



SMU Law Review

Volume 66

Issue 5 *Annual Texas Survey*

Article 14

2013

Taxation

Cynthia M. Ohlenfrost

Sam Megally

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

 Part of the [Law Commons](#)

Recommended Citation

Cynthia M. Ohlenfrost, et al., *Taxation*, 66 SMU L. Rev. 1181 (2013)

<https://scholar.smu.edu/smulr/vol66/iss5/14>

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

*Cynthia M. Ohlenforst**
*Sam Megally***

TABLE OF CONTENTS

I. SALES TAX: STUDIES IN STATUTORY CONSTRUCTION	1182
SCOPE OF TAXATION, EXEMPTIONS, COMPTROLLER INTERPRETATIONS, LEGISLATION	1182
II. FRANCHISE TAX: POLICY VERSUS REVENUE?	1191
VALIDITY OF TAX, CALCULATIONS, COMPTROLLER INTERPRETATION, LEGISLATION	1191
III. PROPERTY TAX: CONTINUING CONFUSION	1198
OWNERSHIP AND STANDING, LEGISLATION	1198
IV. PROCEDURE: INCREASING TAXPAYER BURDENS?	1199
SUCCESSOR LIABILITY, CLAIMS FOR REFUND, RULING LETTERS, INCONSISTENT COMPTROLLER POLICIES, LEGISLATION	1199
V. CONCLUSION	1202

DESPITE its long-term and generally well-deserved reputation as a business-friendly state, recent sales tax and franchise tax developments evidence Texas's increasingly aggressive pursuit of tax revenue. Whether fueled by the comptroller's desire to increase tax revenue in an uncertain economy, to close perceived loopholes on which taxpayers rely, or to seek sound tax policy, the result over the last two years is largely the same: taxpayers find themselves faced with higher bills, changing tax policies and, equally bad, uncertainty.¹ In the sales tax arena, as in the franchise tax arena, the comptroller remains willing to meet with industry representatives to discuss and resolve issues, including prospective changes to longstanding administrative rules. On the other

* B.A., Loyola University; M.A., University of Dallas; J.D., Southern Methodist University. Partner, K&L Gates LLP, Dallas, Texas; cindy.ohlenforst@klgates.com.

** B.B.A., Southern Methodist University; J.D., The University of Texas School of Law. Associate, K&L Gates LLP, Dallas, Texas; sam.megally@klgates.com.

1. This Survey Article focuses primarily on key developments from November 2010 through October 2012 (two Survey periods). Because the Article covers two years, space constraints limited the scope of the article and precluded inclusion of some items (e.g., some 2011 legislative developments). Key developments for the period from November 2012 through October 2013, including the 2013 Legislative Session are in the next Survey Article.

hand, the comptroller is also willing to change her interpretation of law to shore up the agency's position in the midst of ongoing audits and court cases. Property tax disputes with local taxing jurisdictions, facing their own costs and challenges, also demonstrate the impact of a taxing authority's practice and procedures, and offer further evidence that tax interpretation and revenue needs are sometimes inextricably linked.

I. SALES TAX: STUDIES IN STATUTORY CONSTRUCTION

SCOPE OF TAXATION, EXEMPTIONS, COMPTROLLER INTERPRETATIONS, LEGISLATION

Several reported cases illustrate the comptroller's efforts to broaden the scope of the sales and use tax including by narrowly interpreting exemptions to the tax. In *Zimmer US, Inc. v. Combs*,² the taxpayer successfully argued that some of its out-of-state purchases of surgical instruments from its non-Texas parent company were exempt under Texas Tax Code § 151.313.³ Zimmer US, Inc. (Zimmer) sells reconstructive implants to Texas hospitals and healthcare providers, develops techniques for surgical procedures to implant prosthetics, and lends surgical instruments to healthcare providers for use during surgery. According to Zimmer, the items at issue are either exempt orthopedic devices or exempt supplies for orthopedic devices.⁴

An important aspect of this case is its focus on the comptroller's effort to interpret her own rule in a manner that, as the court acknowledged, is contrary to the language of the rule.⁵ Rule 3.284, which addresses the exemption at issue, defines the terms "orthopedic appliance" and "prosthetic device."⁶ The definition "of orthopedic appliances require" that the item perform a function "in the correction or prevention of human deformities and does not include the additional requirement that the device perform its function on an ongoing basis."⁷ In contrast, the definition of "prosthetic device" does contain such a requirement.⁸ Nonetheless, the comptroller attempted to import this requirement into the definition of "orthopedic appliance," arguing that an orthopedic appliance or device is not exempt unless it performs "some function in the actual ongoing correction or prevention of human deformities."⁹ The sole issue before the court of appeals was "whether, in light of this rule," the instruments Zim-

2. *Zimmer US, Inc. v. Combs*, 368 S.W.3d 579 (Tex. App.—Austin 2012, no pet.).

3. TEX. TAX CODE ANN. § 151.313(a)(5) (West 2008) (providing an exemption for certain health care supplies).

4. *Zimmerman US, Inc.*, 368 S.W.3d at 582.

