
  \item[1] is applied to an activity with a substantial nexus with the taxing state;
  \item[2] is fairly apportioned;
  \item[3] does not discriminate against interstate commerce;
  \item[4] is fairly related to the services provided by the state,
  \item[5] does not create a substantial risk of multiple international taxation,
  \item[6] does not prevent the federal government from speaking with one voice when regulating commercial relations with foreign governments.
\end{itemize}

Virginia Indonesia Co., 871 S.W.2d at 868 (citations omitted).
\textsuperscript{173} Id. at 869-70. The court distinguished Japan Line, concluding that in Japan Line the taxpayer submitted “evidence of multiple international taxation in fact.” Id. at 870.
\textsuperscript{174} Id. at 871.
\textsuperscript{175} 113 S. Ct. 1095 (1993). The current import-export clause test is based on the main concerns prompting the framers of the Constitution to adopt the import-export clause.
\textsuperscript{176} Virginia Indonesia Co., 871 S.W.2d at 871 (citing Huddleston, 113 S. Ct. at 1105).
nue from the federal government to the taxing state. The court concluded the third test was not met because goods destined for export do not implicate import revenues.\textsuperscript{177}

The Texarkana Court of Appeals in Melton Truck Lines, Inc. \textit{v. Gregg County Appraisal Dist.}\textsuperscript{178} held that trucks headquartered in Louisiana and which traveled through Gregg County in interstate business were taxable in Gregg County.\textsuperscript{179} The trucks were never located in the county for longer than a temporary period. However, the trucks' owner (Melton) registered trucks for proportional registration in Gregg County pursuant to the International Registration Plan. The taxing unit asserted that the trucks were taxable in Gregg County under section 21.02(a)(4) of the Tax Code,\textsuperscript{180} which provides that property is taxable by a taxing unit if the owner maintains his principal place of business in Texas in the taxing unit and the property is taxable in Texas but does not have a taxable situs under sections 21.02(a)(1), (2) or (3).\textsuperscript{181} Melton asserted that its principal place of business was in Louisiana and, thus, it did not have a principal place of business in Gregg County.\textsuperscript{182} The court concluded, however, that section 21.02(a)(4) merely requires the taxpayer's principal place of business \textit{in Texas} to be in Gregg County, and that Melton's registering its trucks in Gregg County evidenced that Melton had established a place of business (and its principal place of business in Texas) in Gregg County.\textsuperscript{183}

\textsuperscript{177} Id. VICO, however, did not leave the Court of Appeals without one victory. The court agreed with VICO that there was sufficient evidence to conclude that VICO had applied for a freeport exemption. \textit{Id.} at 876. Although VICO had not completed a freeport exemption application form, its 1991 rendition stated that "we hereby apply for property tax exemption." \textit{Id.} at 875 (quoting VICO's 1991 Rendition of Business Personal Property). VICO also failed to check the box on the rendition form claiming the freeport exemption. The appraisal district had granted VICO freeport exemptions in 1989 and 1990 even though VICO had applied for the freeport exemption in the same manner for those years as it did in 1991. The court ruled that, based on the "unique facts of the case," VICO established that it applied for a freeport exemption in 1991, although the court noted that its opinion should not be read to condone VICO's failure to comply with the appraisal district's rules for applying for a freeport exemption. \textit{Id.} at 876.

\textsuperscript{178} 864 S.W.2d 137 (Tex. App.—Texarkana 1993, no writ).

\textsuperscript{179} \textit{Id.} at 140.


\textsuperscript{181} \textit{Id.}

\textsuperscript{182} Melton also asserted that the tax in the facts at hand violated the Commerce Clause. \textit{Melton}, 864 S.W.2d at 140. The court disagreed, reasoning that Melton's trucks avail themselves of Texas' and Gregg County's roads, thus enjoying the benefits and protections provided by those entities. \textit{Id.}

\textsuperscript{183} \textit{Id.} at 139. In another case addressing the constitutionality of taxation of in-transit goods, the Texas Supreme Court in Diamond Shamrock Ref. & Mkt. Co. \textit{v. Nueces County Appraisal Dist.}, 876 S.W.2d 298 (Tex.), \textit{cert. denied}, 115 S. Ct. 500 (1994), affirmed the San Antonio Court of Appeals' decision that the imposition of property taxes on crude oil imported into the United States and temporarily stored in the county before being transported to its final destination, which was in Texas, did not violate either the Import-Export Clause or the Commerce Clause. 1994 Tax Survey at 1667-68 (discussing the court of appeals opinion).
B. Exemptions

Two decisions during the Survey period addressed whether an appraisal district can deny an exemption in a circumstance in which the taxpayer was entitled to the exemption during the immediately preceding year, and the chief appraiser did not request the taxpayers complete a new exemption application for the current year.

