1987

Taxation

John M. Collins
Miller Mitchell Miller

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

Recommended Citation
https://scholar.smu.edu/smulr/vol41/iss1/22

This Article is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in SMU Law Review by an authorized administrator of SMU Scholar. For more information, please visit http://digitalrepository.smu.edu.
TAXATION

by

John M. Collins* and J. Mitchell Miller**

I. LIMITED SALES, EXCISE AND USE TAX

A. Application of Tax

In Bullock v. Cordovan Corp.¹ the Austin court of appeals held that the distribution of a controlled circulation magazine to a select group of readers constituted a taxable sale even though the readers paid no consideration for the magazine.² The court noted that distribution of the magazine satisfied both elements of a sale: transfer of possession and consideration for the transfer. Further, section 151.005 of the Tax Code³ does not require that the recipient of the property pay the consideration.⁴ The court concluded that the advertisers had actually paid consideration for the transfer of the magazine to the readers in the form of increased advertising rates.⁵ The court reasoned that the advertisers were not merely paying to have their advertisements published; they were also paying an additional amount for distribution of the magazine to this select group.⁶

In a case involving a similar principle the comptroller ruled that a transaction was a taxable sale rather than a nontaxable repair service.⁷ In Hearing

* B.A., Duke University; J.D., University of Texas. Partner, Haynes and Boone, Dallas, Texas.
** B.A., Ohio State University; J.D., Southern Methodist University. Associate, Haynes and Boone, Dallas, Texas.

¹ 697 S.W.2d 432 (Tex. App.—Austin 1985, writ ref’d n.r.e.). In this case the comptroller argued that the distribution of the magazine was not a sale because the taxpayer claimed an exemption from the sales and use tax under § 151.302 of the Tax Code with respect to its purchase of certain supplies, materials, and services in the physical preparation of the publications. See TEX. TAX CODE ANN. § 151.302 (Vernon Supp. 1987). The taxpayer argued that the purchase and use of these materials and services was exempt due to the later sale of the magazine. The statute of limitations barred the comptroller’s counterclaim for sales tax on the “sale” of the publication. After this decision the comptroller adopted a rule which imposes a sales tax on persons who advertise in controlled circulation magazines. See infra notes 81-85 and accompanying text.
² 697 S.W.2d at 435.
³ TEX. TAX CODE ANN. § 151.005 (Vernon Supp. 1987).
⁴ 697 S.W.2d at 435.
⁵ Id. The court noted that advertising rates for such controlled circulation publications are much higher than for regular publications because of the promise that the magazine will be delivered only to a specified category of readers.
⁶ The court also noted that courts in Ohio and New Jersey addressed this issue and ruled that the advertisers had supplied consideration for distribution of a magazine. See Fairlawn Shopper, Inc. v. Director, Div. of Taxation, 98 N.J. 64, 484 A.2d 659, 663 (1984); Pento Publishing Co. v. Kosydar, 45 Ohio St. 2d 16, 340 N.E.2d 396, 398 (1976).
⁷ Comptroller Hearing No. 16,418 (Aug. 8, 1985).
16,418 the taxpayer delivered a repaired piece of equipment to the customer from the taxpayer's inventory in exchange for the customer's equipment. The taxpayer based the customer's price on the actual cost of repairing the customer's equipment, which the taxpayer then added to its inventory. The taxpayer provided functional equipment to the customer immediately under this system, rather than taking the customer's equipment, repairing it, and then returning the equipment to the customer. The comptroller, however, placed great emphasis on the source of the consideration for the repair, concluding that the essence of the transaction was an exchange of a functional piece of equipment from the taxpayer's inventory for the customer's defective equipment, with a price determined at a later date.

In a second case concerning exclusion of charges from sales price, the comptroller ruled that certain amounts qualified as charges for transportation of tangible personal property after the sale, and were therefore excludable under section 151.007(c)(7) of the Tax Code. The taxpayer in this case was a national retailer operating catalog and mail order facilities in Texas. On its order forms the taxpayer included a charge for transportation and handling costs based on the weight of the items shipped. The tax division argued that the taxpayer could not exclude the amounts shown as transportation charges from the sales price for tax purposes because such charges were commingled with handling charges and could not be separately identified. The comptroller, however, ruled that all of the charges were in fact transportation and delivery charges after the sale. The comptroller's ruling in this case seems contrary to Hearing 15,628, in which the comptroller held that certain handling services and charges had been included within transportation charges. Such inclusions disqualified those transportation charges from exclusion. The comptroller distinguished the two cases by noting that the transportation charges in Hearing 15,628 were based upon the price of the item, which he considered to be an addition to the sales price, while charges based upon weight were more representative of a true transportation or delivery charge. Although one can make a distinction between the two cases, it is somewhat narrow, and the comptroller's position on transportation and handling charges remains unclear. In addition the trans-

8. If the taxpayer had repaired the customer's equipment and returned it to the same customer, that would clearly qualify as a repair service which is excluded from the definition of sales price and sales receipts under Tex. Tax Code Ann. § 151.007(c)(8) (Vernon Supp. 1987).

9. Comptroller Hearing No. 16,418 (Aug. 8, 1985). The comptroller cited Calvert v. Engineers & Fabricators, Inc., 440 S.W.2d 320 (Tex. Civ. App.—Austin 1969, no writ); Comptroller Hearing No. 11,606 (1984); Comptroller Hearing No. 7827 (1977). In Hearing No. 16,418 the equipment being repaired was an oil field packer, which is used in the well bore of oil and gas wells for completion. A packer is an important piece of equipment and customers may be greatly inconvenienced by waiting for the repair of their own defective packers.


11. The charges were also determined on the basis of the average cost of transporting items from various locations around the country to their ultimate destinations.

portation charges excluded from sales receipts in this case included transportation from the taxpayer's warehouse to a retail location and the comptroller has previously ruled that charges for transportation to a warehouse controlled by the seller are charges for transportation prior to the sale, and therefore not excludable.\textsuperscript{13}

In another decision the comptroller liberally applied the exclusion under section 151.056(a) of the Tax Code\textsuperscript{14} for tangible personal property incorporated into real property by a contractor or repairman.\textsuperscript{15} The taxpayer maintained that equipment installed on an air conditioning system to heighten efficiency constituted a permanent improvement under a lump sum contract for the equipment and installation of the equipment.\textsuperscript{16} The comptroller agreed that the property had become part of the building and permanently affixed to the building.\textsuperscript{17} The comptroller held that the system itself was clearly a fixture, and a permanent modification to the system must also be considered a part of that system and hence an improvement to real property.\textsuperscript{18} Although the comptroller noted that the equipment could be removed without damaging the realty, he considered the equipment's enhancement of the older inefficient system compelling evidence of a permanent modification.

In Hearing, 17,056\textsuperscript{19} the comptroller ruled that a drill bit manufacturer who separately stated on invoices a charge for the drill bit and a "diamond deposit" liable for sales tax on the combined amount, even though the purchaser eventually returned the drill bit and received a partial refund based upon the value of the diamonds at the time of return.\textsuperscript{20} The manufacturer could have structured the transaction as a trade-in allowance, which would permit a reduction in the sales price under section 151.007(c)(6).\textsuperscript{21} Instead, the manufacturer stated the original sales price separately from the deposit and offered a later refund for credit or cash. This offer failed to qualify as a refund under section 151.007(c)(2)\textsuperscript{22} because the manufacturer did not refund the total amount charged for the drill bit. The offer also failed to qual-
ify under section 151.007(c)(6) because the property returned was not used as a trade-in allowance in the sale of a taxable item.

B. Specific Exemptions

The Austin court of appeals in Direlco, Inc. v. Bullock narrowly construed the exemption from sales and use tax under article 20.04(R) for the sale of gas and electricity. The court held that Direlco was selling for commercial use the gas and electricity used in buildings it owned and leased to tenants. Commercial use is defined in article 20.04(R)(3) as "use by persons engaged in selling, warehousing or distributing a commodity or service, either professional or personal." Despite this broad definition of commercial use, Direlco argued that its purchase of gas and electricity for its buildings was not a commercial use because leasing of commercial office space is neither a commodity nor a personal or professional service. The comptroller argued that a commodity is anything useful or valuable, and service means the administering or supplying of a need to others, which would include the leasing of commercial space. The court held that commercial use has two or more meanings and is thus an ambiguous term. Since the comptroller applied a broad definition of commercial use for a substantial period of time without contradiction by the state legislature, the court ruled that the legislature should be treated as having approved the comptroller's long-standing interpretation of the statute. As a result, the definition of commercial use includes all areas of commerce except those specifically excluded by the statute.