5. *See id.* at 586.

6. 34 TEX. ADMIN. CODE §§ 3.284(a)(12)–(13) (2012) (Tex. Comptroller of Pub. Accounts, Drugs, Medicines, Medicinal Equipment, and Devices).

7. *Id.* § 3.284(a)(12).

8. *Id.* § 3.284(a)(13).

9. *Zimmer US, Inc.*, 368 S.W.3d at 586.

mer had loaned to healthcare providers were exempt pursuant to § 151.313(a)(5).¹⁰

Zimmer correctly pointed out that the court need “not defer to the comptroller’s interpretation of Rule 3.284(a)” and that the comptroller should not be allowed to effectively amend the rule without following the procedures required by the Texas Administrative Procedure Act.¹¹ The court agreed that the interpretation urged by the comptroller is inconsistent with the plain language of Rule 3.284.¹² As the court explained, the rule is not ambiguous, but even if it were, the court would not adopt an interpretation of the rule that would contradict the plain language of a rule that reasonably interprets the Tax Code.¹³

Particularly given the efforts of both taxpayers and the comptroller to rely on a long standing interpretation as evidence of a rule’s correctness when it is in their advantage to do so, the court’s response on this point is significant. In addressing the comptroller’s assertion that her longstanding administrative interpretation of the rule should stand, the court observed “these rulings do not bind us to accept an erroneous interpretation simply because it is longstanding.”¹⁴ Although clearly correct, the court’s observation will not preclude parties from continuing to cite the longstanding nature length of an interpretation as a reason to adopt that interpretation. More significantly, the debate will continue about the circumstances in which the comptroller can adopt a different interpretation of law, without a triggering legislative or judicial change, and then collect additional taxes from taxpayers who had followed the prior, longstanding comptroller interpretation. As the *Entertainment Publications* decision shows, the comptroller’s ability to change her mind is limited, and significant policy changes may require the comptroller to comply with official rule-making procedural requirements.¹⁵

Like *Zimmer*, *Combs v. Chapal Zenray, Inc.* involves the taxability of items purchased from out-of-state sellers.¹⁶ The taxpayer purchased materials, including self-adhesive labels and jewelry boxes, from out-of-state sellers and then attached the materials in Texas to jewelry that would be sold outside the state.¹⁷ After the retailers sold the jewelry to their own customers, those customers would presumably detach the labels and tags, and wear the jewelry.¹⁸ The question before the court was

10. *Id.* at 584.

11. *Id.* at 585. *See also* *Combs v. Entm’t Publ’ns, Inc.*, 292 S.W.3d 712, 723 (Tex. App.—Austin 2009, no pet.) (confirming that comptroller may not bypass the requirements for amending administrative rules).

12. *Zimmer US, Inc.*, 368 S.W.2d at 587.

13. *Id.* at 586.

14. *Id.* at 587.

15. *Entm’t Publ’ns*, 292 S.W.3d at 723–24.

16. *Combs v. Chapal Zenray, Inc.*, 357 S.W.3d 751, 753 (Tex. App.—Austin 2011, pet denied).

17. *Id.*

18. *Id.*

whether Chapal was making a taxable use of the materials in Texas.¹⁹ The trial court ruled in the taxpayer's favor, holding that Chapal's use of the materials while in Texas did not constitute a taxable use under Tax Code § 151.011.²⁰ The comptroller prevailed on appeal, convincing the court that Chapal's "attaching" the materials to jewelry was not the kind of "attaching" the legislature had envisioned when it excluded from the definition of taxable use the act of "attaching the property to or incorporating the property into other property to be transported outside the state for use solely outside the state."²¹

The case appropriately turned on statutory construction and, in particular, on the scope of the Texas use tax. Chapal reasonably argued that, under § 151.011(f)(2), attachment of the materials to the jewelry prior to transporting the combined product out of state did not constitute a taxable use of the materials.²² According to the comptroller, however, Chapel's definition of the term "attaching" was inconsistent with the other terms used in § 151.011(f)(2)—processing, fabricating, manufacturing, and incorporating—all of which, in the comptroller's view, "connote a relatively permanent joining of components."²³

The court looked at (and beyond) the ordinary meaning of the word "attach" and concluded that the comptroller's argument, which requires that the attachment of the materials "result in a finished product that has functionality, aesthetic appeal, or usefulness to the ultimate consumer throughout the product's useful life, is not unreasonable and does not contradict the plain language of the statute."²⁴ The court's discussion could be read to suggest that a comptroller interpretation should be upheld if it is both reasonable and consistent with the statute; however, such a reading would ignore other restrictions placed on the comptroller, including those described in *Entertainment Publications*.²⁵ Given the past extensive judicial and legislative attention to what constitutes a taxable use, taxpayers can expect the debate over this issue—and over the weight accorded to comptroller interpretations—to continue.²⁶

19. *Id.* at 757.

