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Taxation

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I. LIMITED SALES, EXCISE, AND USE TAX

A. Application of the Tax

**COMPTROLLER** of Public Accounts v. Austin Multiple Listing Service, Inc.\(^1\) focused on the distinction between sales of taxable property and sales of nontaxable services. Austin Multiple Listing Service (Austin Service) paid Multi-List Inc. to compile, process, and print Austin real estate information in a weekly booklet. The comptroller asserted that the sales involved both services and tangible personal property and alleged taxability on the theory that the essence of the transactions consisted of the printing and distribution of the books. The taxpayer argued that the sales involved only nontaxable services. In holding for the taxpayer, the court reiterated that the test for deciding the taxability of a transaction consists of determining the ultimate object or the essence of the transaction, adding that taxing statutes must be strictly construed against the taxing authority.\(^2\) The court noted that the real estate data had a short useful life, that the data could be transmitted in a variety of forms, and that Multi-List relied upon its customer to supply the data.\(^3\)

In **Bullock v. Texas Monthly, Inc.**\(^4\) Texas Monthly alleged that the sales tax exemption in section 151.312 of the Tax Code for religious periodicals constituted an unlawful discrimination based on the content of the magazine, and therefore violated the first and fourteenth amendments to the United States Constitution, and article I, section 8 of the Texas Constitution.

\(^{1}\) 723 S.W.2d 163 (Tex. App.-Austin 1986, no writ).

\(^{2}\) *Id.* at 165.

\(^{3}\) *Id.* at 165-66. The court relied in part on Geomap Co. v. Bullock, 691 S.W.2d 98, 100 (Tex. App.—Austin 1985, writ ref’d n.r.e.), and Williams & Lee Scouting Serv., Inc. v. Calvert, 452 S.W.2d 789, 792 (Tex. Civ. App.—Austin 1970, writ ref’d). Despite 1987 legislative changes concerning taxation of services, (see *infra* notes 31-71 and accompanying text), the “essence of the transaction” test should remain of critical importance for distinguishing taxable sales from nontaxable sales. See Comptroller Hearings No. 21,164 (May 19, 1987) and No. 19,085 (July 7, 1987). But see Comptroller Hearing No. 18,361 (Jan. 12, 1987) (“essence of the transaction” test not applied to services).

\(^{4}\) 731 S.W.2d 160 (Tex. App.—Austin 1987, writ ref’d n.r.e.). For changes made with respect to magazine taxation since this case, see *infra* note 92.
The district court held for Texas Monthly, but the appeals court reversed.\(^5\) In an opinion that relied primarily on United States Supreme Court cases\(^6\) the appellate court concluded that the exemption did not violate the equal protection clause or the prohibition against establishment of religion in the United States Constitution.\(^7\) The court reasoned that the law does not bind the legislature to tax every member of a class so long as the legislature’s distinctions have a rational basis.\(^8\) The effect of the religious tax exemption must also permit religious organizations to remain independent of government support.\(^9\) The court further concluded that Texas Monthly did not meet its burden of establishing that the failure of the legislature to exempt other types of publication in any way restricted the right of Texas Monthly to free speech.\(^10\)

*Texas Monthly* contrasts with *Arkansas Writers’ Project, Inc. v. Ragland*,\(^11\) in which the United States Supreme Court held unconstitutional an Arkansas tax exemption for certain periodicals. The Texas court attempted to distinguish *Ragland* on the ground that the breadth of *Ragland*’s exemption reduced the quantity of magazines subject to tax to a very small group, whereas the Texas Monthly appeal presented the opposite situation.\(^12\) Other sales tax cases rendered during the survey period include *Direlco Inc. v. Bullock*\(^13\) and *State v. Glass*.\(^14\) *Direlco* upheld the comptroller’s interpretation of “commercial use” for purposes of determining the taxability for certain gas and electricity use.\(^15\) *Glass* denied an exemption from diesel fuel tax, in part, on the well established principles that the comptroller’s tax deficiency creates a presumption of taxability and that courts will strictly construe statutory exemptions from tax against the taxpayer.\(^16\)

The so-called “sixty-day rule,” which requires that a taxpayer present its resale certificates to the comptroller within sixty days of the auditor’s written request,\(^17\) gave rise to a substantial number of administrative decisions.

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5. 731 S.W.2d at 166.
7. 731 S.W.2d at 165.
8. Id. at 163.
9. Id.
10. Id. at 165. Judge Carroll’s dissenting opinion concluded not only that the Texas Constitution contemplates a “stronger belief in the separation of church and state” than does the United States Constitution, id. at 167 n.1, but also that the challenged exemption constitutes an unconstitutional infringement of the establishment clause of the United States Constitution. The dissent further concluded that taxing religious periodicals would result in even greater entanglement between church and state and advocated striking the tax as it applies to all periodicals.
12. 731 S.W.2d at 165.
13. 711 S.W.2d 360 (Tex. App.—Austin 1986, writ ref’d n.r.e.).
14. 723 S.W.2d 325 (Tex. App.—Austin 1987, writ ref’d n.r.e.). The definition of “commercial use” was modified by Act of July 21, 1987, ch. 5, art. 1, pt. 4, § 25 (2d Called Session), 1987 Tex. Sess. Law Serv. 17 (Vernon) [hereinafter cited as House Bill 61 or H.B. 61] (codified at TEX. TAX CODE ANN. § 151.317(c) (Vernon Supp. 1988)).
15. 711 S.W.2d at 364.
16. 723 S.W.2d at 327.
17. See TEX. TAX CODE ANN. § 151.054(c) (Vernon Supp. 1988); TEX. ADMIN. CODE tit.
In general, these decisions reiterate the comptroller’s position that: the requirement applies to sales made prior to October 2, 1984, the effective date of the law; the requirement must be strictly interpreted; and certain alternative proof (rather than resale certificates) may be accepted with respect to transactions that occurred prior to October 2, 1984.

As in other years, administrative decisions illustrate that a taxpayer may be entitled to relief if the taxpayer can demonstrate detrimental reliance on erroneous advice given by a representative of the comptroller’s office. Although the decisions lack consistency on a theoretical basis, they do set forth criteria necessary to illustrate detrimental reliance.

Several of the comptroller’s decisions dealt with exemptions from sales tax. Decisions 18,847 and 16,489 illustrate the comptroller’s established position that a sale by a third party that has received property in a foreclosure or similar proceeding cannot qualify as an occasional sale. In Decision 17,124 the administrative law judge permitted an exemption for an occasional sale of “the entire operating assets of a business or of a separate division, branch, or identifiable segment of a business” within the meaning of section 151.304(b)(2) of the Tax Code. The taxpayer received the exemption despite the tax division’s argument that the drilling rigs sold were not actually used in a business activity because no income had been recognized with respect to them. The administrative law judge held, however, that the key factor was not whether the seller actually used the rig, but whether the seller bought the rig in the pursuit of its business activity. Although the comp-

34, §§ 3.282, 285, 286, 287. See also infra note 85-86 and accompanying text (concerning legislative changes to the 60-day rule).
19. See, e.g., Comptroller Hearing No. 20,866 (May 4, 1987).
20. See, e.g., Comptroller Hearing No. 19,204 (Oct. 20, 1987); see also Comptroller Hearings No. 19,425 (Jan. 8, 1987); No. 18,631 (Feb. 10, 1986) (discussion of the development of the 60-day rule).
21. See, e.g., Comptroller Hearings No. 20,821 (May 18, 1987); No. 20,177 (Apr. 16, 1987); No. 17,565 (Mar. 11, 1987).
22. Comptroller Hearings No. 18,847 (Apr. 6, 1987); No. 16,489 (Apr. 22, 1987). Each of these decisions involved a purportedly exempt sale pursuant to TEX. TAX CODE ANN. § 151.304 (Vernon 1987).
25. See also Comptroller Hearing No. 19,620 (Oct. 7, 1986) (sale held taxable because the taxpayer failed to meet burden of proving that income and expenses of a division could be separately established from the books and records).
26. See also Comptroller’s Hearing No. 19,708 (Oct. 6, 1986) (sale need not include seller’s inventory to qualify as occasional “sale of the entire operating assets of a business” under TEX. TAX CODE ANN. § 151.304(b)(2) (Vernon Supp. 1988)); Comptroller Hearing No. 19,278 (May 7, 1987) (taxpayer who did not hold himself out as engaging in the business of selling taxable items at retail qualified for exemption from sales tax on a sale from one or two taxable items; taxpayer could not, however, qualify for a credit available under TEX. TAX CODE ANN. § 151.427 (Vernon 1982) to a seller who sells in the regular course of its business) (although this decision deals with rentals, which fail to qualify for occasional sales tax treatment under current law, see TEX. TAX CODE ANN. § 151.304(e) (Vernon Supp. 1988), the principles outlined in the decision would apply to other occasional sales); Comptroller Hearing No. 20,567 (Feb. 24, 1988) (sale did not qualify under TEX. TAX CODE ANN. § 151.304(b)(2) (Vernon Supp. 1988) exemption when buyer rejected a portion of the assets offered for sale by seller).
controller generally refuses to consider constitutional arguments, the comptroller set aside an audit in Decision 19,491 on equal protection grounds after finding that the comptroller had audited but not taxed another company that engaged in exactly the same business as the audited taxpayer.