In Inwood Dad's Club, Inc. v. Aldine Indep. Sch. Dist.\textsuperscript{184} the Houston [1st Dist.] Court of Appeals held that the charitable organization property tax exemption granted to the plaintiff (Inwood) in 1984 extended through later years because the chief appraiser did not deliver to Inwood a notice under section 11.43(c) of the Tax Code\textsuperscript{185} requesting a new application for exemption.\textsuperscript{186} Section 11.43(c) provides that once an exemption under certain of the exemption provisions (including the charitable organization exemption) is allowed, the exemption applies in later years until the property changes ownership or the person's qualification for the exemption changes.\textsuperscript{187} Section 11.43(c) further provides that the chief appraiser may require a taxpayer allowed an exemption in a prior year to file a new application to confirm his or her current qualification for the exemption by delivering written notice that a new application is required.\textsuperscript{188} The taxing units asserted that this provision is permissive, not mandatory, and that the delinquent tax notices sent by the taxing units during the relevant years were sufficient notice that the tax exemption had been denied.\textsuperscript{189} In rejecting the taxing units' approach, the court concluded that section 11.43(c) is primarily a mandatory provision, and that the chief appraiser's failure to request a taxpayer to confirm his qualification for exemption allows the exemption to continue without further confirmation.\textsuperscript{190}

The taxing units also argued that Inwood waived its right to complain of the failure to receive a request for a new exemption application because Inwood did not timely protest the loss of the exemption to the appraisal review board. The court also rejected this argument, concluding that Inwood had nothing to protest before the appraisal review board given that its charitable organization exemption had not been properly denied; thus, the appraisal district's removal of Inwood's exemption was a void act that could be challenged at any time.\textsuperscript{191}

The Fourteenth Court of Appeals' decision in Harris County Appraisal Dist. v. Dincans\textsuperscript{192} appears to be somewhat at odds with the decision in Inwood Dad's Club. In Dincans the taxpayer qualified for open-space

\textsuperscript{184} 882 S.W.2d 532 (Tex. App.—Houston [1st Dist.] 1994, no writ).
\textsuperscript{185} TEX. TAX CODE ANN. § 11.43(c) (Vernon Supp. 1995).
\textsuperscript{186} Inwood Dad's Club, 882 S.W.2d at 539.
\textsuperscript{187} TEX. TAX CODE ANN. § 11.43(c) (Vernon Supp. 1995).
\textsuperscript{188} Id.
\textsuperscript{189} Inwood Dad's Club, 882 S.W.2d at 539.
\textsuperscript{190} Id. at 535.
\textsuperscript{191} Id. at 538.
\textsuperscript{192} 882 S.W.2d 75 (Tex. App.—Houston [14th Dist.] 1994, writ denied).
valuation in 1982. In 1983, the appraisal district did not grant the taxpayer open-space land designation; however, the chief appraiser also did not request taxpayer to file a new application or send any notice expressly stating that the open-space designation was denied. The only way the taxpayer would have known that the open-space land designation was denied for the 1983 year was that the notice of appraised value listed the current market value of the property without listing the agricultural value. Years later, the taxpayer challenged the denial of the open-space designation for the 1983 year (and later years).

The court ruled that, assuming the notice of appraised value had been delivered to taxpayer, the taxpayer had failed to exhaust its administrative remedies because it had not timely filed a protest with the appraisal review board. The court rejected the taxpayer's argument that the appraisal district's failure to request a new application under section 23.54(e) of the Tax Code for open-space designation absolved taxpayer from failure to protest, concluding that section 23.54(e) should be read in a manner which is not inconsistent with section 25.19 of the Tax Code, which requires the chief appraiser to deliver a written notice of valuation in certain circumstances.

The wording of section 23.54(e) is strikingly similar to the wording of section 11.43(c), discussed in Inwood above. Indeed, section 23.54(e) provides that "once an application is filed and [special] appraisal [as open-space land] is allowed, the land is eligible for [open-space land valuation] in subsequent years without a new application unless the owner-

193. Id. at 78. The court declined to grant the appraisal district's motion for summary judgment because there was not sufficient evidence establishing that the notice of appraised value had been delivered to the taxpayer.