20. *Id.* at 755; TEX. TAX CODE ANN. § 151.011(f) (West 2008) (providing that "use" in Texas does *not* include "the exercise of a right or power over or the keeping or retaining of tangible personal property for the purpose of: (1) transporting the property outside the state for use solely outside the state; or (2) processing, fabricating, or manufacturing the property into other property or attaching the property to or incorporating the property into other property to be transported outside the state for use solely outside the state") (emphasis added).

21. *Chapal Zenray, Inc.*, 357 S.W.3d at 760; TEX. TAX CODE ANN. § 151.011(f).

22. *Chapal Zenray, Inc.*, 357 S.W.3d at 754.

23. *Id.* at 758. See *infra* note 50 and accompanying text regarding the meaning of processing, fabricating and manufacturing in the context of the manufacturing exemption for these activities.

24. *Chapal Zenray, Inc.*, 357 S.W.3d at 759.

25. See generally, *Combs v. Entm't Publ'ns, Inc.*, 292 S.W.3d 712, 723 (Tex. App.—Austin 2009, no pet.).

26. See, e.g., *Sharp v. Morton Bldgs., Inc.*, 953 S.W.2d 300 (Tex. App.—Austin 1997, pet. denied) (holding that raw materials purchased out of state, incorporated into other products out of state, and then subsequently brought into Texas were not used in the state

Sales tax issues relating to computer services, software and cloud computing provide ample fodder for disputes as both taxpayers and comptroller staff search for appropriate ways to draw lines between taxable and nontaxable items. Rapidly changing technology (and changing comptroller policies) intensified these disputes during the Survey period. On the legislative side, the 2011 legislative session added § 151.108 to the Tax Code to define “Internet hosting” and to confirm that using Internet hosting in the state does not constitute doing business in the state.²⁷

Verizon Business Network Services, Inc. v. Combs, for example, addresses sales and use taxes in the context of software and related services.²⁸ For Texas sales tax purposes, software is treated as tangible personal property, so software maintenance provided in Texas is often taxable in Texas.²⁹ However, the taxing jurisdiction in which maintenance of *custom* software is taxable is generally dependent, for Texas sales tax purposes, on the location at which the benefit of the service occurs.³⁰ Verizon argued in the court of appeals: (1) that when it purchased the services at issue, the object of the transaction was modifying Verizon’s existing custom software; (2) that the benefit of that service was Washington D.C.; and (3) that Texas sales or use tax is due only on copies of the software used in Texas.³¹ The comptroller, by contrast, viewed Verizon as having purchased new software—tangible personal property—for use in Texas.³² Specifically, the comptroller argued that Verizon’s enhancements should be treated as a sale of tangible personal property, and not as maintenance to the existing software.³³ The court of appeals agreed with the comptroller, dismissing all of Verizon’s arguments. The court concluded that the software Verizon purchased, which added new features and efficiencies to Verizon’s current software, was tangible personal property, and not services to existing software. In doing so, the court distinguished between changes to software that merely maintain a software operating system’s original capacity, which would be a computer maintenance ser-

and were therefore nontaxable); *but see* TEX. TAX CODE ANN. § 151.011(a) (West 2008) (as amended in 2003).

27. TEX. TAX CODE ANN. § 151.108 (West Supp. 2012).

28. *Verizon Bus. Network Servs., Inc. v. Combs*, No. 07-11-00025-CV (353rd Dist. Ct., Travis County, Tex. Oct. 29, 2010) *affd.*, No. 07-11-0025, 2013 WL 1343530 (Tex. App.—Amarillo Apr. 3, 2013, pet. filed) (mem. op.); *see* Cynthia M. Ohlenforst et al., *Taxation*, 63 SMU L. REV. 821, 824 (2010) (discussing *Verizon Bus. Network Servs., Inc.*, No. 07-11-00025-CV).

29. TEX. TAX CODE ANN. § 151.009 (West 2008).

30. The comptroller repealed the administrative rule setting forth the criteria for determining whether software is “custom” in 1987; comptroller policy as to whether to continue to apply the criteria from the rule appears inconsistent. *See* Tex. Comptroller Pub. Accounts, Hearing No. 44,668 (Nov. 19, 2004).

31. *Verizon Bus. Network Servs., Inc. v. Combs*, No. 07-11-0025, 2013 WL 1343530, at *3 (Tex. App.—Amarillo Apr. 3, 2013, pet. filed) (mem. op.).

32. *Id.*

33. *See* 34 TEX. ADMIN. CODE § 3.308(b)(3) (2012) (Tex. Comptroller Pub. Accounts, Computers—Hardware, Software, Services and Sales) (relating to computers and software).

vice, and changes to software that add new functionality.³⁴ The court looked to the essence of the transaction to find that Verizon had contracted for the sale of tangible personal property, a master program that Verizon kept in Texas to use for troubleshooting, and not for the sale of computer engineering services attendant or incidental to the program.³⁵ Furthermore, the court found that the sale took place in Texas because Verizon took possession of the software in Texas and paid the lump sum contract for the software before copies of the program were made and installed outside of Texas.³⁶ Even if the sale had not occurred in Texas, the court concluded in the alternative that the software would be subject to Texas use tax because the software was tested and remained in Texas.³⁷