B. Legislative Developments

Legislative developments provided the most significant changes in Texas sales tax law during the survey period. The legislature increased the state sales tax rate to 6%, extended the services subject to tax, and made numerous other changes.

Amusement Services. Although Texas first taxed certain amusement services in 1984, additional amusement services are now taxable, including membership in a private club. The legislature also made conforming changes to the definitions of “sale” or “purchase” and “sales price.” Modification of section 151.3101 of the Tax Code tightened tax exemptions for amusement services by stating that the services qualify for exemption only if exclusively provided by the specifically exempted provider. This change could heavily impact events co-sponsored by commercial entities, such as charity sports events co-sponsored by a radio station or other commercial venture.

Credit Reporting Services. Texas now taxes credit reporting services, which the state defines as assembling or furnishing credit history or credit information that relates to any person. An emergency rule promulgated by the comptroller defines credit reporting services as the assembling or furnishing a credit report, or part of a credit report, for fees or other consideration. The rule broadly defines credit report as including any written, oral, or other compilation of credit history or other information that has a bearing on a

27. See, e.g., Comptroller Hearing No. 18,858 (Apr. 1, 1987) (citing Texas State Bd. of Pharmacy v. Walgreen Texas Co., 520 S.W.2d 845 (Tex. App.—Austin 1975, writ ref'd n.r.e.)).
29. Id.
30. H.B. 61, pt. 1; The legislature increased the rate effective October 1, 1987. See id.; Act of July 21, 1987, ch. 8 (2d Called Session), 1987 Tex. Sess. Law Serv. 88 (Vernon) [hereinafter cited as H.B. 176]. Total state and local tax can be as high as 8%.
31. See TEX. TAX CODE ANN. §§ 151.0101, .0028 (Vernon Supp. 1987); TEX. ADMIN. CODE tit. 34, § 3.298; see also Comptroller Hearings No. 19,985 (Jan. 23, 1987); No. 19,734 (Mar. 13, 1987) (addressing scope of amusement services).
34. Id. § 151.007(e). This section includes initiation fees in the sales price. But see 12 Tex. Reg. 3624 (TEX. ADMIN. CODE tit. 34, § 3.298) (emergency rule adopted Sept. 30, 1987). Contrast this version of the rule with 12 Tex. Reg. 1827 (TEX. ADMIN. CODE tit. 34, § 3.298) (amendments proposed Feb. 17, 1988).
person's credit status or insurability. The rule requires the provider of credit services to collect sales tax if the anticipated transaction that causes the request for credit will occur in Texas, the address of the credit applicant at the time of the request is in Texas, and the requestor of the credit report is located in Texas or doing business in Texas as provided in section 151.107 of the Tax Code. According to spokespersons in the comptroller's office, the rule's intent is to provide a two-prong test: the subject of the credit report must be located in Texas, and the person requesting the credit report must be doing business in Texas. This test is designed to avoid the difficulty of attempting to allocate the use of credit reporting services between in-state and out-of-state.

Data Processing. In 1984 the state began taxing sales of computer programs other than certain custom programs. Data processing services newly subject to tax under 1987 legislation include: word processing; data entry, retrieval, and search; information compilation; payroll and business accounting; data production; and other computerized data and information storage or manipulation. This category also includes the use of a computer or computer time for data processing, whether performed by the party who provides the computer access or by the purchaser or other beneficiary of the service. Due to conforming changes, the definition of tangible personal property no longer excludes custom computer programs. Although the legislature intended to tax the growing number of service-oriented data processing companies, the broad statutory definition of data processing could apply to a very wide range of companies and services, including data processing incidental to reporting by credit card companies and accounting firms. However, the data processing rule provides a more restrictive definition, and specifically provides that data processing does not include computer use to facilitate another service (for example, an accountant's use to produce financial reports). In addition, unrelated, distinct services that are commonly provided on a stand-alone basis are not taxable.

37. 12 Tex. Reg. 3628 (TEX. ADMIN. CODE tit. 34, § 3.343) (emergency rule adopted Sept. 30, 1987). This rule, like other emergency service rules, provides that if the seller is not doing business in Texas and is not required to collect Texas tax, reporting the tax becomes the Texas customer's responsibility. See also 12 Tex. Reg. 4771 (TEX. ADMIN. CODE tit. 34, § 3.343) (proposed Dec. 10, 1987).
38. TEX. ADMIN. CODE tit. 34, § 3.343. The statute treats credit card companies as doing business in Texas if the financial institution issuing the card does business in Texas or if the credit card company is "otherwise doing business in Texas." Id. § 3.343(b)(1)(c).
40. Id. § 151.0035 (Vernon Supp. 1988) (eff. Jan. 1, 1988, id. § 151.0101(a)(12)).
41. Id.
42. Id. § 151.009; see 12 Tex. Reg. 4787 (TEX. ADMIN. CODE tit. 34, § 3.308) (adopted Dec. 9, 1987) (amending comptroller's regulatory definitions of canned and custom software, and making software and installation changes taxable).
44. TEX. ADMIN. CODE tit. 34, § 3.330(d).
Debt Collection Services. The legislature also imposed sales tax on debt collection service, which it defined as an activity to collect or adjust a debt or claim, or to repossess property subject to a claim.\(^4\) The legislation specifically provides that debt collection service does not include the collection of judgments by attorneys if the attorney represented the person in the suit that generated the judgment.\(^5\) The fact that the legislature specifically considered attorneys created the implication that attorneys’ fees for debt collection might be taxable. However, most attorneys’ fees are exempt according to an opinion by the attorney general.\(^6\) The emergency rule with respect to debt collection services\(^7\) offers additional guidance as to what constitutes debt collection.

Information Services. The legislature also made information services subject to tax.\(^8\) These services are defined to include: (1) furnishing general or specialized news or other current information, including financial information, except for information furnished to a general circulation newspaper published at least weekly, or to a federally licensed radio or television station; or (2) electronic data retrieval or research.\(^9\) The comptroller’s emergency rule\(^10\) essentially tracks the statutory definition of information services, but adds language that extends to various means of information transmission in effect now or in the future, including electrical transmission, microwaves, satellites, or fiber optics.\(^11\) The state taxes information gathered, maintained, compiled, and made available to the public or to a specific segment of industry (such as newsletters, oil and gas scouting reports and surveys, mailing lists), but exempts information of a proprietary nature gathered or compiled on behalf of a particular client (such as opinion polls, polygraph tests, account balances, and other information not for resale).\(^12\) Both the statute\(^13\) and the emergency rule\(^14\) include exceptions for information

\(^{46.}\) TEX. TAX CODE ANN. § 151.0036(b) (Vernon Supp. 1988).
\(^{47.}\) The attorney general’s opinion addresses fees to date of judgment for the following: collection of open accounts and debts; filing bankruptcy claims; land foreclosures; enforcing contracts that involve a monetary dispute; enforcing a judgment without having obtained the judgment; negotiating debt and claim adjustments; and enforcing insurance claims. The opinion concludes that legal services are taxable only if the lawyer is acting “as nothing more than a debt collector.” Although the definition of “claim” in 12 Tex. Reg. 3629 (TEX. ADMIN. CODE tit. 34, § 3.354) (emergency rule adopted Sept. 30, 1987) is broad enough to encompass virtually all litigation fees, such fees should not be taxable. See 12 Tex. Reg. 4772 (TEX. ADMIN. CODE tit. 34, § 3.354) (proposed Dec. 10, 1987); 13 Tex. Reg. 1222 (TEX. ADMIN. CODE tit. 34, § 3.354 (adopted Mar. 3, 1988).
\(^{48.}\) 12 Tex. Reg. 3629 (TEX. ADMIN. CODE tit. 34, § 3.354).
\(^{50.}\) Id. § 3.342(e), (g).
services sold to certain newspapers, radio, or television stations if the seller obtains an exemption certificate. The certificate must state that the purchaser is a newspaper with a general circulation published at least weekly or a station licensed by FCC.

**Insurance Service.** The numerous statutes affecting insurance taxation exceed the scope of this Article. Certain insurance taxation provisions in the 1987 legislation, however, merit discussion. The statute defines taxable insurance services as: "[1] insurance loss or damage appraisal, [2] insurance inspection, [3] insurance investigation, [4] insurance actuarial analysis or research, [5] insurance claims adjustment or claims processing, or [6] insurance loss prevention service." The definition excludes, however, payment of premiums for insurance coverage, or payment of commissions to insurance agents for the sale of insurance or annuities. An emergency rule issued by the comptroller defines each of the six components of insurance service listed by the statute and provides additional guidance for determining which services are taxable. A revised version of this rule has been proposed.