In Hearing 15,800 the comptroller took note of the present economic conditions of the Texas oil and gas industry in ruling that drilling equipment built for use outside Texas was exempt from sales tax even though it was stored within the state for eighteen months after construction. Section

---

23. 711 S.W.2d 360 (Tex. App.—Austin 1986, writ ref'd n.r.e.).
25. 711 S.W.2d at 361. Direlco provided certain services to tenants, including the provision of gas and electricity, along with maintenance and security services. The statute generally provided that gas and electricity were exempted from sales and use taxes except when sold for commercial use. The language in § 151.317(A) of the Tax Code is essentially the same. See TEX. TAX CODE ANN. § 151.317(a) (Vernon 1982).
26. TEX. TAX.—GEN. ANN. art. 20.04(R)(3) (Vernon 1969) now codified at TEX. TAX CODE ANN. § 151.317(c)(2) (Vernon 1982)). The language in § 151.317(c)(2) of the Tax Code is virtually identical.
27. 711 S.W.2d at 363.
28. Id. at 364. The court applied the reasoning of Calvert v. Kadane, 427 S.W.2d 605, 608 (Tex. 1968). In Calvert the Texas Supreme Court held that the interpretation of an agency administering a statute is entitled to great weight where the meaning of the statutory provision is unclear or ambiguous.
29. TEX. TAX CODE ANN. § 151.317(c)(2) (Vernon 1982) specifically excludes: (A) processing tangible personal property for sale as tangible personal property; (B) exploring for, or producing and transporting, a material extracted from the earth; (C) agriculture, including dairy or poultry operations and pumping for farm or ranch irrigation; [and] (D) electrical processes such as electroplating, electrolysis, and cathodic protection.
151.324 of the Tax Code\textsuperscript{31} exempts drilling equipment used for the exploration of oil and gas from the sales tax if the equipment is built for exclusive use outside of Texas and if, on completion, the equipment is removed forthwith from the state. Rule 3.332 defines forthwith as removal from the state within a reasonable period of time from the transfer of possession of the property, provided that there is no use or consumption of the property within the state.\textsuperscript{32} The comptroller took into account circumstances in the Texas oil and gas industry at the time the drilling rig was completed, and concluded that storing the rig for eighteen months prior to transportation outside the state was removal within a reasonable period of time.\textsuperscript{33} Although any application of such a standard would involve consideration of the particular circumstances of each case, this ruling could establish a troublesome precedent for the comptroller because of the substantial period of time involved.

In a second comptroller's decision during the survey period the comptroller ruled that a soft drink bottler and distributor did not qualify for the resale exemption with respect to sales made through vending machines.\textsuperscript{34} In Hearing 16,493\textsuperscript{35} the taxpayer owned and maintained the vending machines, kept the machines in good working order, collected all coins, and assumed any losses resulting from the use of slugs. The taxpayer argued that the resale exemption applied because the taxpayer's contract with certain purchasers required the taxpayer to quote a set price per case on the soft drinks.\textsuperscript{36} This arrangement had the appearance of a sale for a set price, with the purchaser then reselling the soft drinks. In addition, the purchasers included an instrumentality of the United States and an exempt organization; sections 151.309\textsuperscript{37} and 151.310\textsuperscript{38} of the Tax Code exempt direct sales to these purchasers. The comptroller noted that the Tyler court of appeals had considered a similar arrangement in 1981.\textsuperscript{39} The court had ruled that sales of food and beverage from vending machines placed in facilities owned or operated by federal governmental agencies were subject to the sales tax and not qualified for exemption.\textsuperscript{40} Although the reasoning of the comptroller in dismissing the set price element of the contract is not convincing, the con-

\begin{thebibliography}{40}
\bibitem[31]{31} TEX. TAX CODE ANN. § 151.324 (Vernon 1982).
\bibitem[33]{33} Comptroller Hearing No. 15.800 (1985).
\bibitem[34]{34} Comptroller Hearing No. 16,493 (June 12, 1985).
\bibitem[35]{35} Id.
\bibitem[36]{36} By quoting a set price for the soft drinks the taxpayer enabled the purchaser to establish the vending machine price, and thereby determine the amount of its commission.
\bibitem[37]{37} TEX. TAX CODE ANN. § 151.309 (Vernon 1982) (taxable items sold, leased, or rented to certain governmental entities are exempt from the Texas sales and use tax: exempt entities include instrumentalities of the United States, and corporations that are agencies or instrumentalities of the United States).
\bibitem[38]{38} Id. § 151.310 (Vernon Supp. 1987) (taxable items sold, leased, or rented to certain non-profit tax-exempt organizations are exempt from the Texas sales and use tax).
\bibitem[39]{39} Bullock v. W. & W. Vending and Food Service of Texas, Inc., 611 S.W.2d 713, 717 (Tex. App.—Tyler 1981, no writ) (issue was whether the taxpayer was an independent contractor or agent of customer).
\bibitem[40]{40} Id.
\end{thebibliography}
tract appears to be an arrangement for a full service vendor, rather than a sale for resale.

In Hearings 17,337\textsuperscript{41} and 17,338\textsuperscript{42} the comptroller narrowly construed the exemptions for use of machinery and equipment for agricultural products under section 151.316 of the Tax Code.\textsuperscript{43} These exemptions require that the machinery and equipment be used exclusively for agricultural purposes. In these cases the taxpayer sold computer hardware to purchasers who provided an exemption certificate stating that they would only use the goods for “farm use,” though the purchasers also purchased an accounting program. The comptroller noted that he had ruled that a computer used in part for payroll was subject to tax because the agricultural use was not exclusive,\textsuperscript{44} and that a single divergent use precluded application of the exemption. Although a seller will ordinarily not know how the purchaser will actually use property after the sale, the comptroller noted that the taxpayer in this case was on notice of the non-exclusive use of the computer because the purchaser acquired the accounting program at the time of purchase. The comptroller appeared to consider whether the seller knew or should have known that the property would not be put to the exclusive use set forth in the exemption.

In Hearing 14,134\textsuperscript{45} the comptroller broadly defined the term “operating assets” as used in the occasional sale exemption.\textsuperscript{46} Rule 3.316(d)(3)\textsuperscript{47} defines operating assets to include all assets used by an enterprise in providing a product or service, but the term does not include assets maintained and used for general business purposes in addition to use by the specific enterprise.\textsuperscript{48} In this case the taxpayer closed its physical plant in Houston and sold most of the Houston assets to one purchaser. The comptroller noted that the taxpayer had transferred various other assets to the taxpayer’s other offices. The taxpayer argued that the assets transferred to other offices were nonoperating assets. The comptroller ruled that the occasional sale exemption did not apply because the taxpayer had used at least one of the items transferred to another office in providing products and services in Houston, making that asset an operating asset.

C. Procedure

In two cases the comptroller considered arguments that taxpayers had detrimentally relied upon advice received from the comptroller, and therefore could not be held liable for taxes otherwise payable. In both cases the

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{41} Comptroller Hearing No. 17,337 (1985).
\item \textsuperscript{42} Comptroller Hearing No. 17,338 (Aug. 20, 1985).
\item \textsuperscript{43} \textsc{Tex. tax code ann.} § 151.316 (7), (8) (Vernon Supp. 1987) (formerly paragraphs (8) and (9)).
\item \textsuperscript{44} \textit{See} Comptroller Hearing No. 11,350 (Nov. 13, 1981).
\item \textsuperscript{45} Comptroller Hearing No. 14,134 (Nov. 26, 1984).
\item \textsuperscript{46} \textit{See} \textsc{Tex. tax code ann.} § 151.304 (Vernon Supp. 1987).
\item \textsuperscript{47} Texas Comp. Tax Rule No. 3.316(d)(3), [1 Tex.] St. Tax Rep. (CCH) ¶ 66-165, at 7321 (Aug. 10, 1981).
\item \textsuperscript{48} \textit{Id.}
\end{itemize}
\end{footnotesize}
comptroller held that the taxpayers had provided neither written documentation nor corroboration by an employee of the comptroller of the incorrect advice allegedly given.\textsuperscript{49} Generally, a taxpayer will be entitled to waiver for detrimental reliance only if the taxpayer establishes that an employee of the comptroller gave him guidance or direction, that the employee had sufficient knowledge of the facts to provide correct advice, that the taxpayer followed that advice, and that the taxpayer actually suffered as a consequence of following that advice.\textsuperscript{50} To utilize the detrimental reliance defense a taxpayer should obtain written advice after providing a detailed statement of the facts of the transaction, and the taxpayer must follow that advice.