194. TEX. TAX CODE ANN. § 23.54(e) (Vernon 1992).

195. Id. § 25.19. The taxpayer in Dincans asserted that the notice provisions in § 23.54(e) prevailed over the notice provisions in § 25.19. Dincans, 882 S.W.2d at 77. However, one can make a strong argument that taxpayer could have prevailed in this case without having to prove that the notice provisions in § 23.54(e) control over those in § 25.19. Indeed, even if property is eligible for an open-space exemption, the chief appraiser is still required to list in a § 25.19 notice both the market value and the agricultural value of the property. (The market value of the property is determined so that the amount of rollback taxes can be calculated if a change in use occurs. TEX. TAX CODE ANN. § 23.55 (Vernon 1992)). Therefore, merely because a § 25.19 notice lists the market value of property does not mean that the appraisal district has concluded that the property is no longer eligible for open-space valuation. Rather, the § 25.19 notice and the § 23.54(e) notice have different purposes. By holding that the notice provisions in § 25.19 prevail over the notice provisions under § 23.54(e), the Dincans court appears to eliminate, for practical purposes, the requirement of an appraisal district to send notices under § 23.54(e) in a circumstance in which the notice under § 25.19 indicates that the agricultural use exemption has been denied.

196. Section 25.19 requires the chief appraiser to deliver a written notice to the property owner of the appraised value of its property if: "(1) the appraised value of the property is greater than its [value] in the preceding year;" (2) the property's appraised value is greater than the property owner's rendition; or "(3) the property was not on the appraisal roll in the preceding year." TEX. TAX CODE ANN. § 25.19(a) (Vernon 1992). In Dincans, 1984 was the first year in which Harris County Appraisal District assumed responsibilities of appraising and assessing the property at issue. In prior years, Harris County had these responsibilities. Therefore, Harris County Appraisal District was required to send a notice under § 25.19(a) because the property was not on its appraisal roll in the preceding year.
ship changes or its eligibility . . . ends." As with section 11.43(c), section 23.54(e) then provides that the chief appraiser may require a person to file a new application to confirm that the land is currently eligible. Whereas the court in Inwood read the language in section 11.43(c) to require the chief appraiser to request a new application for exemption in order to deny the exemption for later years, the court in Dincans reads similar language in section 23.54(e) to be precatory (i.e., failure to send the request for an application does not prevent the appraisal district from denying the open-space land designation). Until Texas courts resolve this issue, taxpayers qualifying for an exemption or a special valuation in the previous year should review carefully the notice of appraised value received during the current year to determine whether the appraisal district has denied the exemption or special valuation for the current year.

The Fort Worth Court of Appeals in Scott v. Harris Methodist HEB held that a taxpayer lacked standing under the Tax Code and common law to challenge an exemption granted to another taxpayer. The taxpayer argued that his taxes were higher because of an allegedly improper exemption granted the hospital. The court concluded, however, that the Tax Code does not allow taxpayers to challenge exemptions granted others, and, although Scott's taxes may have been higher than had the hospital not been granted an exemption, Scott was unable to establish that he suffered an injury distinct from the taxpaying public-at-large.

C. Procedure

The United States Fifth Circuit Court of Appeals issued two opinions concerning taxing units' ability to foreclose on property subject to a tax lien in circumstances in which the Federal Deposit Insurance Corporation (FDIC) also has a mortgage lien on the property. In Matagorda County v. Law the Fifth Circuit held that taxing units may not foreclose on property which is subject to an FDIC lien without the FDIC's consent.
even though the taxing units' liens are superior to the liens acquired by
the FDIC.\textsuperscript{204} In reaching its conclusion, the court relied on section
1825(b) of the Financial Institutions Reform, Recovery and Enforcement
Act of 1989 (FIRREA),\textsuperscript{205} which provides that FDIC property shall not
be subject to levy, attachment, garnishment, foreclosure or sale without
the FDIC's consent.\textsuperscript{206} The taxing units argued that the FDIC's lien was
not "property" within the meaning of the FIRREA regulation; however,
the court reasoned that under federal law, which controls this issue, the
term "property" embraces both the fee and lien interests.\textsuperscript{207}

The taxing units' final argument did, however, catch the court's atten-
tion. The taxing units asserted that failure to award the taxing units re-
cover against the FDIC for the amount secured by the tax lien
effectively constituted a taking without just compensation as prohibited
by the Fifth Amendment of the United States Constitution.\textsuperscript{208} As of the
date of the District Court decision, twenty-seven months had passed since
the FDIC acquired its lien on the property. The court ruled that an un-
constitutional taking had not occurred as of the date of the district court
decision because the taxing units' rights had not been sufficiently in-
fringed so as to constitute an unconstitutional taking;\textsuperscript{209} however, the
court pointed out that the twenty-seven-month delay in this case was ap-
proaching the maximum amount of time for the FDIC to resolve matters
without there being a taking requiring compensation.\textsuperscript{210}