**Real Property Repair and Remodeling.** The new legislation also makes repair and remodeling services taxable. Such services include repairing, restoring, remodeling, or modifying an improvement to real property other than certain described structures or improvements (intended to cover certain residential property). Other legislative provisions made conforming changes to the Tax Code, and an emergency administrative rule provides further guidance.

**Real Property Services.** Newly taxable real property services include landscaping, lawn care, garbage collection, building or grounds cleaning, certain

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62. Id. § 151.0047.
63. See id. § 151.058, which provides that "(a) A person performing repair services taxable under this chapter is the consumer of machinery and equipment used in performing the service," and that "(b) the total amount charged for a repair service taxable under this chapter is subject to tax, including charges for labor, materials, overhead, and profit."
structural pest control services, and the surveying of real property, although the statute exempts certain yard maintenance by individuals under eighteen years old. An emergency rule defines each of the subcategories of real property services subject to tax, defines employee/employer relationship, and provides additional guidance.

Security Services. Texas now taxes security services. Under the relevant emergency rule, the category includes services provided as an investigations company, guard company, or alarm system company. Nontaxable security services include services by an employee for his employer in the regular course of business within the scope of the employee's duties, for which the employee is paid his regular wages or salary.

Exemptions and Grandfathering. The legislature specifically exempted from taxation service transactions among affiliated entities, at least one of which is a corporation, that report their income to the Internal Revenue Service on a single consolidated return for the tax year in which the transaction occurs. By providing that an “affiliated entity” includes entities that would otherwise be excluded from the category pursuant to restrictions imposed by section 1504 of the Internal Revenue Code, the legislature made clear that at least those corporations are included in the definition of affiliated entities. A prior draft of the bill referred to “corporations” instead of “entities.” The change to the broader designation would apparently include associations treated as corporations for federal income tax, but not state law purposes. The term may even extend to partnerships comprised of corporations that report income on a consolidated return. This exemption applies only to a service that would not have been taxable on September 1, 1987, and the service-provider may not purchase for resale services exempted under this

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68. The rule provides several examples of taxable and nontaxable services, and provides, inter alia, exemption for certain services provided by landscape designers or landscape architects.
71. Id.
73. Id.
74. Id.
The new sales tax legislation also includes two separate grandfather provisions. One of these exempts certain receipts from the difference between the new 6% sales tax rate and the old 5.25% rate (but not from the 5.25% rate). One of two preconditions must be met. Under the first option, items sold must be used for the performance of a contract entered into on or before July 21, 1987, and the contract cannot be subject to change by reason of the tax rate increase. Under the alternative provision, the exemption applies to the taxable items used pursuant to bid obligations submitted on or before July 21, 1987, if the bid may not be withdrawn, modified, or changed by reason of the rate increase. In addition to satisfying one of these tests, the taxpayer must provide the comptroller with notice of the contract or bid within sixty days after the effective date of the tax. The exemption expires after July 1, 1990.

The second grandfather clause creates a complete, temporary exemption from the service tax for certain receipts from the sale, use, or rental and the storage, use, or other consumption in this state of items or services that become subject to tax under the new law. Such receipts are exempt from the sales tax if the items or services comprise the subject of a written contract or bid entered into on or before July 21, 1987. This exemption has no effect after January 1, 1990. An administrative rule provides some insight into the interpretation of these provisions. A proposed rule further provides that a transferee of a contract can maintain the prior contract exemption if the transferee is also bound by the contract.

Despite (and because of) the extensive legislative changes and the nearly immediate regulatory guidance from the comptroller, many unanswered questions concerning the new services taxes still remain. For example, what constitutes taxable use in Texas? The new law exempts services performed for use outside this state, and provides that services performed for use both within and outside this state are exempt to the extent the services are for use

75. Id.
76. H. B. 61, art. 1, pt. 3, § 4. Representatives from the comptroller's office have indicated, however, that they do not expect to receive contracts, and that taxpayers should instead keep contracts available for audit. See Tex. Admin. Code tit. 34, § 3.319(d).
77. Id.
78. H.B. 61, art. 1, pt. 4, § 36. Although the two statutes will likely be similarly interpreted in some respects, the comptroller's office has indicated informally that it does recognize that the two exemptions are subject to different standards. See also 12 Tex. Reg. 3626 (Tex. Admin. Code tit. 34, § 3.319) (emergency amendment to Tex. Admin. Code tit. 34, § 3.319) (adopted Sept. 30, 1987); 12 Tex. Reg. 4767 (Tex. Admin. Code tit. 34, § 3.319) (amendment proposed Dec. 10, 1987); 13 Tex. Reg. 1340 (Tex. Admin. Code tit. 34, § 3.319) (adopted Mar. 11, 1988). At least a portion of this rule will apply only to the rate increase exemption.
79. H.B. 61, art. 1, pt. 4, § 36; see also Calvert v. British—American Oil Producing Co., 397 S.W.2d 839 (Tex. 1966) (interprets a similarly worded prior contract exemption statute very narrowly); Comptroller Hearing No. 15,762 (Mar. 10, 1986) (interpreting a prior contract exemption with respect to a 1978 tax).
80. H.B. 61, art. 1, pt. 4, § 36.
outside this state. The exemptions, however, do not apply to services performed outside Texas but for use within Texas. Further administrative and judicial interpretation will likely be necessary to resolve numerous questions. For example, where are information services or data processing services used? How can a taxpayer distinguish between taxable and nontaxable services? Although the administrative rules offer some guidance in these areas, many questions remain. Texas's new service taxes will surely produce additional costs to service businesses not only as a direct result of the sales tax liability itself, but also as a result of the additional complexity of doing business. For many companies, the service taxes will require businesses to revise some traditionally used contracts in order to segregate certain services, based on location and taxability.

The 1987 legislation also modified the requirements concerning resale certificates. Section 151.054 of the Tax Code provides that, in order to deduct the amount of a sale for resale from the total sales amount subject to tax, the seller must obtain resale certificates within sixty days of written request from the comptroller. The new law tightens the resale rule by requiring that the seller must not only acquire the resale certificates within sixty days of the written request, but must also deliver them to the comptroller within that time period. Another change to section 151.151 of the Tax Code deleted the language that permitted a purchaser to give a resale certificate if, at time of sale, the purchaser was unable to ascertain whether property would be held for resale.

The legislature has also expanded the sales tax base by attempting to expand significantly the class of persons and activities subject to Texas sales tax. The legislature redefined the activities that constitute being engaged in business by a retailer. Activities subject to tax now include: deriving rent-
als from a lease of tangible personal property situated in Texas; soliciting orders for taxable items by means of broadcasting, printing, or distributing advertisements from a Texas location (if intended for Texas consumers and only secondarily disseminated to bordering jurisdictions); certain soliciting of orders for taxable items by mail or through other media and subject to (or permitted to be subject to) Texas jurisdiction for tax purposes under federal law; and having a franchisee or licensee operating under its trade name if the franchisee or licensee is required to collect tax. In view of the breadth of the statutory language, past court decisions limiting state jurisdiction over mail order companies, and proposed federal legislation on the same subject, the scope of these provisions could become a significant issue.

In addition to the significant expansion of the sales tax base, the Texas Legislature made several other changes. The state imposes a $110 annual fee on certain professionals, including attorneys. Although most of the new legislation adversely affected taxpayers, the state provided a few relief items. In addition to creating a few new exemptions to sales taxes, Texas enacted a limited credit for manufacturing, effective beginning in 1990. The credit will eventually phase out sales tax for certain manufacturing equipment.