In Hearing 16,939\textsuperscript{51} the comptroller ruled that the taxpayer was obligated to pay the full amount of sales tax collected from a purchaser even though the sales tax had been overstated. In this case the taxpayer calculated the sales tax due on the gross purchase price of items sold, and then deducted an allowance for a trade-in. When the taxpayer remitted the sales tax to the state, the taxpayer corrected the amount of sales tax due by deducting the trade-in allowance from the gross price before calculating the sales tax. The taxpayer did not, however, contact the purchasers and attempt to refund any portion of the sales tax erroneously collected. Thus the comptroller ruled that section 111.016\textsuperscript{52} of the Tax Code required the taxpayer to pay the gross amount of sales tax collected to the state.

\section*{D. 1986 Tax Legislation}

The Texas legislature, in a special session, raised the limited sales, excise and use tax rate from 4.125\% to 5.25\% for all sales during the period from January 1, 1987 through August 31, 1987.\textsuperscript{53} Receipts from the sale, rental, storage, use, or consumption of taxable items will be taxed at the old 4.125\% rate, however, if the items are used for the performance of a written contract entered into prior to January 1, 1987, and the contract is not subject to change or modification by reason of the tax increase, or if the items are used pursuant to an obligation under a bid submitted prior to January 1, 1987, and the bid is not withdrawn, modified, or changed by reason of the tax increase.\textsuperscript{54}

After December 4, 1986, the state will not pay any interest on refunds of erroneously paid taxes, due to the repeal of section 111.106 of the Tax Code.\textsuperscript{55} Section 111.106 provided for payment of ten percent interest on refunds.\textsuperscript{56} Under section 111.060 of the Tax Code\textsuperscript{57} the state will continue

\begin{itemize}
\item \textsuperscript{49} Comptroller Hearing No. 17,879 (Sept. 6, 1985); Comptroller Hearing No. 17,091 (Sept. 3, 1985).
\item \textsuperscript{50} Comptroller Hearing No. 14,541 (Sept. 20, 1985).
\item \textsuperscript{51} Comptroller Hearing No. 16,939 (Oct. 8, 1985).
\item \textsuperscript{52} TEX. TAX CODE ANN. § 111.016 (Vernon 1982) provides that “[a]ny person who receives or collects a tax or any money represented to be a tax from another person is liable to the state for the full amount of the taxes. . . .”
\item \textsuperscript{53} Id. § 151.051(b) (Vernon Supp. 1987).
\item \textsuperscript{55} Acts 1986, 69th Leg., 2d Sess., p. 28, ch. 8, § 1, effective December 4, 1986.
\item \textsuperscript{56} TEX. TAX CODE ANN. § 111.106 (Vernon 1982) (repealed).
\end{itemize}
to collect ten percent interest on delinquent taxes.

During the special session the legislature amended the Local Sales and Use Tax Act\(^5\) and adopted a new County Sales and Use Tax Act\(^6\) authorizing certain counties to impose a sales and use tax. In addition, the legislature has added a new article 1118z to Title 28,\(^6\) authorizing cities to impose a sales and use tax to support a City Transit District.

The legislature has added section 2A to the Local Sales and Use Tax Act\(^6\) and amended other sections of the Act to authorize certain cities and towns to adopt an additional sales and use tax of one-half of one percent of the receipts from the sale at retail of all taxable items within the city adopting the tax.\(^6\) Previously, the statute authorized cities and towns to impose a sales and use tax not to exceed one percent.\(^6\) In addition, the one-half of one percent additional tax is imposed on receipts from the sale at retail within the city of gas and electricity for residential use, unless the residential use is exempted from the local sales and use tax already imposed by the cities. Thus, cities that have adopted a local sales and use tax since 1979 cannot impose the additional tax on the sale of gas and electricity for residential use.\(^6\)

The following cities may not adopt the additional sales and use tax: (1) a city included within the boundaries of a rapid transit authority; (2) a city included within the boundaries of a regional transportation authority created by a "principal city" having a population of less than 800,000; (3) a city wholly or partly located in a county that contains territory within the boundaries of a regional transportation authority created by a principal city having a population in excess of 800,000, unless the city is a contiguous city; and (4) a city which imposes a sales and use tax to support the city transit department as authorized by new article 1118z.\(^6\) A qualified city or town may adopt the new sales and tax only by majority vote in an election held for that purpose.\(^6\) Section 26.041 of the Tax Code requires that the revenue produced by the additional local sales be used to reduce property taxes in the city.\(^6\)

The legislature amended article 2353e of the Revised Civil Statutes\(^6\) to

---

57. Id. § 111.060 (Vernon Supp. 1987).
59. Id. art. 2353e, §§ 20-32 (Vernon Supp. 1987).
60. Id. art. 1118z, §§ 1-12 (Vernon Pam. Supp. 1987).
61. Id. art. 1066c, § 2A.
62. Id. §§ 4, 5.
63. Id.
64. Id. § 2A.B.
65. Id. § 2A.A.
66. Id. § 2A.C.
67. TEX. TAX CODE ANN. § 26.041 (Vernon Supp. 1987). The city must calculate the amount of additional sales and use tax revenues to be received during each year that the city imposes this additional tax. If the amount so determined exceeds the amount of additional tax used in the preceding year to reduce property taxes, the property tax rate must be reduced again; if the amount of taxes to be received in the current year is determined to be less than the amount received in the prior year, the property tax rate must be increased.
include an new county sales and use tax authorizing a county to impose a sales and use tax of either one-half of one percent or one percent of sales at retail of all taxable items within the county, if no part of the county is located in either a rapid transit authority or a regional transportation authority. If a county does adopt such a tax, neither a rapid transit authority nor a regional transportation authority may impose a sales or use tax in that county. The rate will be one-half of one percent if there is an incorporated city or town within the county, and will be one percent if there is no incorporated city or town within the county. To adopt such a tax the tax must be approved by a majority vote in an election held to approve the tax. Section 26.042 added to the Tax Code, a provision that county property taxes will be reduced by the sales and use tax collected in a manner similar to that under Section 26.041.

New article 111824 authorizes an incorporated city or town operating a mass transportation system and having a population of 56,000 or more to create a city transit department and cause that department to levy a special sales and use tax of either one-fourth of one percent or one-half of one percent to finance the system. A city or town may not, however, create a city transit department with authority to levy such a tax if: (1) the city or town is located wholly or partly within a county, federal metropolitan statistical area, or primary statistical area containing a city included in a metropolitan rapid transit authority or regional transportation authority; and (2) such city is a “principal city” as defined in the law authorizing such a metropolitan rapid transit authority or regional transportation authority. A city council of an eligible incorporated city or town may create a mass transit department by resolution at any time after September 1, 1987: the council must call an election to approve the tax. Section 26.043 of the Tax Code requires a reduction in the property taxes imposed by a city which has adopted a city transit department sales and use tax.

Local sales and use taxes collected by the comptroller and deposited with the state treasurer will not earn any interest for the local authorities, and any interest earned from such taxes while on deposit with the state treasurer will be credited to the state general revenue fund. To implement this change the following sections have been amended, effective September 7, 1986: section 8(a) of article 1066c, section 11B(B)(f) of article 1118x, and section 16(f)(5) of article 1118y.