The Fifth Circuit in \textit{Donna Indep. Sch. Dist. v. Ball}\textsuperscript{211} reconfirmed that
taxing units may not foreclose on property subject to an FDIC lien with-
out the FDIC's consent.\textsuperscript{212} The court again rejected the taxing units' as-
sertion that the FDIC's delay in consenting to a foreclosure by the taxing
units was an unconstitutional taking, although the delay in this case was

\textsuperscript{204} 19 F.3d at 222-23.
\textsuperscript{206} Id. § 1825(b)(2).
\textsuperscript{207} \textit{Matagorda County}, 19 F.3d at 221. The court also indicated that under Texas law
the FDIC's lien might be treated as "property." \textit{Id.}
\textsuperscript{208} U.S. CONS.T. amend. V. Although § 1825 did not extinguish the taxing units' liens,
the taxing units argued that the indeterminable delay in being able to foreclose on the lien
constituted a compensable taking. \textit{Id.} at 223.
\textsuperscript{209} \textit{Id.} at 225. In making this determination, the court examined the three factors
that the United States Supreme Court in \textit{Penn Cent. Transp. Co. v. City of New York}, 438 U.S.
104, 124 (1978) considered in addressing whether a regulation constitutes a taking, those
factors being: (i) "[t]he economic impact of the regulation on the claimant"; (ii) "the ex-
tent to which the regulation . . . interfered with distinct investment-backed expectations";
and (iii) "the character of the governmental action." \textit{Id.}
\textsuperscript{210} \textit{Matagorda County}, 19 F.3d at 225. In this case, the property was worth approxi-
mately $333,000, the taxing units' liens were for approximately $52,000, and the FDIC's
lien totalled over $890,000. \textit{Id.} at 217, 225 n.11. Given that the taxing units' liens had
priority over the FDIC's liens and that the value of the property was over six times the
amount of the taxing units' liens, it is not clear how the taxing units have suffered a taking
as a result of the FDIC's delay in consenting to the foreclosure. Unless it is reasonably
possible that the property would substantially drop in value, there should be adequate
value to satisfy the taxing units' liens even if the foreclosure were delayed well beyond the
27-month period.
\textsuperscript{211} 21 F.3d 100 (5th Cir. 1994).
\textsuperscript{212} \textit{Id.} at 101.
approximately four years with respect to one taxing unit and over six years in the case of the other taxing unit (far longer than the twenty-seven month delay that, the Fifth Circuit threatened in Law, approached the maximum delay without constituting an unconstitutional delay). In Balli the property was valued at approximately $530,000, the taxing units' tax liens totalled approximately $74,000 and the FDIC's lien was for approximately $197,000. The court reasoned that, unlike the facts in Law (in which the FDIC lien was in excess of the value of the property), survival of the FDIC liens did not prevent a tax sale because the FDIC's lien was less than the value of the property. Unfortunately, after Law and Balli, it remains unclear in what circumstances lengthy delays by the FDIC in consenting to a foreclosure sale by taxing units constitute an unconstitutional taking.

The Corpus Christi Court of Appeals held in Department of Hous. & Urban Dev. v. Nueces County Appraisal Dist. that a taxpayer which owned property on January 1, 1991, but had sold the property before filing suit to challenge the appraisal review board's valuation of the property for the 1991 tax year had standing to challenge the appraisal review board's order. Section 42.01 of the Tax Code provides that a "property owner" is entitled to appeal the appraisal review board's order determining protest. The appraisal district asserted that, at the time of the filing of the petition, the taxpayer was not the "property owner." Although the taxpayer was not technically the owner of the property when suit was filed, the Tax Code provides that owners of property on January 1 of each year are personally liable for taxes for such year even if the property is later conveyed. In rejecting the appraisal district's argument, the court reasoned that the Texas Legislature intended for "the Tax Code to allow taxpayers a regular, systematic way to protest property appraisals," and that the Texas Legislature did not intend that a taxpayer who transfers the property after January 1 be entitled to only part of the review process (i.e., administrative appeals only).