The legislature also imposed a controversial tax on third-party plan administrators of welfare benefit plans. A discussion of this tax, which is technically part of the Texas Insurance Code, exceeds the scope of this Article. Judicial intervention, however, will likely be necessary to resolve satisfactorily the legal issues raised. In brief, the new legislation imposes an "Administrative Services Tax" on plan administrators. The state imposes an annual tax of 2.5% on the gross amount of administrative or service fees

89. Id.
90. See, e.g., National Bellas Hess, Inc. v. Dep't of Revenue, 386 U. S. 753 (1967).
92. See, e.g., TEX. TAX CODE ANN. § 151.423 (reducing from 1% to 0.5% the collection fee a taxpayer may keep); § 151.201 (sales tax permit and renewal fees); § 151.314 (food and food products); § 151.323 (certain additional telecommunications services); § 151.330 (certain formerly exempt sales of tangible personal property to a common carrier); § 151.317(c) (gas and electricity sold for commercial purposes) (Vernon Supp. 1988). Several comptroller's hearings interpreted this section as in effect prior to this revision. See, e.g., Comptroller Hearing No. 20,795 (Mar. 18, 1987).
93. H.B. 61, art. 9. The statute also imposes the fee on: physicians; dentists; optometrists; chiropractors; psychologists; CPAs; architects; engineers; real estate broker licensees; securities dealers; certain officers and salesmen; and veterinarians. These tax increases apply to all fees that first become due on or after September 1, 1987, but before August 31, 1989.
94. TEX. TAX CODE ANN. § 151.318(g), (h) (Vernon Supp. 1988).
95. TEX. INS. CODE ANN. art. 4.11A (Vernon Supp. 1988).
96. Id. The legislature also imposed a temporary surtax on certain unauthorized insurers
received by an insurance carrier (or certain "persons") under an administrative service contract to be performed in Texas or on behalf of persons in Texas or for risks located in Texas, and relating to any of a comprehensive list of benefit plans.\textsuperscript{97} Because the gross amount of the administrative or service fee includes not only the total gross amount of all consideration received by the carrier, but also the total amount of all claims and benefits paid to or on behalf of employers, employees, spouses, dependents, or other persons under a plan,\textsuperscript{98} the tax effectively applies to the gross benefits paid under a plan (subject to certain exclusions). Under certain circumstances the tax applies to the welfare plan rather than to the third-party administrator.\textsuperscript{99} It would appear that federal law would preempt this tax to some extent, but substantial disagreement exists as to what extent.\textsuperscript{100}

\section*{II. Franchise Tax}

\subsection*{A. Calculation of Taxable Capital}

Texas courts rendered few franchise tax decisions during the survey period, but those few were significant. In \textit{Bullock v. Sage Energy Co.}\textsuperscript{101} the Austin court of appeals held that the comptroller's rule\textsuperscript{102} requiring corporations to capitalize, rather than expense, intangible drilling costs if the corporation capitalizes such costs on its books and records violates the standard of equal and uniform taxation set forth in the Texas Constitution.\textsuperscript{103} The Securities and Exchange Commission required Sage Energy, a publicly held corporation, to capitalize its intangible drilling costs on its books and records. Therefore, the comptroller required it to capitalize such costs on its franchise tax report. The comptroller allowed taxpayers not regulated by the Securities and Exchange Commission to expense their intangible drilling costs for franchise tax purposes if they did not capitalize such costs on their books and records.

The taxpayer in \textit{Sage Energy} asserted that the comptroller's rule with respect to intangible drilling costs treated similarly situated taxpayers differently by requiring some corporations to capitalize such costs (thereby including such costs in the corporations' taxable surplus, and increasing the corporations' franchise tax liability) while allowing other corporations to expense intangible drilling costs. The taxpayer alleged that such unequal treatment violated the Texas Constitution. The court agreed, stating that the

\begin{thebibliography}{99}
\bibitem{97} Id. art. 1.14-1(c), (h); art. 1.14-2(e); art. 4.10, § 10A; art. 4.11, § 5A; art. 9.59, § 4A.
\bibitem{98} Id. art. 4.11A.
\bibitem{99} Id.; see id. § 3(2).
\bibitem{100} Id. art. 4.11A; see id. § 4.
\bibitem{101} This tax, by the terms of the statute, applies only to the extent not preempted by federal law. \textit{Id. See generally} \textit{General Motors Corp. v. California State Bd. of Equalization, 600 F. Supp. 76} (C.D. Cal. 1984) (preemption of state tax on employee benefit plans).
\bibitem{102} 728 S.W.2d 465 (Tex. App.—Austin 1987, writ ref'd n.r.e.).
\bibitem{103} TEX. ADMIN. CODE tit. 34, § 3.391(b)(1) (amended Mar. 19, 1984).
\bibitem{104} TEX. CONST. art. VIII, § 1.
\end{thebibliography}
taxpayer paid "more franchise taxes than other similarly situated oil and gas operating corporations" for enjoying the same value of the privilege of doing business in Texas.\textsuperscript{104}

In \textit{State v. Sun Refining \& Marketing, Inc.}\textsuperscript{105} the Austin court of appeals held that taxable surplus should not include two reserve accounts reflecting reasonable estimates of the taxpayer's liabilities.\textsuperscript{106} One reserve account reflected expected liabilities pursuant to its self-insurance program. The corporation made the entries in accordance with generally accepted accounting principles. The other reserve account reflected estimates of amounts owed to other oil companies pursuant to a federal program that required payments between oil companies based on the price a company paid for crude oil in comparison to the average price paid by the other oil companies for crude oil. The events fixing liabilities with respect to this federal program had already occurred, but the actual liability could not yet be determined.

The comptroller argued that reserve accounts should be included in surplus unless they reflect absolute and fixed liabilities. The court held, however, that the events giving rise to the liabilities estimated in these reserve accounts had occurred and the estimates of the liabilities were reasonable, so the reserves should not be included in surplus.\textsuperscript{107} The court noted that including these reserve accounts in the taxpayer's taxable surplus would not provide an accurate picture of the corporation's present financial condition.\textsuperscript{108} The court also stated that the comptroller's position with respect to contingent reserve accounts conflicted with two Texas decisions holding that analogous contingent reserve accounts should not be included in surplus.\textsuperscript{109}

\textsuperscript{104} 728 S.W.2d at 468. The court in \textit{Sage Energy} awarded additional damages of $10,000 to the taxpayer because the comptroller disregarded a prior unpublished court of appeals decision that also held unconstitutional the rule at issue in \textit{Sage Energy}. See \textit{Bullock v. Samedan Oil Co.}, No. 14,146 (Tex. App.—Austin, Jan. 9, 1985, no writ). Although the court in \textit{Sage Energy} noted that the \textit{Samedan} decision did not constitute precedent, the court stated that the comptroller, as a servant of the state, should not disregard the decision. 728 S.W.2d at 469.

As a result of the Texas Supreme Court's refusal to issue a writ of error in \textit{Sage Energy}, the comptroller has established a task force to determine the amount of refunds due, if any, to corporations that the comptroller had mandated capitalization of intangible drilling costs.

\textsuperscript{105} 740 S.W.2d 552 (Tex. App.—Austin 1987, no writ).

\textsuperscript{106} \textit{Id.} at 555.

\textsuperscript{107} \textit{Id.}

\textsuperscript{108} \textit{Id.} The Texas Legislature enacted provisions in the 1987 regular session to address the issues presented in the \textit{Sun Refining} decision by defining "surplus" to include contingent and estimated reserve accounts (with certain exceptions). \textit{See infra} notes 154-56 and accompanying text. \textit{Sun Refining} and \textit{State v. Sun Oil Co. (Delaware)}, 740 S.W.2d 556 (Tex. App.—Austin 1987, no writ) (discussed \textit{infra} at notes 110-11) still carry enormous impact with respect to years prior to the effective date of this new legislation.

\textsuperscript{109} \textit{See Huey \& Philip Hardware Co. v. Shepperd}, 151 Tex. 462, 468, 251 S.W.2d 515, 520 (1952) (reserve for bad debts); \textit{Calvert v. Houston Lighting \& Power Co.}, 369 S.W.2d 502, 510 (Tex. Civ. App.—Austin 1963, writ ref'd n.r.e.) (reserve for deferred federal income taxes). The court in \textit{Sun Refining} also addressed the proper franchise tax treatment of a deferred employee pension account. The taxpayer established a pension for its employees that obligated the taxpayer to pay benefits for past work. Although the taxpayer paid these benefits over ten years, it expensed the payments over thirty years to reflect more closely the fact the benefits had been earned over a much longer period than ten years. This disparate accounting treatment resulted in the liability on the accounting records being much less than the amounts actually paid as pension benefits. The taxpayer booked this difference as a separate entry and subtracted the amount from taxable surplus (although it recorded it as an asset on its balance
In a related case, *State v. Sun Oil Co. (Delaware)*, the court reviewed four reserve accounts reflecting contingent liabilities and held that all of the reserves reflected reasonable estimates of liabilities, and that none of the accounts should be included in surplus. The reserve accounts at issue involved estimated liabilities with respect to: (1) the regulation of the price of natural gas already sold by the taxpayer; (2) lawsuits filed by royalty owners in which taxpayer's counsel determined there was probable liability; (3) obligations for removing drilling platforms; and (4) a current franchise tax audit for which taxpayer's counsel and accountants believed that liability existed.

The comptroller also issued several noteworthy decisions during the survey period. In Decision 18,111 the comptroller expressly overruled the holding in Decisions 16,496 and 16,603 that the threshold test for determining if a purported debt between related corporations should be treated as a capital contribution for franchise tax purposes is whether there is a provision for, and payment of, interest. The comptroller ruled in Decision 18,111 that the advances between the related corporations should be treated as loans for franchise tax purposes in spite of the fact that the lender charged zero percent interest on the advances.

In Decision 18,135 the comptroller ruled that the taxable surplus of a wholly owned subsidiary of a bank should not include property to which the subsidiary had legal but not equitable title. The subsidiary was a shell corporation and merely acted as the parent's nominee or agent in acquiring these properties.