69. *Id.* § 21.
70. Id.
71. Id.
73. *See supra* note 67.
75. *Id.* § 2.
76. *Id.* § 3.
80. *Id.* 1118x, § 11B(B)(f).
81. *Id.* art. 1118y, § 16(f)(5).
E. Sales Tax Procedure

During the Survey period the comptroller adopted and amended a number of rules. The comptroller amended rule 3.299\textsuperscript{82} in response to the Austin court of appeals decision in Bullock v. Cordovan Corp.\textsuperscript{83} Under amended rule 3.299(b)(3), the publisher of a controlled circulation magazine must collect sales tax from persons who advertise in the magazine based upon the sales price of the magazine.\textsuperscript{84} The publisher is also required to separately state the charge for advertising and the sales price of the magazine; the sales price must be reasonable, and will be considered so if the publication meets second class postal rate requirements.\textsuperscript{85} This rule, however, does not apply to magazines provided as part of membership in an organization if either a part of membership dues is identified as the sale price of the magazine plus tax, or the membership dues do not identify the sales price of the magazine, but the organization paid the sales tax on the cost of publication.\textsuperscript{86}

The comptroller amended rule 3.298\textsuperscript{87} to provide an objective test for determining whether an amusement event will qualify for exemption where a nonprofit organization is a co-provider of the event. Under section 151.3101 of the Tax Code\textsuperscript{88} and rule 3.298, amusement services provided by nonprofit organizations or other exempt entities are generally exempt from sales tax. Further, if an exempt entity is a co-provider of an amusement event, the event will be exempt if the exempt provider establishes it has a substantial financial investment in the event. As amended, rule 3.298(g)(3)(C)\textsuperscript{89} now provides that an exempt provider may establish its substantial financial involvement by a written contract signed prior to the date of the event under which the co-providers agree that the nonprofit organization will receive at least twenty percent of the net profit, and will pay at least twenty percent of all losses incurred in producing the event.

The comptroller amended rule 3.308,\textsuperscript{90} concerning taxation of computer software, to include a definition of "non-custom software" and deleted the definition of "custom computer program" from the rule. The comptroller will consider a program non-custom software, and therefore taxable, if (1) the source code cannot be modified by the seller (other than by inserting file names or formatting data); (2) the program can be replaced by the vendor at the same charge as for the original; (3) copies of the program are

\textsuperscript{82} Texas Comp. Tax Rule No. 3.299, [1 Tex.] St. Tax Rep. (CCH) ¶ 66-087, at 7303-04 (May 21, 1986).
\textsuperscript{83} 697 S.W.2d 432 (Tex. App.—Austin 1985, writ ref’d n.r.e.); see supra § 1-6 and accompanying text.
\textsuperscript{84} Texas Comp. Tax Rule No. 3.299(b)(3), [1 Tex.] St. Tax Rep. (CCH) ¶ 66-087, at 7304 (May 21, 1986).
\textsuperscript{85} Id.
\textsuperscript{86} Id.
\textsuperscript{87} Texas Comp. Tax Rule No. 3.298, [1 Tex.] St. Tax Rep. (CCH) p 66-082, at 7299-305 (May 5, 1986).
\textsuperscript{88} TEX. TAX CODE ANN. § 151.3101 (Vernon Supp. 1987).
\textsuperscript{89} Texas Comp. Tax Rule No. 3.298(g)(3)(C), [1 Tex.] St. Tax Rep. (CCH) ¶ 66-082, at 7304 (May 5, 1986).
mass-produced for the manufacturer, inventoried by a vendor, or otherwise held for repeated sale, license, or lease; or (4) the program is sold, licensed, or leased by means of a "shrink-wrapped," "box-top," or "tear-open" license agreement or bill of sale.\textsuperscript{91}

The comptroller amended and expanded the rule governing application of the sales and use tax to persons engaged in the graphic arts. Rule 3.312\textsuperscript{92} now includes photographers, commercial artists, portrait painters, and persons who draw, paint, engrave, and etch as graphic artists. Persons who paint or apply decorative material to tangible personal property are also considered to be engaged in graphic art activities. Sales tax is not due on charges for furnishing original letters or other printed material or carbon copies produced simultaneously with the original. Sales tax must be collected, however, on the total charge for producing multiple copies of printed material, regardless of the type of equipment used in production.

The comptroller has adopted rule 3.353\textsuperscript{93} to reduce administrative costs of maintaining sales tax permits for permit holders who are inactive. Under this rule, a permit will be cancelled due to abandonment if a permit holder has no business activity, which is defined as zero gross sales, zero taxable sales, and zero taxable purchases. An applicant whose permit is canceled under this rule may apply for a new sales tax permit.

II. PROPERTY TAX

A. Application of Tax

In \textit{Dallas County Appraisal District v. L.D. Brinkman & Co.},\textsuperscript{94} the Dallas court of appeals limited the statutory presumption that exempts property brought into the state for no longer than 175 days from property tax. Section 11.01 of the Tax Code exempts from taxation property that is only temporarily located in Texas.\textsuperscript{95} The Tax Code presumes that property is located only temporarily in Texas if the taxpayer imports the goods from out of state and then ships the goods out of state within 175 days.\textsuperscript{96} In \textit{Brinkman} the trial court had excluded from tax the portion of the taxpayer's inventory that the taxpayer intended to ship out of Texas within 175 days.\textsuperscript{97}

The Dallas court of appeals held that, regardless of whether the taxpayer's inventory satisfied the statutory presumption for exemption, the goods still may be subject to tax if the Texas constitution does not exempt the goods from taxation and if federal law considers the goods to be in Texas for longer

\textsuperscript{91} Texas Comp. Tax Rule No. 3.308(b)(1) [1 Tex.] St. Tax Rep. (CCH) ¶ 66-127, at 7314 (Nov. 11, 1985).
\textsuperscript{92} Texas Comp. Tax Rule No. 3.312, [1 Tex.] St. Tax Rep. (CCH) ¶ 66-150, at 7317-2 (Feb. 12, 1986).
\textsuperscript{94} 701 S.W.2d 20 (Tex. App.—Dallas 1985, writ ref'd n.r.e.).
\textsuperscript{95} TEX. TAX CODE ANN. § 11.01(c) (Vernon 1982).
\textsuperscript{96} Id. § 11.01(d).
\textsuperscript{97} 701 S.W.2d at 21.
than a temporary period. After finding that the Texas constitution did not exempt the taxpayer's goods from taxation, the court concluded that federal law considers goods as located only temporarily in a state if the goods are in interstate transit. Federal law considers goods in interstate transit as located in a state more than temporarily, however, if the owner halts the transit of the goods for business purposes unrelated to necessary transportation delays. In *Brinkman* the taxpayer brought goods from out of state to its Texas warehouse, where the taxpayer segregated certain goods which had been presold to out of state customers before shipping this portion out of state. Since the taxpayer had not halted the transit of the goods merely as part of a necessary transportation delay, the court held that the taxpayer had detained all the goods in Texas for business purposes and thus had subjected the goods to state or local property taxes.

In *Arkansas County Appraisal Review Board v. Texas Gulf Shrimp Co.* the Corpus Christi court of appeals held unconstitutional section 21.03(a) of the Tax Code. This section taxes only the portion of the total value of personal property that reflects the property's use in Texas and applies only to property continually used outside the state. In *Texas Gulf Shrimp Co.* the taxpayer operated shrimp trawlers seventy percent of the year in the Gulf of Mexico, outside the boundaries of Texas. The trawlers were domiciled in Texas and never acquired a tax situs in another state or nation. The tax assessors argued that the statute creates a partial exemption not authorized by the Texas constitution or required by some overriding federal law. Further, the tax assessors argued that, if the Texas constitution or other federal law does not authorize a tax exemption, a statute that taxes property with a taxable situs in the state at less than its fair value is effectively providing an exemption from tax and, thus, is unconstitutional as a matter of law. The taxpayer argued that section 21.03(a) did not provide a tax exemption, but rather defined the tax situs of property following federal constitutional restrictions. The Corpus Christi court of appeals concluded that the Texas constitution does not permit exemption of travelers. In addition the court held that federal law does not restrict the state's power to tax the shrimp trawlers since Texas permitted the trawlers to use Texas port facilities and to receive benefits from their use.