Key to this case, as well as to multiple pending audits and administrative hearings, is determining whether improvements or enhancements to a computer program constitute the service of maintaining software or the sale of a new computer program. As the parties' positions in *Verizon* demonstrate, the line between modifying an existing program and creating a new one is sometimes far from clear. Moreover, the line seems to waver as the comptroller's current view of what constitutes software maintenance appears narrower than the comptroller's earlier views. Regardless of whether the shift in the comptroller's view is based on changing technology or on revenue concerns, the task of distinguishing taxable sales from nontaxable sales in this context can be difficult.³⁸

Combs v. Health Care Services Corp. addresses another frequently contested issue: the applicability of the sale-for-resale exemption in the context of a federal contract.³⁹ Health Care Services Corporation (HCSC), as successor to Blue Cross Blue Shield of Texas, prevailed before the district court on its claim for exemption for items purchased for resale to the federal government.⁴⁰ HCSC had entered into a cost-plus contract to provide nontaxable, health care management services to the government. The contract included a title-shifting provision (common in federal government contracts) that transferred title of purchased items to the gov-

34. *Verizon Bus. Network Servs.*, 2013 WL 1343530, at *7–8.

35. *Id.* at *8–9.

36. *Id.* at *7.

37. *Id.*

38. See also Tex. Comptroller Pub. Accounts, Hearing No. 44,127 (July 8, 2005) (confirming that maintenance services for custom software are taxed based on multi-state benefit location pursuant to TEX. TAX CODE ANN. § 151.330(f) (West 2008) and 34 TEX. ADMIN. CODE § 3.330 (West 2012) (Tex. Comptroller Pub. Accounts, Data Processing Servs.)); TAX POLICY NEWS, WINDOW ON STATE GOVERNMENT (July 2012) <http://window.state.tx.us/taxinfo/taxpnw/tpn2012/tpn1207.html#issue4> (last visited Aug. 31, 2013) discussing the § 151.330 multistate benefit exemption for certain services—including repair and maintenance of custom computer programs—that benefit an identifiable segment of a business; this discussion is noteworthy in part because it suggests a definition for “identifiable segment” that is arguably inconsistent with existing law.

39. *Combs v. Health Care Servs. Corp.*, No. 03-09-00617-CV, 2011 WL 1005419, at *1 (Tex. App.—Austin Mar. 16, 2011), (mem. op.) *aff'd in part, rev'd in part*, 401 S.W.3d 623 (Tex. 2013), (often referred to as the Blue Cross Blue Shield case); see Ohlenforst, *supra* note 28, at 63 SMU L. REV. 821, 823–24.

40. *Health Care Servs. Corp.*, 2011 WL 1005419, at *1.

ernment customer. The district court agreed that not only the tangible personal property, but also the leases, licenses, products, and taxable services purchased by HCSC qualified for the exemption.⁴¹

The comptroller appealed unsuccessfully, asserting that there was no evidence either to show that taxable items were resold to the federal government or to support the district court's determination that HCSC did not double-recover by receiving both a sales tax refund and reimbursements of sales tax payments from the federal government.⁴²

Relying on the plain meaning of the controlling statutes, the Texas Supreme Court affirmed the court of appeals' decision, except with regard to HCSC's leases of certain property.⁴³ In affirming the court of appeals and rejecting the comptroller's attempt to interpret the resale exemption statutes beyond the plain meaning of their language, the supreme court stated that it "read[s] unambiguous statutes as they are written, not as they make the most policy sense. If a statute is worded clearly, we must honor its plain language."⁴⁴ The Court also refused deference to the comptroller's interpretation, stating that "a precondition to agency deference is ambiguity; 'an agency's opinion cannot change the language.' There is no ambiguity about the ambiguity requirement."⁴⁵ The supreme court reversed the court of appeals with regard only to the resale exemption for leases of tangible personal property. Although the leased property was eventually transferred to the government when HCSC's *original* purpose in leasing the property was to re-lease it.⁴⁶

While HCSC was pursuing its tax contest, the Texas legislature revised the resale exemption, apparently intending to limit the availability of the deduction in the context of certain government contracts, at least for periods after the effective date of the amendment. New subsection 151.006(c) provides that a sale for resale does not include the sale of tangible personal property or a service to a purchaser who acquires it to perform "a service that is not taxed under this chapter," unless it is purchased to resell to the United States in a contract that meets the description of § 151.006(c).⁴⁷ This subsection, and other amendments to § 151.006, could create confusion about whether the statute requires that, in order to be validly resold, an item must have already had tax imposed on it—as opposed to requiring only that, in order to be validly resold, an item must

41. *Id.* at *3.

42. *Id.* at *3, *15.

43. *Combs v. Health Care Servs. Corp.*, 401 S.W.3d 623, 625 (Tex. 2013).

44. *Id.* at 629.

45. *Id.* at 630 (citation omitted).

46. *Id.* at 632. See also TEX. TAX CODE ANN. § 151.006(a)(1) (West Supp. 2012) (defining "sale for resale" as the sale of tangible personal property or a taxable service to a purchaser who acquires the property or service *for the purpose* of reselling it" (emphasis added)).