213. Id.
214. Id.
215. Id. In yet another case during the Survey period addressing tax liens, the Dallas Court of Appeals in City of Dallas v. Cornerstone Bank, N.A., 879 S.W.2d 264 (Tex. App.—Dallas 1994, no writ) held that the property tax lien existing under TEX. TAX CODE ANN. § 32.01 (Vernon 1992) (amended 1993) applied to after-acquired inventory. Interestingly, § 32.01(b) was added in 1993 to provide expressly that the tax lien applies to after-acquired inventory.
216. 875 S.W.2d 377 (Tex. App.—Corpus Christi 1994, no writ) [hereinafter HUD].
217. Id. at 380.
218. TEX. TAX CODE ANN. § 42.01 (Vernon 1992).
219. Id. § 32.07(c).
220. HUD, 875 S.W.2d at 380. If a property owner on January 1 who later sells the property were not allowed to contest in court the property's value for the year in which the owner was liable for the property taxes, an appraisal review board's decision concerning the property's value would effectively be a final, non-appealable decision.
IV. OTHER DEVELOPMENTS, PROCEDURE, LIENS, SUCCESSOR LIABILITY

In one of the most interesting cases of the year, *R Communications Inc. v. Sharp*, the Texas Supreme Court held that a taxpayer’s right to challenge judicially a sales tax deficiency could not be conditioned on payment of the tax at issue. To do so, the court held, violates the open courts policy. R Communications sought relief from a sales tax assessment by seeking judicial review; the district court had dismissed the taxpayer’s suit for lack of jurisdiction and the court of appeals had affirmed. The Supreme Court of Texas, in a unanimous decision, reversed the lower court decision.

R Communications asserted that several provisions of the Tax Code violate the equal protection, open courts and due course of law provisions of the Texas Constitution: section 112.108 which denies a taxpayer any form of declaratory relief; section 112.051, which conditions the right to file suit attacking the tax’s validity or its assessment or collection upon prior payment of the taxes; section 112.101, which precludes injunctive relief without prior tax payment or the posting of a bond, approved by both the court and the attorney general, equal to twice the amount of estimated tax liability; and section 111.022, which authorizes summary collection procedures without the state filing suit. R Communications also alleged these provisions violated due process and equal protection under the United States Constitution.

The supreme court focused on the taxpayer’s assertion that the Tax Code violated the fundamental requirement that all courts shall be open, and every person for an injury done him, in his lands, goods, person, or reputation, shall have remedy by due course of law. In determining the legislature’s purpose in enacting the law, the court emphasized that until 1989 taxpayers were able to seek a declaratory judgment of no tax liability without satisfying the prepayment provisions of section 112.051. According to the court, the right to declaratory judgment was terminated by the 1989 enactment of section 112.108, whose purpose, according to the court, was to ensure prompt payment of taxes by insurance companies. Viewing R Communications as without adequate recourse to the courts, the supreme court held section 112.108 “unconstitutional and

221. 875 S.W.2d 314 (Tex. 1994). Interestingly, taxpayer’s attorney did not appear for supreme court argument, and the court’s decision underscores its commitment to taxpayers’ right to open courts.
222. No. 91-4893 (345th Dist. Ct., Travis County, Tex., July 8, 1991), aff’d, 839 S.W.2d 947 (Tex. App.—Austin, 1992), rev’d 875 S.W.2d 314.
224. *Id.* § 112.051.
225. *Id.* § 112.101.
226. *Id.* § 111.022.
227. *R Communications*, 875 S.W.2d at 314-15.
228. *Id.* at 315 (citing *Tex. Const.* art. I, § 13).
229. *Id.* at 316.
void" in that it precludes a taxpayer from obtaining judicial review of its tax liability by means of a declaratory action.\textsuperscript{230}

Subsequent to \textit{R Communications}, the comptroller has an incentive to narrow the court's holding; unless the comptroller can convince the courts to limit the scope of this case, taxpayers will often be able to delay tax payment for years by contesting their taxes. (The court noted that the \textit{R Communications} case took over six years to reach the Texas Supreme Court).\textsuperscript{231} Accordingly, comptroller representatives quickly focused on the fact that \textit{R Communications} was in dire financial straits, and took the position that \textit{R Communications} was intended to reach only such taxpayers.