In *Coastal State Petroleum Co. v. Corpus Christi Independent School Dis-

---

98. *Id.* at 22. The Texas constitution taxes all real and tangible personal property located in Texas, unless the constitution otherwise specifically authorizes an exemption. TEX. CONST. art. VIII, §§ 1-2. The court recognized that federal law sometimes limits a state's power to tax. 701 S.W.2d at 22. The court thus would uphold the statutory presumption only to the extent authorized by the Texas constitution or by federal law. *Id.*
99. 701 S.W.2d at 23.
101. 701 S.W.2d at 23.
102. 707 S.W.2d 186 (Tex. App.—Corpus Christi 1986, writ ref’d n.r.e.).
103. TEX. TAX. CODE ANN. § 21.03(a) (Vernon 1982).
104. This argument is similar to the reasoning of the Dallas court of appeals in *Brinkman*. 701 S.W.2d at 22; see *supra* note 98 and accompanying text.
105. 707 S.W.2d at 192.
106. *Id.* at 191-92.
The taxing authority had valued the crude oil inventory using comparable market values, but had ignored certain federal guidelines that were in effect at the time. Under these guidelines a refinery could sell its oil at a price based upon the refiner's consistent and historical accounting practices as long as this price did not exceed the refiner's actual cost for the inventory, plus any transportation expenses. In accordance with these guidelines and its accounting practices, the taxpayer valued its inventory at book value using the last-in first-out accounting method. The court concluded that the federal energy price rules controlled only the price that the taxpayer could charge its customers and did not determine the oil's market value. The court, citing State v. Whittenburg, recognized that property tax assessment is a quasi-judicial function and that courts should not set aside a valuation by a board of equalization absent compelling circumstances. The court noted that under federal regulations, a refinery could sell crude oil for up to $30.00 a barrel. The court consequently concluded that the evidence presented to the trial court indicated that book value was not a proper measure of taxable value. The court held that the taxpayer failed to show that the board of equalization's valuation was excessive.

B. Specific Exemptions

In Grand Prairie Hospital Authority v. Tarrant Appraisal District the Fort Worth court of appeals held that a medical office building leased by a hospital authority to private physicians was not used exclusively for public purposes and, therefore, that section 11.11(a) of the Tax Code did not exempt the building from property tax. The court ruled that the hospital authority did not use the property exclusively for the benefit of the public
since private doctors leased offices in the building for their own commercial benefit.\textsuperscript{118}

In a similar fact situation the attorney general issued an opinion\textsuperscript{119} that a hospital district's lease of a portion of a building to two nonprofit corporations and a state agency did not subject the building to property tax. The attorney general noted that the Texas Supreme Court has consistently held that public property is tax-exempt if used primarily for the health, comfort and welfare of the public.\textsuperscript{120} The attorney general concluded that public property does not lose its tax-exempt status merely because a charge is made for the use of the property, provided that the charges are incidental to the public use and the proceeds inure to the benefit of the political subdivision.\textsuperscript{121}

In another opinion the attorney general ruled that a city airport's lease of a facility to a private individual for the purpose of selling fuel to airport operators, subject to the directions of the city, satisfied the public purpose test that exempts property from property tax.\textsuperscript{122} The attorney general, however, determined that the city airport's lease of land surrounding the airport for the purposes of farming and ranching did not meet the public purpose test.\textsuperscript{123} The property was therefore subject to property tax.\textsuperscript{124}

In \textit{General Association Branch Davidian Seventh Day Adventist v. McLennan County Appraisal District}\textsuperscript{125} the Waco court of appeals denied an exemption from ad valorem taxes under section 11.20 of the Tax Code for a seventy-five acre tract of land adjacent to a church's property on the ground that the property was not an actual place of worship.\textsuperscript{126} In order for its real property to qualify for tax exemption under section 11.20(a), a religious organization must use the property primarily as a place of regular religious worship and must reasonably need to use the property to engage in religious worship.\textsuperscript{127} In \textit{General Association Branch} the church argued that under its religious beliefs the church members held the land to be sacred and that the church used the land for the health and education of its members. The land, however, was used during the time in question as a range for animals owned by the church, for walking, and for the health, welfare and education of its members. The court concluded that the church had failed to meet its burden of proof.\textsuperscript{128}

\textsuperscript{118} 707 S.W.2d at 284.
\textsuperscript{120} \textit{Id.}; see Satterlee v. Gulf Coast Waste Disposal Auth., 576 S.W.2d 773, reh'g denied, 576 S.W.2d 770, 779 (Tex. 1978).
\textsuperscript{124} \textit{Id.}
\textsuperscript{125} 715 S.W.2d 391 (Tex. App.—Waco 1986, no writ).
\textsuperscript{126} \textit{Id.} at 343.
\textsuperscript{127} TEX. TAX CODE ANN. § 11.20(a) (Vernon 1982).
\textsuperscript{128} 715 S.W.2d at 393. The Texas Supreme Court has held that courts must narrowly and strictly construe claims for tax exemption and that the claimant was the burden of proving
In *Waterwood Improvement Association v. San Jacinto County Appraisal Review Board* 129 the Beaumont court of appeals held that a homeowners’ association’s land was not entitled to an exemption from property taxes under section 23.18 of the Tax Code. Waterwood involved a timber land that a developer conveyed to the homeowners’ association and that would revert to the developer if the association failed to use the property for recreational or educational purposes. Section 23.18 mandates that an appraiser value certain property that a nonprofit homeowners’ organization holds for the use, benefit, and enjoyment of its members at nominal value to avoid double taxation. 130 The association argued that because of the deed restrictions the timber land had a nominal value of only one dollar. The court concluded that the timber land was not property held for the benefit of the homeowner’s association since the timber provided the sole value of the land. 131

In *Bower v. Edwards County Appraisal District* 132 the San Antonio court of appeals held that land used for deer hunting leases is not land used for agricultural use and, therefore, is not entitled to be valued for tax purposes under the method set forth in the Texas constitution. 133 The constitution defines agricultural use as the business of raising livestock or growing crops, the profit from which constitutes the owner’s primary source of income. 134 The taxpayer argued that raising deer for human consumption fits within the broad definition of agricultural use. The court noted that the State Property Tax Board’s Guidelines exclude wild deer from the definition of livestock and concluded that the principal use of the land in this case was for hunting and recreation and not for agricultural use. 135

C. Procedure

During the Survey period the courts reaffirmed the requirement that a party must pursue its administrative remedies under chapters 41 and 42 of the Tax Code to be entitled to judicial review. In *Dallas County Appraisal District v. La!* 136 the Dallas court of appeals held that the taxpayer lost his right to challenge the administrative decision in district court since he failed to file a notice of protest as required by section 41.44 of the Tax Code. 137

---

129. 697 S.W.2d 827, 829 (Tex. 1985).
130. TEX. TAX CODE ANN. § 23.18(a) (Vernon 1982). Property such as swimming pools, parks, meeting halls, parking lots, tennis courts or other similar property qualify for nominal valuation. *Id.* The court noted that it found no cases construing the statute. 697 S.W.2d at 836.
131. 697 S.W.2d at 835-36.
132. 697 S.W.2d 528 (Tex. App.—San Antonio 1985, no writ).
133. *Id.* at 529-30; see TEX. CONST. art. VIII, § 1-d(a).
134. TEX. CONST. art. VIII, § 1-d-1.
135. 697 S.W.2d at 530.
136. 701 S.W.2d 44 (Tex. App.—Dallas 1985, writ ref’d n.r.e.).
137. *Id.* at 46 (citing Rockdale Indep. School Dist. v. Thorndale Indep. School Dist., 681 S.W.2d 225 (Tex. App.—Austin 1984, writ ref’d n.r.e.); TEX. TAX CODE ANN. § 41.44 (Vernon Supp. 1987)). For further discussion of Rockdale, see supra note 12, at 713.
The courts also continue to strictly apply the notice of appeal requirements of section 42.06 of the Tax Code. In *Town Square Associates v. Angelina County Appraisal District* the Beaumont court of appeals reaffirmed that a taxpayer's notice of appeal must be properly served on the appraisal district and the appraisal review board to perfect judicial review of the final order of the review board. The court noted that the Dallas court of appeals reached the same conclusion in *Corchine Partnership v. Dallas County Appraisal District*. In a similar case the Texarkana court of appeals ruled that the time requirements in section 42.06 of the Tax Code are statutes of limitations, which if not pleaded are waived. The appraisal district neglected to raise the taxpayer's failure to comply with the time limitations until its motion for judgment notwithstanding the verdict. The court ruled that as statutes of limitations the time requirements are an affirmative defense that the appraisal district must pleaded.