47. TEX. TAX CODE ANN. § 151.006(c) (West Supp. 2012). Nontaxable services should be contrasted with "taxable services" as defined in TEX. TAX CODE ANN. § 151.0101 (West 2008); that category of services (i.e., nontaxable services) is not coextensive with services to which tax does not apply for some other reason (e.g., because the sale is out of state or because an exemption applies).

be generally taxable under the code. In any event, the revised statute is likely to generate additional litigation rather than stem the tide.

Southwest Royalties v. Combs, one of the year's most talked-about refund cases, focuses on sales tax paid in connection with equipment used in oil and gas exploration and production.⁴⁸ Southwest Royalties (SWR), a producer and processor of oil and natural gas, purchased items related to its oil and gas production and processing operations—various above-ground equipment, such as piping, valves, fittings, flanges, and below-ground equipment such as pumps, couplings, motors, and separators. SWR contends that the equipment is used or consumed in or during the actual processing of tangible personal property for ultimate sale, is necessary or essential to such processing, and qualifies for the exemption set forth in § 151.318 of the Tax Code.⁴⁹ This exemption is often referred to as the “manufacturing exemption.” That term, though, is a shorthand reference to an exemption that, by its statutory terms, applies to tangible personal property directly used or consumed during actual manufacturing, fabricating, or processing, if the property directly makes or causes a chemical or physical change to the product.⁵⁰ SWR points out that the equipment at issue was used in or during the actual “processing” of a product to extract and separate the mixture into its components of oil, gas, and water; that the equipment is necessary and essential to that process; and that the equipment is therefore exempt.

Although multiple comptroller hearings confirm that the manufacturing exemption applies to oil and gas equipment, the comptroller has recently changed her position and now asserts that items used in the exploration and production of minerals are not eligible for the exemption.⁵¹ The comptroller cites a recent district court order as support for her current position, but the pending SWR case may well be more important to the ultimate resolution of the issue.⁵²

Judge Dietz originally ruled from the bench for SWR, concluding that the oil and gas production equipment at issue is eligible for Texas's sales

48. *Southwest Royalties v. Combs*, No. D-1-GN-09-004284, 1 (353rd Dist. Ct., Travis County, Tex. Apr. 30, 2012) (oral argument to the Third District Court of Appeals occurred on Sept. 25, 2013).

49. TEX. TAX CODE ANN. § 151.318(a)(2) (West 2008).

50. *Id.*

51. *See, e.g.*, Tex. Comptroller Pub. Accounts Hearing No. 23,055 (August 17, 1988) (stating, “[i]f the Tax Division wishes to remove all mining activities from manufacturing, processing, and fabrication, a duly promulgated rule should be proposed.”). Even this taxpayer-favorable decision is too favorable to the comptroller given its underlying assumption that a rule, as opposed to a statutory change, could exclude mining activities from an exemption that, by its terms, encompasses not all of manufacturing, fabrication, and processing. *See id.*

52. *See Leoncito Plant, L.L.C. v. Combs*, No. D-1-GN-11-001116 (126th Dist. Ct., Travis County, Tex. May 23, 2012) (granting partial summary judgment for comptroller when taxpayer had sought a refund of tax paid on purchases of equipment for use in its uranium mining operation, including well casings and other equipment, arguing that it qualifies as a manufacturer, including because it performs processing that occurs prior the extraction of minerals and because neither the statute nor the comptroller rule excludes mineral extraction from the definition of manufacturing).

tax exemption for property used in manufacturing. However, three weeks later, after a rehearing, the judge's decision effectively reversed the bench ruling by concluding that the physical or chemical changes to extracted minerals are naturally occurring changes incident to the minerals' movement to the surface, and that the equipment was "merely an indirect cause of the changes."⁵³

The post-rehearing decision recognizes that a physical change occurs when petroleum is brought to the surface, that the "changes from liquid to gas and gas to liquid are 'physical changes' within the meaning of the statute," and "that the physical changes are caused by differences in pressure and temperature that result from lifting the petroleum to the surface."⁵⁴ However, the court found (somewhat confusingly) that although "the evidence established that the direct cause of the physical change is the change in pressure and/or temperature," the taxpayer had failed to establish that the equipment at issue directly causes the physical change to the petroleum.⁵⁵

The original bench decision triggered substantial commentary about its possible fiscal impact and debate about the appropriateness of the comptroller's argument that the fiscal impact of a comptroller loss could be significant.

In *Austin Engineering v. Combs*, the taxpayer claimed its erosion control measures were either nontaxable or exempt.⁵⁶ Austin Engineering provides construction services to businesses and governmental entities and specializes in "utility and environmental construction of underground utilities, drainage improvements, roads and highways, airports, pump stations, water and wastewater treatment plants, and storm water filtration facilities."⁵⁷ Austin Engineering argued that even if the transactions at issue were considered taxable as the sale or rental of tangible personal property, the transactions would qualify for exemption. The court of appeals concluded "that the essence of the transactions was the sale or rental of tangible personal property in the form of silt fences, tri-dikes, and inlet protectors, rather than the provision of an erosion control service"; therefore, the court held that transactions are subject to sales tax.⁵⁸

The court also concluded that with respect to certain improvements of government-owned real property, the § 151.311 exemption does not apply because the exemption requires tangible personal property to be incorporated into real property, and the erosion control devices were not so incorporated.⁵⁹ The court also denied the taxpayer's claim for an exemption under § 151.355 because the court determined there was no evidence

53. *Southwest Royalties*, No. D-1-GN-009-004284, at 3.