It took only a short time, in fact, for taxpayers to rely on \textit{R Communications} to file prepayment court cases on a variety of taxes and to petition for refunds of amounts already paid. For example, in \textit{Weck v. Sharp}\textsuperscript{232} the taxpayer argued that he should be permitted to seek a declaratory judgment on the constitutionality of the Controlled Substances Act.\textsuperscript{233} The taxpayer in \textit{Weck} had purchased over 800 pounds of marijuana from undercover agents, and was assessed for over a million dollars for failure to pay taxes due under the Controlled Substance Act.\textsuperscript{234} Noting that it had struck section 112.108 of the Tax Code\textsuperscript{235} insofar as it would prevent taxpayers from seeking declaratory judgment on tax cases,\textsuperscript{236} the court concluded that the invalidation of section 112.108 provided the trial court with jurisdiction, and remanded the case for further proceedings.\textsuperscript{237}

Property tax suits filed without payment also are pending, creating concerns that school funding and budgets may be adversely affected if the court's holding in \textit{R Communications} is consistently applied.

Other taxpayers with financial difficulties were the subject of litigation addressing lien priorities. The Fifth Circuit addressed the priority of a state fuel tax lien relative to a federal excise tax lien in \textit{Western Nat'l Bank v. United States}.\textsuperscript{238} The controversy centered on competing claims of the United States and the State of Texas with respect to a bank account that held payments from the taxpayer's customers. The bank account was also the subject of a lockbox arrangement with a secured party. One argument advanced by the state was that its claim was entitled to superpriority status under section 6323 of the Internal Revenue Code\textsuperscript{239} which provides that a lien is not valid against the purchaser of a security who lacked actual knowledge of the lien at the time of purchase. Though the

\begin{itemize}
\item \textsuperscript{230} Id. at 318.
\item \textsuperscript{231} Id. at 317.
\item \textsuperscript{232} 884 S.W.2d 153 (Tex. 1994) (per curiam).
\item \textsuperscript{233} See \textit{TEX. TAX CODE} §§ 159.001 - .301 (Vernon 1992 & Supp. 1995).
\item \textsuperscript{234} The court offers no comment as to whether anyone actually expects dealers in illegal taxes to pay the tax at issue.
\item \textsuperscript{235} \textit{TEX. TAX CODE ANN.} § 112.108 (Vernon 1992).
\item \textsuperscript{236} \textit{Weck}, 884 S.W.2d at 154.
\item \textsuperscript{237} Id.
\item \textsuperscript{238} 8 F.3d 253 (5th Cir. 1993).
\item \textsuperscript{239} 26 U.S.C.A. § 6323(b)(1)(A) (West Supp. 1994).
\end{itemize}
state contended it qualified as a purchaser of money, which is a security, the court disagreed and found that to qualify as a purchaser there must be an exchange of consideration and there is no such exchange in the collection of revenue.\textsuperscript{240} The court further relied upon the fact that Congress enacted a superpriority for state real property tax and special assessment liens but has not granted such status to state fuel or sales taxes.\textsuperscript{241} The court concluded that the priority of competing state and federal tax claims, when section 6323 is not applicable, is determined by the rule that the first in time is the first in right; and in this case the federal excise tax lien was entitled to priority because the IRS assessed the excise taxes against the taxpayer prior to the time Texas’ equitable interest arose.\textsuperscript{242}

\textit{Amsco Steel Company v. Sharp}\textsuperscript{243} held against the comptroller on an important procedural issue.\textsuperscript{244} The comptroller had asserted that the issuance of a refund check is an administrative decision, and that taxpayers who receive refund checks and do not file motions for new hearings can therefore be precluded from subsequently raising objections or filing new refund claims, on the ground that an administrative decision on the franchise tax year at issue had already become final.\textsuperscript{245} The court held to the contrary, concluding that issuing a refund check under the law in effect at the time did not constitute a final decision under the comptroller’s rules or under the Texas Administrative Procedures and Texas Register Act.

Another interesting case affecting the statute of limitations is \textit{Borden, Inc. v. Sharp}.\textsuperscript{246} Borden relied on the technically correct reading of two statutes (sections 111.205(4)\textsuperscript{247} and 111.107 of the Tax Code\textsuperscript{248}) to conclude that a taxpayer who has timely filed a tax refund has effectively tolled the statute of limitations indefinitely. The comptroller argues that this reading of the statute is inconsistent with legislative intent and with long-standing comptroller practice.