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10. 740 S.W.2d 556 (Tex. App.—Austin 1987, no writ).
11. Id. at 559. The court merely set forth the facts related to each reserve account without an explanation of the applicable legal principles. Instead, the court made reference to the principles set forth in the *Sun Refining* decision. Id.
16. The comptroller determines whether an obligation constitutes a debt on a case-by-case basis, considering repayment history, whether the transaction is in writing, expectation of repayment and capitalization of the debtor, among other factors. See Comptroller Hearing No. 21,227 (May 14, 1987). Although Decision 18,111 clarifies the test applied in debt/equity issues, two other decisions clouded the debt/equity test. In distinguishing between loans and capital contributions, the comptroller considered the fact that the loan recipient could not have obtained a similar loan on similar terms from an unrelated party. The comptroller agreed, however, that the loan recipient could have borrowed the same amount of funds from an unrelated entity. See Comptroller Hearing No. 17,870 (Jan. 16, 1987). In Comptroller Hearing No. 18,784 (Apr. 9, 1987), however, the comptroller viewed the fact that the loan recipient borrowed funds from a related entity only because it offered a lower interest rate to be an indication that the purported loan was bona fide. These decisions appear to conflict directly.
17. Comptroller Hearing No. 18,135 (Apr. 10, 1987); see also Comptroller Hearing Nos. 18, 974, 18,975, 19,012 (June 2, 1987) (comptroller applied a “substance over form” approach in treating purported advances to taxpayers from their sister corporation as capital contributions by the parent of the taxpayers to their sister taxpayers).
B. Allocation of Capital

In Decision 20,396\textsuperscript{119} the comptroller interpreted the provision in the Tax Code commonly called the "throw-back rule."\textsuperscript{120} The rule provides that gross receipts from the sale of tangible personal property shipped outside the state will be deemed to be Texas receipts if the seller is not subject to taxation in the state to which the property is shipped.\textsuperscript{121} The relevant comptroller’s rule\textsuperscript{122} states that the comptroller will apply the tests used to determine whether a corporation is subject to Texas franchise tax (rule 3.406)\textsuperscript{123} to determine whether a corporation is subject to taxation in the state to which the property is delivered. This decision, however, provides that although the comptroller applies the standards in rule 3.406, the presumption that the foreign state’s law with respect to determining if a corporation is subject to taxation in that state falls if the law of such state is proved up.\textsuperscript{124}

In Decision 18,464\textsuperscript{125} the comptroller faced a unique situation involving electricity sold and delivered via transmission lines running from outside Texas into Texas. The parties had executed an agreement providing that the sale was deemed to occur on the state line. The comptroller ruled that because the parties intended that “on the state line” meant on each respective party’s side of the state line, the taxpayer’s sale took place outside Texas and did not produce Texas receipts.\textsuperscript{126}

C. Liability for Tax—Doing Business in Texas

The comptroller ruled in Decision 20,625\textsuperscript{127} that two holding companies with no real property or employees in Texas were doing business in Texas for franchise tax purposes.\textsuperscript{128} The corporations’ relationship to Texas consisted of borrowing funds from Texas (and non-Texas) banks, lending funds to Texas (and non-Texas) subsidiaries, using employees of a subsidiary located in Texas to maintain their accounting records, keeping the accounting records and shareholder ledger in Texas, and using a letterhead showing a Texas address when corresponding with lenders. One corporation also held shareholders’ and directors’ meetings in Texas. The comptroller ruled that the corporations’ activities exceeded those of a mere passive holding company\textsuperscript{129} because such activities involved more than merely receiving and

\textsuperscript{119} Comptroller Hearing No. 20,396 (Mar. 20, 1987).
\textsuperscript{120} TEX. TAX CODE ANN. § 171.103(1) (Vernon Supp. 1988).
\textsuperscript{121} Id.
\textsuperscript{122} TEX. ADMIN. CODE tit. 34, § 3.403.
\textsuperscript{123} Id. § 3.406.
\textsuperscript{124} Comptroller Hearing No. 20,396 (Mar. 20, 1987).
\textsuperscript{125} Comptroller Hearing No. 18,464 (Feb. 25, 1987). The comptroller stated that this decision carries no precedential value beyond interpreting ambiguous contracts in accordance with the intent of the parties.
\textsuperscript{126} Id.
\textsuperscript{127} Comptroller Hearing No. 20,625 (May 1, 1987).
\textsuperscript{128} Id.
\textsuperscript{129} In State v. Humble Oil & Ref. Co., 263 S.W. 319 (Tex. Civ. App.—Austin 1924, writ ref’d n.r.e.), the Austin court of appeals held that owning a controlling amount of capital stock of a Texas corporation does not, in itself, constitute doing business in Texas. Id. at 325.
paying dividends. The comptroller identified a constitutional nexus to Texas, based on the activities in which the corporations engaged. Although withdrawn in accordance with a settlement by the parties, the decision provides useful insight to the comptroller’s broad interpretation of “doing business.”

In Decision 17,769 the comptroller ruled that a foreign corporation, which had no offices or employees in any state, conducted business in Texas by virtue of using its parent corporation as an agent to sell certain communications equipment. The taxpayer’s only business activity consisted of serving as an agent of its parent to sell this equipment. Fourteen percent of the taxpayer’s gross receipts were allocable to Texas. The comptroller concluded that in order for the taxpayer to generate gross receipts it must have had to “borrow” the employees of its parent (given that it had no employees of its own). The comptroller ruled that the taxpayer was doing business in Texas, apparently based on the Texas receipts and the parent’s Texas activities.

D. 1987 Franchise Tax Legislation

Texas passed significant franchise tax legislation in 1987. The legislature increased the franchise tax rate temporarily from $5.25 to $6.70 per $1,000 of a corporation’s taxable capital allocable to Texas. The minimum tax per report year increased from $68.00 to $150.00. The rate increase applies to all regular report periods beginning on or after May 1, 1988, and for which tax payments are due on or after March 15, 1988. The rate will revert to the previous rates for regular reporting periods beginning on or after May 1, 1990, and for which tax payments are due on or after March 15, 1990.

The Texas Legislature added section 171.109 of the Tax Code to define surplus, net assets, and debts for franchise tax purposes. The Tax Code previously failed to define these terms, although the comptroller provided defi-
nitions in his rules.142 The new section also prescribes accounting methods for determining surplus.

According to section 171.109, surplus refers to the excess of the net assets of the corporation over its stated capital,143 and net assets means total corporate assets in excess of total corporate debts.144 The term "debt" includes any legally enforceable obligation, measured in a certain amount of money, which must be performed or paid within an ascertainable period of time or on demand.145 The new statute provides that surplus includes contingent or estimated liabilities or losses or any writedown of assets, except for reserves for uncollectible accounts, contra-asset accounts for depletion, depreciation, or amortization, and reserves for deferred income taxes.146 Thus, the new statute sanctions (prospectively) the comptroller's treatment of contingent and reserve accounts.147

The new statute also specifies that a corporation must use generally accepted accounting principles (GAAP) to determine its surplus, except as otherwise provided.148 Prior to the enactment of this statute, the comptroller had seemingly inconsistent requirements with respect to the use of GAAP.149 Although a comptroller's rule supposedly required GAAP,150 the comptroller did not allow GAAP in some circumstances151 and did not require GAAP in other circumstances.152 In a provision apparently intended to prevent smaller corporations from incurring the additional expense of creating and maintaining an additional set of books in accordance with GAAP solely for franchise tax purposes, the legislature provided that corporations whose surplus for federal income tax purposes is less than one

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142. TEX. ADMIN. CODE tit. 34, § 3.405 (1977).
144. Id.
145. Id.
146. Id.
147. See supra notes 105-10 and accompanying text.
148. TEX. TAX CODE ANN. § 171.109(b) (Vernon Supp. 1988). The statute's provision with respect to contingent and reserve accounts conflicts with GAAP, but deals with a circumstance in which GAAP does not control for franchise tax purposes.
149. See, e.g., United N. & S. Dev. Co. v. Heath, 78 S.W.2d 650 (Tex. Civ. App.—Austin 1934, writ ref'd) (comptroller held surplus created by reappraisal of assets includable in surplus; no requirement that reappraisal be made in accordance with GAAP).
150. TEX. ADMIN. CODE tit. § 3.405 (1977).
151. A comptroller's rule also provided that preparation of franchise tax reports must be in accord with taxpayers' books and records. TEX. ADMIN. CODE tit. 34, § 3.391 (amended 1987). Therefore, to the extent that a taxpayer's books and records would reflect a higher amount of taxable surplus than would exist pursuant to GAAP, the comptroller required, in some circumstances, the use of the accounting method that would result in a higher amount of taxable surplus. See Comptroller Hearing No. 19,330 (June 29, 1987) (required write-up of assets for franchise tax purposes if a taxpayer writes-up assets on its books and records); Comptroller Hearing No. 20,278 (May 16, 1987) (push-down accounting). After Sage Energy (discussed supra, at notes 101-04 and accompanying text), this policy comes under serious question even for report years prior to the effective date of this new legislation.
152. See Comptroller Hearing No. 13,035 (Sept. 26, 1983) (use of cash basis rather than accrual basis, which GAAP requires). New § 171.109(b) of the Tax Code also provides that if GAAP remains unsettled or does not specify a particular accounting practice for purposes related to computing surplus, the comptroller may provide its own rules to specify the applicable accounting practice for franchise tax purposes. TEX. TAX CODE ANN. § 171.109(b) (Vernon Supp. 1988).
million dollars may report their surplus for franchise tax purposes according to the method of accounting used in preparing their federal income tax return.\footnote{153} New section 171.109(g) of the Tax Code provides that all oil and gas and production activities must be reported for franchise tax purposes pursuant to either the successful efforts or the full cost method of accounting, both of which are methods of capitalizing intangible drilling cost rather than expensing such costs.\footnote{154} This provision is a legislative response to \textit{Bullock v. Sage Energy Co.}\footnote{155} Certain new provisions apply to dividends and changes in accounting methods.\footnote{156}