54. *Id.* at 2.

55. *Id.* at 3.

56. *Austin Eng'g Co. v. Combs*, No. 03-10-00323-CV, 2011 WL 3371557, at *2 (Tex. App.—Austin Aug. 5, 2011, no pet.) (mem. op.).

57. *Id.* at *1.

58. *Id.* at *4; TEX. TAX CODE ANN. § 151.355 (West 2008).

59. *Austin Eng'g Co.*, 2011 WL 3371557, at *4–5.

to show that the erosion control measures were “used solely to construct or operate” water system projects.⁶⁰ The court also denied the taxpayer’s sale-for-resale claim under § 151.302.⁶¹

The court of appeals affirmed the trial court’s denial of Austin Engineering’s motion for summary judgment but, as to whether the provision of erosion control devices is subject to the exemption for consumable supplies, reversed the trial court’s summary judgment order in favor of the comptroller and, based on a remaining fact issue, remanded for further proceedings.⁶²

The comptroller adopted proposed amendments to Rule 3.346 concerning use tax to modify provisions regarding direct-payment permit holders and local tax allocations.⁶³ According to the comptroller, amendments to the rule were necessary to be consistent with the Tax Code.⁶⁴ The adopted rule modifies provisions regarding the local tax responsibilities of direct-payment permit holders and other persons who purchase items out of state that are stored in the state, when it is unknown at the time if the items will be used in Texas or out of state.⁶⁵ It is also worth noting, including because of attendant, major publicity, that Amazon.com, Inc. (Amazon) began collecting and paying Texas sales tax on July 1, 2012 under a joint settlement agreement with the state.⁶⁶ Amazon and the comptroller had long been at odds over whether the retailer legally had sufficient physical presence in the state—by virtue of an affiliate’s Dallas-area distribution center—to subject Amazon to Texas sales tax law.⁶⁷ The comptroller had assessed Amazon with \$269 million in back taxes based in part on the comptroller’s view that Amazon’s separate entities could create nexus for one another.⁶⁸

During the 2011 legislative session, the governor vetoed a stand-alone bill that would have codified the comptroller’s positions in the Amazon disagreement.⁶⁹ Among other significant changes, House Bill 2403 would have provided that an out-of-state retailer is engaged in business in Texas if it has an ownership interest in, or is owned by, an entity that maintains a location in the state, provided that the retailer either sells the same kinds of products as the in-state entity or the in-state facility is used to

60. *Id.* at *7–8.

61. *Id.* at *8; (reasoning that Austin Engineering was not the party required to collect the tax, but holding that a subcontractor could attempt to claim this exemption); (citing Tex. Tax Code Ann. § 151.302 (West 5008)).

62. *Austin Eng’g Co.*, 2011 WL 3371557, at *7.

63. 37 Tex. Reg. 8857 (2012) (adopting 37 Tex Reg. 3677 (2012)) (to be codified as an amendment to 34 TEX. ADMIN. CODE § 3.346).

64. *Id.*

65. *Id.*

66. Press Release, Susan Combs, Texas Comptroller of Public Accounts, Texas, Amazon Announce Agreement to Create Jobs (Apr. 27, 2012), <http://www.window.state.tx.us/news2012/120427-Amazon.html>.

67. *See generally id.*

68. *See generally id.*

69. Veto Message of Gov. Perry, Tex. H.B. 2403, 82d Leg. R.S. (2011).

promote or perform other tasks on behalf of the out-of-state entity.⁷⁰ However, the governor's veto did not have its desired effect for very long: because the amendments contained in House Bill 2403 made their way into the general appropriations bill, and Governor Perry signed that bill—and its changes to the state's nexus laws—into effect.⁷¹

II. FRANCHISE TAX: POLICY VERSUS REVENUE?

VALIDITY OF TAX, CALCULATIONS, COMPTROLLER INTERPRETATION, LEGISLATION

Beginning in 2011, the Texas Supreme Court heard the first constitutional challenge to the state's margin-based franchise tax.⁷² It is helpful to keep in mind the backdrop against which the comptroller and taxpayers have entered into these disputes: the revised franchise tax had not been the cash cow legislators expected and, because the initial franchise tax shortfalls coincided with the economic downturn, the state had been looking for other sources of revenue, including by pursuing increasingly aggressive positions in the franchise tax context.⁷³ While the substance of the challenges to the tax has varied, some of the most interesting and instructive lessons from the cases involve the supreme court's justified reluctance to take on a full docket of cases featuring complicated, technical questions with statutorily-prescribed ruling deadlines.