\textsuperscript{240} Western \textit{Nat’l Bank}, 8 F.3d at 255.
\textsuperscript{242} The state argued that the funds in the account were held in trust for the state by the secured party pursuant to TEX. \textit{TAX CODE ANN.} § 111.016 (Vernon 1992), which requires collectors of fuel taxes to hold the funds in trust for the state, and therefore the IRS lien could not attach to the funds in the account which were collected to pay the fuel taxes. Western \textit{Nat’l Bank}, 8 F.3d at 255.
\textsuperscript{243} No. 91-5685 (250th Dist. Ct., Travis County, Tex., Nov. 1993), appeal docketed, No. 3-94-00169-CV (Tex. App.—Austin).
\textsuperscript{244} The case also held against the comptroller on the franchise tax issue involved, by agreeing with the taxpayer that, since it had a net operating loss for federal income tax purposes, it could recover the claimed refund without reduction for tax effecting.
\textsuperscript{245} This comptroller policy illustrates the maxim that hard facts make bad law; the comptroller’s policy was designed with the understandable goals of allowing the comptroller to issue refund checks to taxpayers efficiently in the aftermath of Bullock \textit{v. Sage Energy Co.}, 728 S.W.2d 465 (Tex. App.—Austin 1987, writ ref’d n.r.e.), and to bring closure to taxpayer refund claims for the years at issue; nonetheless, the policy effectively deprived taxpayers of the right to administrative hearings on contested issues.
\textsuperscript{246} No. 92-08383 (250th Dist. Ct., Travis County, Tex., Dec. 1993), appeal docketed, No. 3-94-00074-CV (Tex. App.—Austin).
\textsuperscript{247} TEX. \textit{TAX CODE ANN.} § 111.205(4) (Vernon Supp. 1995).
\textsuperscript{248} \textit{Id.} § 111.107.
The attorney general and comptroller also continued their efforts to impose successor liability on Texas taxpayers. The comptroller held, for example, that a taxpayer who purchased a restaurant business was liable for the taxes of the restaurant seller under section 111.020 of the Tax Code. In a few cases, however, taxpayers prevailed. In one hearing, for example, the taxpayer succeeded in showing the comptroller that she should not be liable as a successor under the successor liability rules, since her acquisition of the “business” was more the nature of an acquisition of a tradename than the acquisition of a continuing business. As the comptroller more aggressively pursues successors, it becomes more important for sellers to consider requesting tax clearance certificates, setting up escrows, or otherwise protecting themselves from unanticipated tax liability.

Serna v. State and Jonnet v. State further illustrate the potential for personal liability for officers of corporations that have failed to pay franchise taxes. These two cases show the significance of the risk to which officers of such corporations are exposed. In Serna the defendant officers had argued that an officer could not be held liable unless an officer or employee of the corporation took some specific action to create a debt. Thus, Serna asserted, he could not be held liable for the corporation's failure to plug abandoned oil wells after the corporation had forfeited its charter since, according to Serna, the obligation to plug the wells arose from action by the Railroad Commission rather than action by the corporation's agents. The court disagreed, holding that "[t]he Tax Code no longer requires that debts be knowingly and consensually created for an officer to be held liable." Jonnet decided the same day although by a different judge, reached a similar result.

252. 877 S.W.2d 516 (Tex. App.—Austin 1994, writ denied).
253. 877 S.W.2d 520 (Tex. App.—Austin 1994, writ denied).
254. 877 S.W.2d at 518.
255. Id.
256. Id., relying on TEX. TAX CODE ANN. § 171.255(a) (Vernon 1992) and noting that Serna had failed to raise the affirmative defense, available under id. § 171.255(c), that the debt was incurred over his objection or without his knowledge and that he could not have gained the knowledge through reasonable diligence. Serna, 877 S.W.2d at 519. The court further provided guidance on the circumstances in which certain debts which relate back to periods before forfeiture do not give rise to officer liability. Note, however, that Texas law is not entirely consistent on this second issue.
257. 877 S.W.2d 520.
258. Both cases were decided June 8, 1994, Jonnet by Justice Kidd and Serna by Justice Bea Ann Smith. The Jonnet panel also issued concurring and dissenting opinions that discuss the issues at some length. See also Cain v. State, 882 S.W.2d 515 (Tex. App.—Austin 1994, no writ). In El T. Mexican Restaurants, Inc. v. Bacon, No. 01-92-00605-CV, 1995 WL 2622 (Tex. App.—Houston [1st Dist.], Jan. 5, 1995, n.w.h.), issued shortly after the close of the survey period, the court concluded that a sole shareholder of a corporation that had had its charter forfeited for failure to pay franchise taxes, but that had not been dissolved, was not able to bring suit individually as a successor in interest to the corporation. The court recognized that the shareholder was holder of the beneficial title to the
Several administrative decisions also focus on officer and director liability. One decision addressed petitioner's contention that he was not an officer and director of the corporation. The comptroller concluded that one of the individuals was not a corporate officer, but that two who were officers were properly assessed for sales tax due after the date when the initial franchise tax report was due, but not filed.