The legislature enacted new section 171.112 of the Tax Code, which defines gross receipts as all revenues that would be recognized annually under a GAAP method of accounting, without deduction for the cost of property sold, materials used, labor performed, or other costs incurred, unless otherwise specified.\footnote{157} This definition does not reflect a change in the comptroller's interpretation of the meaning of gross receipts.\footnote{158}

The Texas Legislature added a new exemption from franchise taxes for corporations whose only activity in Texas is the solicitation of orders on an occasional basis at trade shows.\footnote{159} Amended section 171.063 of the Tax Code expands the exemption from franchise tax afforded to nonprofit corporations by including title-holding corporations exempted from federal income tax under sections 501(c)(2) or 501(c)(25) of the Internal Revenue Code of 1986. The exemption applies if the corporation or corporations for which the entity holds title is either exempt from or not subject to Texas franchise tax.\footnote{160}

\section*{III. Property Tax}

\subsection*{A. Application of Tax}

In \textit{City of El Paso v. El Paso Community College District}\footnote{161} the Texas Supreme Court ruled that increases in ad valorem taxes of a school district or community college district realized from property located in a reinvestment zone may be pledged for repayment of bonds issued to finance develop-

\begin{footnotes}
\item 153. \textsc{Tex. Tax Code Ann.} \textsection 171.109(c) (Vernon Supp. 1988). In addition, the statute does not require corporations fitting within this exception to use GAAP in determining their gross receipts allocable to Texas. \textit{Id.} \textsection 171.112.
\item 154. \textit{Id.} \textsection 171.109(g).
\item 155. 728 S.W.2d 465 (Tex. App.—Austin, writ ref’d n.r.e.) (discussed \textit{supra} at notes 101-04 and accompanying text).
\item 156. \textsc{Tex. Tax Code Ann.} \textsection 171.109(e), (f) (Vernon Supp. 1988).
\item 157. \textit{Id.} \textsection 171.112.
\item 159. \textsc{Tex. Tax Code Ann.} \textsection 171.084.
\item 160. \textit{Id.} \textsection 171.063. Sections 501(c)(2) and (25) of the Internal Revenue Code of 1986 exempt certain corporations that hold property for entities exempt from federal income tax under section 501(c) of the Code. \textsc{I.R.C.} \textsection 501(c)(2), (25) (West Supp. 1987).
\item 161. 729 S.W.2d 296 (Tex. 1986).
\end{footnotes}
A 1981 amendment to the Texas Constitution provides that the legislature may authorize an incorporated town or city to issue bonds to finance the development or redevelopment of a reinvestment zone and to pledge for repayment of such bonds increases in ad valorem tax revenues imposed on property in the area by the city or town or other political subdivisions. The school districts claimed that under article VII, section 3 of the Texas Constitution the school districts' ad valorem taxes must be used for educational purposes and cannot be seized without the consent of the school districts' board of trustees. In order to harmonize these seemingly inconsistent provisions of the Texas Constitution, the school districts asserted that they should not be cast as "political subdivisions." The Texas Supreme Court ruled that the framers of the 1981 amendment meant the term "political subdivisions" to include school districts.

In Temple Eastex, Inc. v. Spurger Independent School District the Beaumont court of appeals interpreted section 23.78 of the Tax Code, which deals with timber land valuation. Section 23.73 of the Tax Code provides that qualified timber land is generally to be appraised based on income capitalization methods rather than appraising the land based on its market value, and section 23.78 states that the appraised value reached by using the income capitalization method cannot be less than the taxing unit's appraised value of such land in the 1978 tax year. In arriving at the 1978 appraised value of the taxpayer's parcel of timber land, the appraiser determined the average 1978 appraised value per acre of the parcel and applied that value to each acre of the parcel whose current timber use value was less than the average 1978 per-acre value (i.e., an acre-by-acre approach). The city asserted that the 1978 appraised value of the land, as referred to in section 23.78 of the Tax Code, meant any portion of the parcel of qualified timber land. The court held that the reference to the land applied to the entire parcel of land appraised in 1978, and that the city improperly appraised the 1978 value of the taxpayer's parcel of timber land.

162. Id. at 299.
163. TEX. CONST. art. VIII, § 1-g(b).
164. The Texas Supreme Court originally addressed only one of the school districts' three constitutional challenges to the El Paso tax increment financing plan—that the school districts were not "political subdivisions" within the meaning of art. VIII, § 1-g(b) of the Texas Constitution. In addressing the school districts' motion for rehearing, however, the Texas Supreme Court addressed the school districts' two other points of error (unconstitutionality of the El Paso ordinance based on school district revenues pledged for noneducational purposes and so committed without the consent of their respective boards of trustees) and held that the existence of such facts do not undermine the Texas Constitution. 729 S.W.2d at 299.
165. Id. The Texas Supreme Court relied on two Texas Supreme Court decisions that support including school districts within the definition of political subdivision. See Guaranty Petroleum Corp. v. Armstrong, 609 S.W.2d 529 (Tex. 1980); Lewis v. Independent School Dist., 139 Tex. 83, 87, 161 S.W.2d 450, 452 (1942).
166. 720 S.W.2d 607 (Tex. App.—Beaumont 1986, no writ).
167. TEX. TAX CODE ANN. § 23.78 (Vernon 1982).
168. Id. §§ 23.73(a), 23.78.
169. This decision resulted in the 1978 appraised value setting a minimum taxable value below which the appraised value of a qualified timber land parcel may not fall. Had the court adopted the city of Austin's interpretation, a parcel of qualified timber land could conceivably
In another opinion concerning special valuation of qualified property, the attorney general ruled that a rollback tax should not be imposed on land that failed to qualify for "open-space" land special valuation under current standards, because its use had not changed from the time when it did qualify for special valuation. The attorney general ruled that the rollback tax under section 23.55 of the Tax Code can be imposed only if an actual change takes place in the use of the land.

B. Specific Exemptions

The Austin court of appeals in University Christian Church v. City of Austin exempted from property tax two church parking lots leased to a commercial parking lot company under an arrangement whereby the church reserved certain parking rights. The court addressed the narrow issue of whether the parking lots were used primarily as a place of religious worship under section 11.20(a)(1) of the Tax Code, and determined that the church property must be examined as a whole rather than by using a piecemeal approach. Because there was no evidence to support a finding that the primary use of the sanctuary was not religious worship, the court ruled that the church property, including the parking lots, was used primarily for religious worship. The City of Austin relied on Davies v. Meyer in asserting that the primary use of the parking lot should be examined apart from the primary use of the church property as a whole. In Davies the Texas Supreme Court held that all but 2 of 155 acres of a church-owned camp failed to qualify for property tax exemption. The court in University Christian Church noted that in Davies religious worship occurred only on a de minimus percentage of the property; therefore, the primary use of the property as a whole was not religious worship. In this case, however, the size of their parking lot was comparable to the needs of the membership; therefore, no disproportionate use existed.

The Dallas court of appeals denied a property tax exemption to a publicly

have a higher appraised value for the current year than its 1978 appraised value or its value based on income capitalization methods.