Legislation enacted in 2006 to replace the old earned surplus/taxable capital version of the tax, which generally became effective in 2008, imposed the franchise tax, for the first time, on limited partnerships,⁷⁴ including Allcat Claims Service, L.P. (Allcat), the plaintiff in *In re Allcat Claims Service, L.P. and John Weakly, Relators*.⁷⁵ Many legislators viewed the 2006 statutory revisions to the franchise tax as closing a long-standing, though perfectly legal, loophole through which limited partnerships (among other entities) had not been subject to the tax for years. However, Allcat, a Texas limited partnership, challenged the tax based on the Bullock Amendment to the Texas Constitution, which prohibits imposition of a tax on the "net income of natural persons" without prior voter approval.⁷⁶

Allcat claimed it was entitled to a refund of franchise tax paid under protest with respect to each of its partner's allocated shares of partner-

70. Tex. H.B. 2403 § 2, 82d Leg., R.S. (2011).

71. Tex. S.B. 1 Art. 30, 82d Leg., 1st C.S. (2011).

72. See generally, *In re Allcat Claim Serv., L.P.*, 356 S.W.3d 455 (Tex. 2011).

73. Although wholesale reform of the franchise tax in 2013 was not expected, the push for legislative tinkering on several franchise tax fronts yielded several substantive changes. The 2009 legislative session extended the \$1 million no-tax-due threshold through December 31, 2013. With the Consumer Price Index adjustment required by § 171.006(b) of the Texas Tax Code, the no-tax-due threshold is \$1,030,000 for reports originally due on or after January 1, 2012, and before January 1, 2014. TEX. TAX CODE ANN. § 171.06(b) (West 2000).

74. See TEX. TAX CODE ANN. §§ 171.0002 (West Supp. 2012), 171.001 (West 2008).

75. *In re Allcat Claims Serv.*, 356 S.W.3d at 455.

76. TEX. CONST. art. VIII, § 24.

ship income. Allcat reasoned that the tax indirectly reached its partners' net incomes and that, because the tax had not been approved by voters, the tax violated the Bullock Amendment and was therefore unconstitutional.⁷⁷

Allcat filed two alternate suits to claim a refund of its tax payments: one in Travis County District Court, and another directly with the Texas Supreme Court.⁷⁸ Allcat relied on a provision in the new franchise tax that vests in the supreme court "original jurisdiction over a challenge to the constitutionality of [the new franchise tax] Act or any part of [the] Act."⁷⁹

The supreme court carefully considered its jurisdictional authority under the revised franchise tax act and concluded that, at least on the Bullock Amendment issue, it did have authority to consider the arguments.⁸⁰ However, rather than determine whether the franchise tax was effectively an income tax with respect to the natural-person partners of taxable partnerships, as many tax practitioners and taxpayers had hoped the court might, the court instead focused primarily on examining the statutory and jurisprudential separation between partnerships and their partners.⁸¹ The court concluded that partnerships and their partners should be considered separate entities and, as a result, the taxation of a partnership's margin under the revised tax did not amount to the taxation of the partners' net incomes, even to the extent the franchise tax reached partnership income that had been allocated to the partners.⁸²

In addition to Allcat's facial challenge to the tax's constitutionality under the Bullock Amendment, Allcat also raised an as-applied challenge to the tax under the Texas constitutional requirement that taxes be imposed equally and uniformly.⁸³ However, the supreme court determined that the Franchise Tax Act's grant of original jurisdiction for purposes of considering the constitutionality of the tax did not extend to as-applied challenges, and it declined to consider that portion of Allcat's suit.⁸⁴ The court also dismissed Allcat's claim for attorneys' fees based on a lack of jurisdiction to hear the claim.⁸⁵

Two related cases, *In re Nestle USA, Inc., Switchplace, LLC, and NSBMA, LP, Relators*⁸⁶ and *In re Nestle USA, Inc., Relator*,⁸⁷ join Allcat among the first set of cases to test the constitutional muster of the new Texas franchise tax. Nestle USA, Inc. (Nestle) brought original petitions before the Texas Supreme Court seeking: (1) a declaration that the re-

77. *In re Allcat Claims Serv., L.P.*, 356 S.W.3d at 457.

78. *Id.* at 459.

79. *Id.* at 460.

80. *Id.* at 460–63.

81. *Id.* at 463–65.

82. *Id.* at 468–70.

83. *Id.* at 479.

84. *Id.* at 471.

85. *Id.* at 472.

86. *In re Nestle USA, Inc.*, 359 S.W.3d 207, 208 (Tex. 2012).