In *Gruy v. Jim Hogg County Appraisal District* the Texarkana court of appeals held that a taxpayer's appearance before the review board waives any defense concerning a prior defect in notice. The appraisal district had failed to comply with section 25.19 of the Tax Code, which requires written notice to the taxpayer of the reappraisal of its agricultural land within twenty days before the date the board begins to consider the protest. The taxpayers, however, appeared at a full hearing before the board, and the court ruled that the taxpayer's voluntarily appearance waived any prior defect in notice.

In *Garza v. Block Distributing Co.* the San Antonio court of appeals held that the appraisal board must first give a taxpayer notice of a proposed increase in the valuation of his property before the board may acquire jurisdiction to consider any increase in valuation. In *Block* the taxpayer paid the assessed tax, which the appraisal district had based on its appraisal of the taxpayer's prior year's liquor inventory. After certifying the tax roll, the tax assessor-collector prepared a supplemental tax roll based on information from the Alcoholic Beverage Commission, which increased the valuation of the taxpayer's inventory. The court ruled that the appraisal board lacked jurisdiction to consider the increase in the taxpayer's inventory since due process requires that the board first provide a taxpayer with notice and the opportunity to be heard before encumbering this property with an additional

---

138. TEX. TAX CODE ANN. § 42.06 (Vernon 1982).
139. 709 S.W.2d 776 (Tex. App.—Beaumont 1986, no writ).
140. Id. at 777-78.
141. 695 S.W.2d 734 (Tex. App.—Dallas 1985, writ ref'd n.r.e.). For further discussion of Corchine, see Collins, supra note 12, at 713.
142. Morris County Appraisal Dist. v. Nail, 708 S.W.2d 473, 474 (Tex. App.—Texarkana 1986, writ ref'd n.r.e.).
143. Id.
144. 715 S.W.2d 170 (Tex. App.—Texarkana 1986, no writ).
145. Id. at 172.
146. TEX. TAX CODE ANN. § 25.19 (Vernon 1982).
147. 715 S.W.2d at 172.
149. Id. at 262.
tax.\textsuperscript{150}

In another case during the Survey period the Eastland court of appeals defined property owner for purposes of determining who is entitled to appeal the final order of the review board under section 42.01 of the Tax Code.\textsuperscript{151} The lessee of an airplane had appealed the appraisal review board's tax assessment of the plane, and the appraisal district had challenged the lessee's standing to appeal under section 42.01. The court first noted that the Tax Code does not define property owner.\textsuperscript{152} The court then ruled that an owner is one who owns property or has legal or rightful title, whether he possesses it or not.\textsuperscript{153} The court noted that since the lessor retained ownership and title to the airplane, the taxpayer-lessee was not the property owner of the airplane, and therefore was not the proper party to bring an action to appeal the order of the appraisal review board.\textsuperscript{154}

In a similar case, Robstown Independent School District v. Anderson,\textsuperscript{155} the Texas Supreme Court ruled that a taxpayer's failure to comply with the administrative procedure of first filing his protest of nonownership with the appraisal review board precludes him from later raising this defense in a suit brought to enforce collection of delinquent taxes.\textsuperscript{156} The taxpayer raised the defense of non-ownership of property for the first time at the district court level. The supreme court noted that section 41.41 of the Tax Code\textsuperscript{157} requires a taxpayer to protest the determination that he was the owner of property before the appraisal board.\textsuperscript{158} The court noted that the taxpayer waived this defense by failing to comply with the administrative review procedures.\textsuperscript{159}

In City of Heath v. King\textsuperscript{160} the Dallas court of appeals held that no statutory basis exists for a proration of taxes under section 21.01 of the Tax Code.\textsuperscript{161} Section 21.01 provides that a city may tax real property if the property is located within the city limits on January 1st of the year of which the taxes are assessed.\textsuperscript{162} The taxpayers had contended that the city had no power to levy taxes against their property after the date for which their property was disannexed from the city. The court strictly construed the statute and held that no basis for a proration of taxes existed and that the tax assessor could not take into account circumstances occurring after the first

\textsuperscript{150} Id.
\textsuperscript{151} Bennett-Barnes Investments Co. v. Brown County Appraisal Dist., 696 S.W.2d 208 (Tex. App.—Eastland 1985, writ ref'd n.r.e). \textit{Tex. Tax Code Ann.} § 42.01 (Vernon 1982) provides that a property owner is entitled to appeal the appraisal review board's tax assessment order.
\textsuperscript{152} 696 S.W.2d at 209.
\textsuperscript{153} Id.
\textsuperscript{154} Id.
\textsuperscript{155} 706 S.W.2d 952 (Tex. 1986).
\textsuperscript{156} Id. at 952-53.
\textsuperscript{158} 706 S.W.2d at 952.
\textsuperscript{159} Id. at 952-53 (citing \textit{Tex. Tax Code Ann.} § 42.09 (Vernon 1982)).
\textsuperscript{160} 705 S.W.2d 812 (Tex. App.—Dallas 1986, no writ).
\textsuperscript{161} Id. at 814.
\textsuperscript{162} \textit{Tex. Tax Code Ann.} § 21.01 (Vernon 1982).
day of January when assessing property taxes.\textsuperscript{163}

In \textit{Kyle v. Stone}\textsuperscript{164} taxpayers contended that the city must include its budget surplus from the preceding year when computing the ad valorem tax rate for the present year. The city had carried over a portion of its general fund balance as a cash surplus. The court concluded that Texas law gives a city discretion on levying taxes and that the Texas constitution and the city's charter imply that the city has the power to maintain a reasonable budget surplus.\textsuperscript{165}

\section*{D. Property Tax Rules}

The comptroller adopted several amendments to the property tax rules during the Survey period. Rule 165.142 adopts the State Property Tax Board's revised model form for the Notice of Protest used by taxpayers in filing protests with a local appraisal review board.\textsuperscript{166} The simplified form reflects the Property Tax Code's changes in the taxpayer's time period for filing a protest. Amended rule 155.17 revises the contents of the exemption application form for charitable organizations.\textsuperscript{167} The rule now requires additional information concerning the financial activities of the charitable organization and the use of the property by the applicant. The comptroller adopted similar rules to revise the exemption application forms for youth groups, religious organizations and privately owned schools.\textsuperscript{168} Rule 161.1 adopts by reference the Guidelines for the Valuation of Agricultural Lands as revised by the State Property Tax Board.\textsuperscript{169} The new guidelines conform the definition of "net to land" to that of the Property Tax Code. Rules 165.71 through 165.77\textsuperscript{170} adopt the State Property Tax Board's new procedures for administrative hearings concerning the findings of the taxable property value by a school district. The new rules outline the procedures for protesting determinations of school district's taxable value and determinations of an appraisal district's level and uniformity of property appraisals.

\section*{III. Franchise Taxes}

\subsection*{A. Calculation of Taxable Capital}

In \textit{Central Power \\& Light Co. v. Bullock}\textsuperscript{171} the Austin court of appeals held that an investment tax credit shown as a liability constitutes a part of a

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{163} 705 S.W.2d at 814.
\item \textsuperscript{164} 699 S.W.2d 578 (Tex. App.—Texarkana 1985, writ ref'd n.r.e.).
\item \textsuperscript{165} \textit{Id.} at 579.
\item \textsuperscript{166} Tex. Comp. Tax Rule No. 165.142, [1 Tex.] ST. TAX REP. (CCH) \$ 28-630, at 4465 (Jan. 21, 1986).
\item \textsuperscript{167} Tex. Comp. Tax Rule No. 155.17, [1 Tex.] ST. TAX REP. (CCH) \$ 28-203, at 4327-28 (Jan. 21, 1986).
\item \textsuperscript{168} Tex. Comp. Tax Rule Nos. 155.18-.20, [1 Tex.] ST. TAX REP. (CCH) \[ 28-205 to 28-215, at 4328-54 (Jan. 21, 1986).
\item \textsuperscript{169} Tex. Comp. Tax Rule No. 161.1, [1 Tex.] ST. TAX REP. (CCH) \$ 28-340, at 4431 (Jan. 21, 1986).
\item \textsuperscript{170} Tex. Comp. Tax Rules Nos. 165.71-.77, [1 Tex.] ST. TAX REP. (CCH) \$\$ 28-510 to 28-535, at 4461-63 (Jan. 21, 1986).
\item \textsuperscript{171} 696 S.W.2d 30 (Tex. App.—Austin 1984, no writ).
\end{itemize}
\end{footnotesize}
The taxpayer reported its investment tax credit under the deferral method and stated the tax credit as a liability. The taxpayer argued that unlike the typical treatment of ratably moving a part of the deferred credit into retained earnings over the life of the asset, the rate regulatory process requires the taxpayer to pay the credit ratably to the ratepayers in the form of lower utility rates. The comptroller, however, requires in rule 3.405 that taxpayers include deferred investment credit in surplus. The court rejected the taxpayer's argument that the deferred credit is a debt due the ratepayer that reduces the taxpayer's taxable capital.