173. 724 S.W.2d 94 (Tex. App.—Austin 1987, writ granted).
174. Id. at 97. The church leased the parking lots for a monthly rental fee plus a percentage of the gross receipts.
175. TEX. TAX CODE ANN. § 11.20(a)(1) (Vernon 1982).
176. 724 S.W.2d at 97.
177. 541 S.W.2d 827 (Tex. 1976).
178. Id. at 830. A recent case very similar to Davies is General Ass'n Branch Davidian Seventh Day Adventist v. McLennan Co. Appraisal Dist., 715 S.W.2d 391 (Tex. App.—Waco 1986, no writ), in which the Waco court of appeals held that no exemption from property tax existed for a 75-acre tract of land located adjacent to the taxpayer's church and parsonage.
179. 724 S.W.2d at 96. The court also held that renting church property for secular use does not deprive the church of its property tax exemption as long as the primary purpose of the property remains religious worship. Id. at 96.
owned office building leased, in part, by private doctors in furtherance of their own commercial enterprises.\textsuperscript{180} The taxpayer claimed an exemption under section 11.11(a)\textsuperscript{181} of the Tax Code, which provides an exemption for property owned by the state or a political subdivision of the state if the property is used for public purposes, and section 16 of article 4437e,\textsuperscript{182} which provides an exemption from all taxation for property owned by a hospital authority created under the Hospital Authority Act. The court ruled that for an exemption to apply under either of these provisions the property must be devoted exclusively to the use and benefit of the public; therefore, an exemption was not allowed.\textsuperscript{183}

An attorney general opinion\textsuperscript{184} held that in order for a biomedical research corporation to qualify for a property tax exemption under section 11.23(h)\textsuperscript{185} of the Tax Code, it must meet not only the requirements of that section but must also meet the requirement in the Texas Constitution that it qualifies as an institution of purely public charity.\textsuperscript{186} The Texas Constitution\textsuperscript{187} authorizes the legislature, by general law, to exempt from property taxation only property of an institution of purely public charity.\textsuperscript{188}

\section*{C. Procedure}

During the Survey period the courts continued to apply strictly the procedural requirements set forth in the Tax Code. In a case of first impression, the Houston (14th District) court of appeals held in \textit{Flores v. Fort Bend Central Appraisal District}\textsuperscript{189} that the taxpayer's failure to file a petition in district court within forty-five days after receiving an order of determination from the appraisal review board caused the taxpayer to forfeit its right of district court review of the appraisal review board's order.\textsuperscript{190} Section 42.21(a)\textsuperscript{191} of the Tax Code provides that the taxpayer must file the petition for review with the district court within forty-five days after the party received notice of the entering of a final order from which an appeal is taken.

\begin{itemize}
\item[180.] Grand Prairie Hosp. Auth. v. Dallas Co. Appraisal Dist., 730 S.W.2d 849 (Tex. App.—Dallas 1987, writ ref'd n.r.e.).
\item[181.] TEX. TAX CODE ANN. § 11.11(a) (Vernon 1982).
\item[182.] TEX. REV. CIV. STAT. ANN. art. 4437e, § 16 (Vernon 1976).
\item[183.] 730 S.W.2d at 851. The court followed the Texas Supreme Court's decision in Daugherty v. Thompson, 71 Tex. 192, 9 S.W. 99 (1888), which held that the legislature lacks the power to tax property held solely for public purpose and devoted exclusively to the use and benefit of the public.
\item[185.] TEX. TAX CODE ANN. § 11.23(h) (Vernon 1982) (repealed 1987). This exemption still exists, although currently considered an exemption for a "charitable organization" rather than a "miscellaneous exemption." See Act of June 17, 1987, ch. 430, § 1 (to be codified at TEX. TAX CODE ANN. § 11.18).
\item[186.] The courts have defined a purely public charity to be an institution making no profit, accomplishing wholly benevolent ends, and preventing people, through gratuity, from burdening society. See City of Houston v. Scottish Rite Benev. Ass'n, 111 Tex. 191, 200, 230 S.W. 978, 981 (1921).
\item[187.] TEX. CONST. art. VIII, § 2(a).
\item[189.] 720 S.W.2d 243 (Tex. App.—Houston [14th Dist.] 1986, no writ).
\item[190.] Id. at 245.
\item[191.] TEX. TAX CODE ANN. § 42.21(a) (Vernon Supp. 1988).
\end{itemize}
The taxpayer contended that the forty-five-day period did not begin to run upon receipt of the order of determination of protest because the order of determination did not constitute a final order. The court ruled that even though the order of determination is not labeled as a final order, it operates as a final determination because the order leaves nothing else in dispute.

Two noteworthy decisions by the Texas courts of appeals addressed the requirements of proper notice. In *Uvalde County Appraisal District v. Kincaid Estate* the San Antonio court of appeals held that the taxpayer did not receive proper notice of the reappraisal of his property because the taxing authority failed to send the notice to the taxpayer's authorized agent named on the last property rendition filed by the taxpayer. Rather, the notice was sent to the name and address listed on the computer roll, which probably reflected the taxpayer's agent for a prior property tax year. In *MCI Telecommunications Corp. v. Tarrant County Appraisal District* the Fort Worth court of appeals held admissible into evidence a return receipt for delivery of the county appraisal review board's order determining protest of a corporate property owner. The return receipt established proper delivery of notice, although it contained only the taxpayer's name and address without being directed to the attention of the appointed fiduciary. The county sent the notice to the taxpayer at its correct address, to the attention of its appointed fiduciary. Someone other than the fiduciary accepted the notice. The fiduciary claimed he never personally received the notice. Because the Tax Code requires only that the notice be delivered to the fiduciary's address, the court admitted the certified mail receipt as evidence demonstrating that the appraisal review board properly notified the taxpayer of its order.

In *Hunt County Tax Appraisal District v. Rubbermaid, Inc.* the Dallas court of appeals held that the taxpayer forfeited its right to appeal the county tax appraisal review board's order because the taxpayer made a voluntary payment of an alleged illegal tax by paying the full amount of the property tax imposed on the property rather than paying the minimum amount required to maintain an appeal. The taxpayer first asserted that

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192. The court agreed with the taxpayer that the statute at issue could have been worded more clearly, but still provided no relief to the taxpayer. 720 S.W.2d at 245.
193. *Id.* (citing *Southern Union Gas Co. v. Railroad Comm'n*, 690 S.W.2d 946 (Tex. App.—Austin 1985, writ ref'd n.r.e.)).
194. 720 S.W.2d 678 (Tex. App.—San Antonio 1986, writ ref'd n.r.e.).
195. *Id.* at 680.
196. The court found no evidence that the notice was actually delivered to the authorized agent for the tax year at issue. *Id.*
197. 723 S.W.2d 350 (Tex. App.—Fort Worth 1987, no writ).
198. *Id.* at 352.
199. The court also did not require the appraisal review board to send the taxpayer a separate notice of issuance of its order and copy of the order itself; rather, in this case the order also acted as a notice of issuance of the order. *Id.*
200. 719 S.W.2d 215 (Tex. App.—Dallas 1986, writ ref'd n.r.e.).
201. *Id.* at 218; see *Prudential Ins. Co. v. Crystal City Indep. School Dist.*, 714 S.W.2d 74 (Tex. App.—San Antonio 1986, writ ref'd n.r.e.) (because the taxpayer made payment of the full amount in dispute without knowledge of the relevant facts, the court held the payment...
the full payment was "under protest," thereby entitling the taxpayer to an appeal. The court ruled that the taxpayer forfeited its claim for refund by making the voluntary payment, even if under protest.\textsuperscript{202} The taxpayer also asserted that its payment was not voluntary because section 42.08 of the Tax Code (as in effect for the 1982-83 tax years) required it to pay the greater of the amount of taxes not in dispute (which was uncertain in this case) or the amount of taxes paid on its property for the previous tax year, as a condition to maintain an appeal of the board's order. The court held that the taxpayer is not required to make full payment of the taxes assessed in order to comply with the statutory requirement\textsuperscript{203} because the statutory reference to the amount of taxes not in dispute means the assessed value of the property that the taxpayer does not dispute.\textsuperscript{204}

The Dallas court of appeals in \textit{Dallas County Appraisal District v. Institute for Aerobics Research}\textsuperscript{205} held that appraisal districts must file an appeal bond under section 42.28 of the Tax Code to appeal a district court decision.\textsuperscript{206} The Dallas County Appraisal District unsuccessfully asserted that because section 42.28\textsuperscript{207} of the Tax Code exempts chief appraisers from such requirements, the Tax Code implicitly exempts appraisal districts from filing an appeal bond.

\section*{D. 1987 Property Tax Legislation}

The Texas Legislature passed several important items of property tax legislation during its 1987 regular and special sessions.\textsuperscript{208} In an era in which the legislature is keeping a constant eye toward increasing revenues, taxpayers benefited by the addition of section 31.12\textsuperscript{209} of the Tax Code. The change provides for the accrual of interest at a rate of 1% per month on certain refunds if the state fails to pay the refund on or before the sixtieth day after the date the liability for the refund arises.\textsuperscript{210} This new law applies to refunds resulting from (1) an approval for a late application for a residence homestead exemption, (2) an election reducing the property tax rates, (3) a correction of the tax roll, (4) an overpayment or erroneous payment under section 31.11\textsuperscript{211} of the Tax Code, or (5) a final determination of an involuntary); see also Missouri Pac. R.R. v. Dallas Co. Appraisal Dist., 732 S.W.2d 717 (Tex. App.—Dallas 1987, no writ) ("substantial" compliance with the minimum payment provisions under § 42.08 of the Tax Code).