Refund claim assignments continue to be troublesome, particularly since the comptroller has taken the position that a taxpayer who has paid tax to a vendor may not file a claim for refund without an assignment of refund claim from the vendor. In other procedural matters that are more taxpayer-favorable, the comptroller confirmed that the state has the burden of proving that services are taxable, and agreed that an audi-

corporation's assets and was entitled to prosecute actions necessary to protect his rights; nonetheless, the court held that the shareholder could not recover individually on the corporation's claims or, since the corporation had not dissolved, as a successor in interest.

260. See also Tex. Comp. Pub. Acc'ts, Hearing No. 29,685 (Jan. 24, 1994) in which the comptroller asserted that officers of corporations should be held liable for taxes collected, but not remitted, relying on such TEX. TAX CODE ANN. § 111.016 (1992) (Tex. Comp. Pub. Acc'ts, Hearing No. 30,732 had relied on TEX. TAX CODE ANN. § 171.255). In distinguishing Dixon v. State, 808 S.W.2d 721 (Tex. App.—Austin 1991, writ dism'd w.o.j) (individual liable), from this administrative hearing, the administrative law judge pointed out that the facts in the Dixon case quite clearly showed that Dixon had committed the tort of conversion. In properly drawing a distinction between someone who converts funds that belong to the state and someone who is serving as an officer of a corporation, this decision may be useful in determining the circumstances in which the state's auditors will attempt to collect tax from officers of the corporation.

261. See TAX POLICY NEWS, July 1994, at 2-3. Note also that in several cases, a taxpayer who paid tax to vendors has filed a claim for a refund of taxes paid only to discover that the statute of limitations has expired for the vendor's claims for refund; in these cases, the comptroller has denied the taxpayer's claim on the ground that the vendor had no valid claim to assign, and that neither the taxpayer nor the vendor is entitled to a refund of the overpaid taxes.

262. Tex. Comp. Pub. Acc'ts, Hearing No. 30,461 (Jan. 7, 1994), was decided on the basis of the failure of the tax division to carry its burden of proof that the services at issue were subject to tax. The issue was whether grease trap cleaning services for fast food restaurants was non-taxable maintenance to real property or taxable repairs to real property. The administrative law judge analyzed the burden of proving a service is taxable:

[T]he legislature of the State of Texas has only elected to tax a few, enumerated services as opposed to all services. Thus, it is the burden of the Tax Division not merely to prove, prima facie, that it was a service that was purchased/sold tax-free; the Tax Division must show, prima facie, that it was a taxable service as enumerated in Section 151.0101 and as defined elsewhere in the Tax Code and by valid Comptroller's rule that was purchased/sold tax-free.

The decision holds that once the tax division proves a service is subject to tax, the burden shifts to the taxpayer to prove "either by a preponderance of the evidence that the Tax Division is wrong . . . or by clear and convincing evidence that even though the work constituted a taxable service it was exempt from taxation." See also Tex. Comp. Pub. Acc'ts, Hearing No. 30,660 (Mar. 22, 1994) (tax division failed to meet burden of establishing a taxable service); Tex. Comp. Pub. Acc'ts, Hearing No. 32,245 (June 16, 1994) which focused on work provided by an engineering company that had elements of both non-taxable maintenance/repair and taxable repair or restoration. The taxpayer argued that since some of the services at issue were taxable, the tax division had the burden of proving that the other services were taxable; the judge agreed with the tax division that the taxpayer must prove the exclusion from taxation.
tor's samples can be used to project not only tax deficiencies but also tax credits.263

Although the 1995 legislative session will likely not effect major changes to Texas tax law, judicial and administrative interpretations — from Texas and other jurisdictions — will continue to refine (and perhaps expand) the scope of Texas taxes.

263. In Texas Instruments, Inc. v. Sharp, No. 91-2823 (345th Dist. Ct., Travis County, Tex., Apr. 12, 1994), the comptroller agreed that Texas Instruments could rely on the sampling projection to determine refunds to which it is entitled. (The comptroller had originally taken the position that refunds would be allowed only for transactions with respect to which Texas Instruments secured a vendor assignment). The comptroller has been working on guidelines to implement using sampling for certain refunds, and representatives have indicated that these guidelines will permit the use of audit-generated samples, but will not permit claims for refund to rely on a projected sample, although it is unclear that the courts will permit the comptroller to refuse to accept valid samples in a refund claim context.