In *Enserch Corp. v. Bullock* the Austin court of appeals strictly construed the exemption from franchise tax found in section 171.052 of the Tax Code for transportation companies that pay an annual gross receipts tax. Lone Star Gas Co. is a division of Enserch and qualifies as a gas utility. As a gas utility, Lone Star must pay a quarterly tax based on its gross receipts. Enserch argued that the company was exempt from the franchise tax since it derived its greatest percentage of gross receipts from Lone Star's activities as a transportation company, which pays an annual gross receipts tax. The comptroller argued that the gross receipts tax imposed on Enserch requires a taxpayer to remit its gross receipts tax on a quarterly basis and does not satisfy the requirement for the exemption under section 171.052 of paying an annual gross receipts tax. The court of appeals noted that the meaning of paying an annual gross receipts tax as required in the statute was not clear, and the court therefore concluded that Enserch failed to satisfy its burden of proof that the exemption applied to its activities.

During the Survey period the comptroller rendered a number of signifi-

---

172. Id. at 33.

173. The court noted that corporate accounting has developed two methods of reporting the investment credit. Most unregulated companies use a flow through method, which recognizes that a reduction in income taxes flows through to retained earnings, thereby creating a surplus in the tax year in which the company purchases the investment credit property. The deferral method requires that the tax credit be stated as a liability that the company ratably applies to retained earnings over the life of the investment credit property. Id. at 31.


175. Id. at 6, 151 S.W.2d at 570.

176. 707 S.W.2d 246 (Tex. App.—Austin 1986, writ ref'd n.r.e.).

177. TEX. TAX CODE ANN. § 171.052 (Vernon 1982). In 1985 the legislature amended § 171.052 to end exemption of transportation companies from the franchise tax if the companies pay an annual gross receipts tax. Id. (Vernon Supp. 1987).

178. TEX. REV. CIV. STAT. ANN. art. 6060, (Vernon 1982). Article 6660 requires every gas utility to file a quarterly statement with the Railroad Commission and pay a tax equal to one fourth of one percent of its gross receipts. Id. The Railroad Commission treats Lone Star as a transportation company. 707 S.W.2d at 248.

179. TEX. TAX CODE ANN. § 171.052 (Vernon 1982), before being amended in 1985, provided: “A corporation that is [a] transportation company . . . now required to pay an annual tax measured by their gross receipts is exempted from the franchise tax.”

180. 707 S.W.2d at 249. The court cited Texas Unemployment Compensation Comm'n v. Bass, 137 Tex. 151 S.W.2d 567 (1941). In *Bass*, the Texas Supreme Court adopted the well-established rule of construction that when faced with a claim of exemption from taxation, a court should liberally construe a statute in favor of the taxing authority and strictly construe the statute against the person claiming the exemption. Id. at 6, 151 S.W.2d at 570.
cant decisions concerning the calculation of taxable capital. Two cases addressed whether taxpayers’ accounting method adjustments actually corrected errors in the taxpayers’ books and records so that the taxpayers could obtain a tax refund. In Hearing 16,769 the comptroller ruled that the taxpayer’s book adjustments to reclassify dividends paid as an intercompany account receivable was not an actual correction of an error under rule 3.408. In Hearing 14,541 the taxpayer failed to obtain approval from the Secretary of the Treasury for the method used to allocate tax liability among the members of its affiliated group. The taxpayer claimed that its failure to obtain such approval resulted in its not making any election. The taxpayer argued that it was then free to retroactively adjust its books and at the same time adopt a more favorable allocation method set forth in the Internal Revenue Code. The comptroller ruled that the taxpayer’s failure to obtain approval of the allocation method used was not an actual book error so as to allow the taxpayer to claim a refund for franchise tax purposes.

In Hearings involving the same taxpayer, the comptroller determined that a holding company was actually doing business in Texas for the purpose of assessing the franchise tax. The taxpayer performed the basic business of a holding company, investing, managing investments, and seeking out new investments. The taxpayer argued that the definitions of doing business for franchise tax purposes and transacting business for purposes of the Texas Business Corporation Act are identical, and that its activities as a holding company did not constitute doing business. The comptroller noted that the definition of doing business is much broader than merely transacting business. The comptroller also noted that the taxpayer held director and stockholder meetings in Texas, managed investments in Texas, rented office space in Texas, and employed most of its workers in Texas. The comptroller held that the taxpayer performed virtually every activity that a holding company could perform and found that nothing in the tax statutes, legislative history, or case law could be construed to hold that the taxpayer was not doing business in the state for the purposes.

---

183. Id.; see Tex. Comp. Tax Rule No. 3.408, [1 Tex.] St. Tax Rep. (CCH) ¶ 14-086, at 1042 (Oct. 19, 1979). This rule prevents the revaluation of franchise tax liability for a prior year due to an adjustment or change in a later year to a corporation’s books and records, unless the adjustment or change actually corrects an error in the books and records. Id.
185. Id.
186. Comptroller Hearing Nos. 8,727 and 13,338 (Oct. 31, 1985) (two hearings involving same taxpayer consolidated into one opinion).
187. Id.
188. TEX. TAX CODE ANN. § 171.001 (Vernon 1982) imposes a franchise tax on any corporation that does business in Texas. The Tax Code, however, does not define doing business in Texas.
189. TEX. BUS. CORP. ACT ANN. art. 8.05 (Vernon Supp. 1987) mentioning transacting business in Texas, but does not define the term.
of the franchise tax.\textsuperscript{191}

In Hearing 13,946\textsuperscript{192} the comptroller restated his position that under rule 3.391\textsuperscript{193} a taxpayer must file its franchise tax report in accordance with the taxpayer's books and records and not with federal income tax reporting methods.\textsuperscript{194} The comptroller required the taxpayer to report for franchise tax purposes its long-term construction contracts under the percentage of completion method utilized on its books and records and not under the completed contract method utilized for its federal income tax return.\textsuperscript{195}

\subsection*{B. Apportionment of Capital: Business in Texas}

In Hearing 7546\textsuperscript{196} the comptroller ruled that the taxpayer must include proceeds from the sale of natural gas to interstate pipeline customers in Texas who then moved the gas to points outside Texas in gross receipts for the calculation of business done in Texas.\textsuperscript{197} Since the pipeline companies accepted delivery of the natural gas in Texas, the comptroller held that section 12.02(1)(b)(i) of the Tax Code required inclusion of the receipts from the sale.\textsuperscript{198} The comptroller noted that in \textit{Bullock v. Enserch Exploration, Inc.}\textsuperscript{199} the court held that whether goods travelled on interstate commerce did not affect the application of section 12.01(1)(b)(i). Section 12.02(1)(b)(i) will allocate gross receipts to Texas if, at the time of sale, property is delivered or shipped to a purchaser in Texas.\textsuperscript{200} In section 7546 the sales contract stipulated that the title to the natural gas passes to the buyer in Texas.

In Hearing 16,164\textsuperscript{201} the comptroller ruled that a foreign corporation should include receipts from the leasing of piggyback trailers to Texas corporations in receipts attributable to business done in Texas because the leased property had a tax situs in Texas during the period of the lease.\textsuperscript{202} Since the trailers spent a significant amount of time in Texas during the lease period, the comptroller held that the leased property obtained a tax situs in Texas.