202. 719 S.W.2d at 218.
203. Id. at 219.
204. The court noted that although the taxpayer remained uncertain of the disputed amount, it had several options. For example, it could have paid the previous year's taxes, paid the taxes based on an appraisal, or paid taxes based on its estimate of the property's value. \textit{Id.}\textsuperscript{205}. 732 S.W.2d 735 (Tex. App.—Dallas 1987, writ granted).
206. \textit{Id.} at 737.
207. \textit{Tex. Tax Code} Ann. § 42.28 (Vernon 1982).
208. During the 1987 regular and special sessions, the Texas Legislature either amended, added, or repealed almost 70 of the Property Tax Code sections.
210. \textit{Id.} § 31.12(a).
211. \textit{Id.} § 31.11 (Vernon 1982).
appeal of a taxpayer’s protest.212

The Texas Legislature also expanded the list of exemptions from property tax. The legislature amended section 11.14 of the Tax Code to broaden the exemption from property tax for the category of personal effects items.213 Pursuant to the amendment, exempt personal effects now include boats owned and used by a family or individual for recreational activities and not held or used for the production of income.214

New section 11.23(h) of the Tax Code entitles nonprofit corporations to an exemption from property tax for property that they own and use in scientific research and educational activities for the benefit of colleges and universities.215 Amended section 11.13 of the Tax Code includes in the definition of a residence homestead real property owned by a cooperative association and used as a dwelling place for its stockholders.216 A new exemption also exists for property under construction owned by a religious organization.217

The Texas Legislature expanded the definition of qualified open-space land, entitling the property to special appraisal.218 Prior to this amendment one of the criteria for determining if property qualified as open-space land focused on whether it had been devoted principally to agricultural use for five of the last seven years. Effective January 1, 1988, the land can be devoted principally to agricultural use or to production of timber or forest products for five of the last seven years.219

The Texas Legislature made several changes to the procedures that a taxing unit must follow in calculating its property tax rate. For example, new section 26.012 of the Tax Code sets forth specific formulas for determining

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212. In the 1987 regular session, the Texas Legislature also amended section 42.43 of the Tax Code to entitle religious organizations interest of 10% per year on refunds generated by erroneously denied exemptions. The interest accrues from the date of payment by the religious organization. Id. § 42.43(b) (Vernon Supp. 1988).

213. Id. § 11.14(b)-(d).

214. The amendment provides, however, that the governing body of a taxing unit may provide for the property taxation of such boats. This legislation is apparently a response to the decision in Twiford v. Nueces Co. Appraisal Dist., 725 S.W.2d 325 (Tex. App.—Corpus Christi 1987, writ ref’d n.r.e.), in which the Corpus Christi court of appeals held that the Texas Constitution did not exempt from property a boat used exclusively for recreational purposes. Id. at 328. Amended § 11.14 of the Tax Code became effective May 26, 1987.

215. TEX. TAX CODE ANN. § 11.23(h) (Vernon Supp. 1988). The new statute also provides that the exemption remains valid if the property is used for a purpose incidental to its scientific research and educational activities, which benefits the nonprofit corporation and the colleges or universities it supports. Id.

216. Id. § 11.13(o), (p). The attorney general interpreted the prior version of § 11.13 of the Tax Code to exclude cooperative associations from the definition of a residence homestead.

217. Id. § 11.20(a)(5), (f). The land on which the property under construction is located also qualifies for exemption to the extent it will be reasonably necessary for the religious organization’s use of the improvement as a regular place of worship. Id. The Texas Legislature also added an exemption from property tax for land dedicated as a disposal site for depositing and discharging materials dredged from the main channel of the Gulf Intracoastal Waterway under the direction of state or federal government. Id. § 11.29.

218. Id. § 23.51. This revision also applies to qualification for productivity appraisal. Id. § 23.72.

219. This amendment also changed the method of valuing “qualified open-space land.” Id. § 23.72.
the effective tax rate and the rollback tax rate. Amended section 26.04 of the Tax Code requires the designated officer or employee of a taxing unit to calculate both the effective tax rate and the rollback tax rate for the taxing unit. The governing body of a taxing unit may not adopt a tax rate that exceeds that lower of the rollback tax rate or 103% of the effective tax rate unless it has held a public hearing on the proposed increase. Another change in rate calculation applies to the additional 1/2% local sales and use tax under section 2A of article 1066c. In estimating the additional local sales and use tax revenue to be raised by an adoption of this additional local sales and use tax, the designated officer or employee of the taxing unit must, for the first year of the additional tax, multiply by .95 the comptroller’s estimate of the additional local sales and use tax revenue for the preceding four quarters.

The Texas Legislature also changed several procedural requirements with respect to protests and appeals of property taxes and property tax appraisals. One change requires that all notices of issuance of an appraisal review board’s order determining a protest sent to the property owner must contain a prominently printed statement in upper-case bold lettering informing the property owner of its right to appeal. Effective January 1, 1987, new requirements apply with respect to filing a notice of appeal of an appraisal to a district court from an order of an appraisal review board. Under amended section 41.47(b) of the Tax Code, if the appraised value of a fractional property interest changes as the result of a protest or challenge, the appraised value of the other fractional interests of such property must also change.

The Tax Code amendment under section 25.195 provides that a property owner or his designated agent may inspect only the appraisal records and the supporting data and schedules thereto submitted to the appraisal review board by the chief appraiser that relate to the property owner’s property. Effective January 1, 1988, the law prohibits taxing units created after June

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220. Id. § 26.012.
221. Id. § 26.04.
222. Id. § 26.05(c).
225. TEX. TAX CODE ANN. § 41.47(e) (Vernon Supp. 1988). Strangely, the Act of May 21, 1987, ch. 145, § 1, 1987 Tex. Sess. Law Serv. 604 (Vernon) made a similar but slightly different amendment adding § 41.47(e) of the Tax Code. The prior amendment requires the statement to be in “clear and concise language,” whereas the latter amendment does not so provide.
226. TEX. TAX CODE ANN. § 42.06 (Vernon Supp. 1988).
227. Id. § 41.47(b). The Texas Legislature also provided that in a suit to enforce collection of delinquent taxes, the taxpayer can raise two affirmative defenses: (1) In a suit to enforce personal liability for the tax, that the taxpayer did not own the property on January 1 of the year the tax was imposed; and (2) in a suit to foreclose a lien securing payment of a real property tax, that on January 1 of the year the tax was imposed the property was not located in the taxing unit seeking to foreclose a lien. TEX. TAX CODE ANN. § 42.19 (Vernon Supp. 1988). Previously the Tax Code did not specify any affirmative defenses.
30 from imposing taxes for the year in which they are created.\textsuperscript{229} Prior to this amendment to section 26.12 of the Tax Code, if a taxing unit was created at any time during the year after January 1, the statute required the chief appraiser to prepare an appraisal roll as if the unit had existed on January 1.\textsuperscript{230}

\section*{IV. Tax Procedure}

Both the Texas Legislature and the comptroller have made changes regarding the procedures for challenging taxes imposed by the comptroller.\textsuperscript{231} A motion for rehearing of a refund claim and a suit for refund now must set forth the amount of refund sought; in addition, a copy of the motion for rehearing must be attached to the original petition in a suit for refund.\textsuperscript{232} The original petition in a suit after protest payment must have a copy of the written protest attached.\textsuperscript{233} New section 112.058(d)\textsuperscript{234} of the Tax Code eliminates suspense account treatment for protest payments with respect to sales tax, franchise tax, and other taxes.\textsuperscript{235}

During the Survey period the comptroller amended virtually every rule with respect to practice and procedure. The more significant changes include limiting hearings to two hours unless cause is demonstrated for an extended hearing,\textsuperscript{236} restricting the admission of certain documentary evidence by a taxpayer after filing the statement of grounds,\textsuperscript{237} eliminating the payment of interest by the comptroller on refunds of taxes,\textsuperscript{238} and limiting taxpayers' ability to present additional facts in a reply to the position letter.\textsuperscript{239}

\section*{V. Conclusion}

The Survey period has seen numerous legislative, regulatory,\textsuperscript{240} and judicial developments in Texas taxation. Undoubtedly there will be continuing changes, including the issuance of many new administrative rules in the coming months. The Select Committee on Tax Equity will recommend fur-
ther changes. As these changes illustrate, it is becoming not only more expensive to pay Texas taxes, but also more difficult to stay informed as to the rapidly changing law.

241. This committee was authorized by the legislature to study and make recommendations as to major state and local tax issues. Act of Mar. 30, 1987, ch. 10, 1987 Tex. Sess. Law. Serv. 52 (Vernon). A final report of the committee's findings should be completed prior to the January 1989 convening of the next legislative session.