\textsuperscript{191} Comptroller Hearing Nos. 8,727 and 13,388 (Oct. 31, 1985).
\textsuperscript{192} Comptroller Hearing No. 13,946 (Oct. 10, 1985).
\textsuperscript{194} Comptroller Hearing No. 13,946 (Oct. 10, 1985).
\textsuperscript{195} Id.
\textsuperscript{196} Comptroller Hearing No. 7546 (Sept. 30, 1985).
\textsuperscript{197} Id.
\textsuperscript{198} Id.; see \textbf{TEX. TAX-GEN. ANN.} art. 12.02(1)(b)(i) (Vernon 1982) (codified as \textbf{TEX. TAX CODE ANN.} § 171.103(1) (Vernon 1987)). Under this section gross receipts of a corporation from business done in Texas include the sale of tangible personal property if the property is delivered or shipped to a buyer in Texas, regardless of the F.O.B. point or other conditions of sale. \textit{Id.}
\textsuperscript{200} \textbf{TEX. TAX-GEN. ANN.} art. 12.02(1)(b)(i) (Vernon 1982) (codified as \textbf{TEX. TAX CODE ANN.} § 171.103(1) (Vernon 1987)).
\textsuperscript{201} Comptroller Hearing No. 16,164 (Oct. 21, 1985).
\textsuperscript{202} \textit{Id.} Both the taxpayer and the tax division claim that Comptroller Hearing No. 3998 (1968) is controlling. In Hearing 3998 the comptroller determined that in applying the franchise tax to a lease, the calculation of business done in Texas is based on the determination as to where the leased property was situated during the time of the lease.
even though the trailers were never permanently stationed in Texas.\textsuperscript{203}

Also noteworthy is an attorney general’s opinion that, under section 171.105 of the Tax Code,\textsuperscript{204} oil received under an oil exchange agreement or an oil matching buy/sell agreement constituted a receipt for franchise tax purposes.\textsuperscript{205} Section 171.105 provides that gross receipts include receipts from the sale of tangible personal property.\textsuperscript{206} The attorney general noted that courts have defined a sale as any transfer from one person to another for valuable consideration.\textsuperscript{207} The attorney general held that this definition would include an exchange and thus the oil received in an exchange would be a receipt from a sale.\textsuperscript{208}

The comptroller has adopted revised rule 3.393 that outlines the procedures a corporation must follow to adopt a special reporting method for allocating and apportioning business activities between Texas and other locations.\textsuperscript{209} The revised rule no longer denies a corporation permission to use a special reporting method if the petitioning corporation is delinquent in filing its prior franchise tax returns. The rule requires that any petition for special reporting must be filed with the comptroller by March 1 of the year in which the annual franchise report is due.\textsuperscript{210} The comptroller amended paragraph (a)(2) of the rule to provide that, if the comptroller requests additional information to make a determination on a petition, the taxpayer must submit the information within ninety days after the later of the original due date of the tax return or the date of the comptroller’s request.\textsuperscript{211} Revised rule 3.393(a)(4) provides that a corporation’s failure to notify the comptroller of changes in the corporation’s organizational structure, including any merger, consolidation, or other reorganization will not automatically revoke the permission granted to the corporation to use the special reporting method.\textsuperscript{212} If, however, the corporation fails to notify the comptroller and the comptroller discovers that the corporation is no longer eligible for special reporting, the comptroller will revoke the special reporting privilege granted to the corporation retroactively to the first day of ineligibility and assess penalties pursuant to Tax Code section 171.362.\textsuperscript{213} The comptroller also amended rule 3.393(a)(3) to allow a corporation that had previously used a special reporting method to file a report using the regular statutory

\textsuperscript{203} Comptroller Hearing No. 16,164 (Oct. 21, 1985).
\textsuperscript{204} TEX. TAX CODE ANN. § 171.105 (Vernon 1982).
\textsuperscript{206} TEX. TAX CODE ANN. § 171.105 (Vernon 1982).
\textsuperscript{207} See McKinney v. City of Abilene, 250 S.W.2d 924, 925 (Tex. Civ. App.—Eastland 1952, writ ref’d n.r.e.).
\textsuperscript{210} Id.
\textsuperscript{211} Id.
\textsuperscript{212} Id.
\textsuperscript{213} Id. TEX. TAX CODE ANN. § 171.362 Vernon (1982) imposes a priority of five percent of the total tax due.
reporting method.\textsuperscript{214} Changing to the regular statutory reporting method will cause the corporation to automatically forfeit the privilege of using a special reporting method for subsequent years, unless the corporation timely files a new petition and a substantial change in the nature of the corporation's business occurs.\textsuperscript{215}

IV. MISCELLANEOUS TAXES

In Hearing 17,140\textsuperscript{216} the comptroller strictly construed the Texas motor vehicle tax to apply to the entire amount paid for a specially rigged truck.\textsuperscript{217} The taxpayer argued that the tax should not apply to the portion of the purchase price attributable to labor costs for installing special equipment.\textsuperscript{218} The taxpayer, however, did not have the equipment installed after taking delivery of the truck; rather, the seller installed the equipment before the taxpayer paid for and took possession of the truck. As a result the comptroller ruled that section 152.002 of the Tax Code\textsuperscript{219} requires the motor vehicle sales tax to be based upon the total consideration paid for the truck and all costs of installing accessories.\textsuperscript{220} Under rule 3.87\textsuperscript{221} a purchaser must purchase and receive title to a vehicle prior to installation of accessories to exclude the labor charges from the sales tax. Even in that event the sales and use tax must be paid on the cost of the accessories themselves.\textsuperscript{222}

The legislature increased fuel taxes\textsuperscript{223} from $.10 per gallon to $.15 per gallon\textsuperscript{224} for the period from January 1, 1987, through August 31, 1987, and also imposed a new dealer inventory tax on dealers of those fuels.\textsuperscript{225} New section 153.016 of the Tax Code applies an inventory tax on dealers of gasoline and diesel fuel for increases in the tax rate, and such dealers will be entitled to a refund upon any reduction in the tax rates.\textsuperscript{226} The comptroller has amended rule 3.173\textsuperscript{227} to eliminate the requirement of submitting in-

\textsuperscript{215.} Id.
\textsuperscript{216.} Comptroller Hearing No. 17,140 (1985).
\textsuperscript{217.} Id.
\textsuperscript{218.} The trucks, after being specially equipped, were used for servicing oil and gas pumping units.
\textsuperscript{219.} TEX. TAX CODE ANN. § 152.002 (Vernon 1982).
\textsuperscript{220.} Comptroller Hearing No. 17,140 (1985).
\textsuperscript{221.} Texas Comp. Tax Rule No. 3.87, [1 Tex.] St. Tax Rep. (CCH) ¶ 65-105, at 7223 (June 12, 1979).
\textsuperscript{222.} Id.
\textsuperscript{223.} TEX. TAX CODE ANN. §§ 153.102, 153.202, 153.210(b), 153.301(b), 153.305(e) and 151.416 (Vernon Supp. 1987).
\textsuperscript{224.} Id. § 153.102 (Vernon Supp. 1987).
\textsuperscript{225.} Id. § 153.016. The tax applies only to dealers with an inventory of 2,000 or more gallons of fuel. As of January 1, 1987, any such dealer must report his inventory to the comptroller and pay the additional tax of $.05 per gallon. Section 153.016 requires the comptroller to provide a method for claiming a refund if the tax rate is reduced. Id.
\textsuperscript{226.} Id.
voices and other documentation with refund claims for gasoline and diesel fuel taxes.

To reduce the hearing case load the comptroller adopted, on an emergency basis, rule 3.5,\textsuperscript{228} which provides a special procedure for the settlement of interest and penalties. The new rule provides that the taxpayer has five days after the conclusion of an audit exit conference to make a written request to the audit manager to settle amounts of penalty and interest.\textsuperscript{229} The audit manager has the authority to settle all amounts under $5000.\textsuperscript{230} The audit manager is required to provide the taxpayer a written response to the taxpayer's settlement office.\textsuperscript{231} If no audit is performed, the taxpayer files a written settlement request with the Tax Administration Division of the comptroller's office.\textsuperscript{232}

\begin{footnotes}
\item[228] Texas Comp. Tax Rule No. 3.5, [1 Tex.] St. Tax Rep. (CCH) ¶ 89-927, at 8989-90 (adopted on an emergency basis Mar. 3, 1986, adopted to be effective permanently beginning July 1, 1986).
\item[229] Id.
\item[230] Id.
\item[231] Id.
\item[232] Id.
\end{footnotes}