87. *In re Nestle USA, Inc.*, 387 S.W.3d 610, 611–12 (Tex. 2012).

vised, margin-based franchise tax is unconstitutional; (2) an injunction prohibiting the comptroller from collecting the tax; and (3) a mandamus ordering the comptroller to refund franchise taxes.⁸⁸ In its first attempt to secure a judicial decision on the merits, Nestle sued for a refund of taxes paid with respect to tax years 2008 through 2011.⁸⁹ Nestle cited a provision in the revised franchise tax, which gives the supreme court original jurisdiction to hear constitutional challenges to the tax, as authority for bringing the suit before that court without first proceeding through the typical administrative and judicial procedures required for other taxpayer suits.⁹⁰ Nestle did not pay the taxes under protest, so Nestle did not rely on either a comptroller denial of a refund claim or on a protest payment to establish its basis for suit.⁹¹

Instead of focusing on the merits of Nestle's constitutionality claims and requests for declaratory and injunctive relief, the court examined the legislature's grant of original jurisdiction for constitutional claims to the court and determined that the grant was only a narrow exception to the regular jurisdictional requirements for taxpayer suits—not, as Nestle urged, an alternate jurisdictional path.⁹² The court noted that allowing taxpayers to bring original petitions before the state's supreme court without first exhausting available administrative remedies as required by Tax Code Chapter 112 would disrupt the state's tax collection scheme and deprive—possibly for years—the comptroller of notice of any alleged illegalities in the imposition or collection regimes.⁹³ Many practitioners believe the court may also be reticent to jump into the middle of complicated tax analyses on the accelerated timetable required by the legislature's grant to the court of original jurisdiction over certain constitutional challenges to the tax.

Nestle paid under protest the asserted tax liability with respect to the 2012 tax year and again filed an original petition with the Texas Supreme Court to address the same substantive claims at issue in its prior challenge.⁹⁴ Central to Nestle's complaint was its assertion that the franchise tax violates both the Texas Constitution's Equal and Uniform Clause, and the U.S. Constitution's Equal Protection and Due Process rights as articulated in the Fourteenth Amendment. Nestle argued that its manufacturing activities outside Texas should not subject Nestle, whose Texas activities are limited to retail and wholesale trade, to the general 1.0% rate applicable to most Texas franchise taxpayers.⁹⁵ Rather, Nestle ar-

88. *In re Nestle USA, Inc.*, 359 S.W.3d at 208.

89. *Id.* at 207.

90. *Id.* at 209–10.

91. *Id.* at 209.

92. *Id.* at 210. The court noted further that it had not explored the Chapter 112 jurisdictional requirements as it had in the *Allcat* case because *Allcat* had complied with all such requirements and had filed concurrent suits both at the district court level and at the Supreme court. *Id.*

93. *Id.* at 211.

94. *In re Nestle USA, Inc.*, 387 S.W.3d 610, 616 (Tex. 2012).

95. *Id.*

gued that it should be subject to the favorable 0.5% rate applicable to certain retailers and wholesalers.⁹⁶ Nestle also argued that the comparably higher rate imposed on taxpayers with manufacturing businesses outside the state violates the interstate commerce protections under the Commerce Clause of the U.S. Constitution.⁹⁷

After reviewing the origins of and numerous changes to the franchise tax, including a review of various taxpayer classifications that the tax has long included, the court concluded that “the Legislature’s structuring of the franchise tax is reasonably related to its object,”⁹⁸ and that the tax does not violate the Equal and Uniform Clause of the Texas Constitution because, in part, “for nonproperty taxes, the uniformity which is required has always been stated as being a uniformity within classes.”⁹⁹ Nestle had already conceded that the outcome of its Equal and Uniform challenge would control the fate of its Equal Protection challenge under the U.S. Constitution, so the Court ruled against Nestle on that challenge as well.¹⁰⁰

As for Nestle’s assertion that the 1.0% rate discriminated against certain retailers and wholesalers engaged in interstate commerce, the court held that differing tax rates are permissible if the differences are based on the activities of the taxpayers rather than on their locations.¹⁰¹

While Texas courts produced more than their fair share of interesting tax cases during the Survey period, California produced one of the most significant franchise tax apportionment cases in recent memory. Its possible impact on Texas merits discussion.

While many states rely on single-sales-factor calculations or on a three-factor calculation (property, payroll, and sales), variations exist both within these formulas and outside of them. The *Gillette* case addresses questions about whether and the extent to which Multistate Tax Compact (MTC) member states may elect to use apportionment formulas that differ from the Compact’s prescribed three-factor formula.¹⁰² These questions—and their answers—threaten to undermine the continuing viability of the MTC.

96. *Id.*

97. *Id.* at 616–17.

98. *Id.* at 621–24.

99. *Id.* at 620–21.

100. *Id.* at 624. The court also cited *Ford Motor Co. v. Beauchamp*, 308 U.S. 331, 333–34 (1939), for the proposition that “the franchise tax d[oes] not violate due process because in ‘a unitary enterprise, property outside the state, when correlated in use with property within the state, necessarily affects the worth of the privilege within the state.’” *In re Nestle USA, Inc.*, 387 S.W.3d.

101. *In re Nestle USA, Inc.*, 387 S.W.3d at 625. (noting that taxes need not precisely align with the values provided by states because the franchise tax was, in effect, closely related enough to the services provided by Texas to justify the differing rates for different classes of taxpayers).

102. *Gillette Co. v. Franchise Tax Bd.*, 147 Cal. Rptr. 3d 603, 606–07 (Cal. Ct. App. 2012) *review granted and opinion superseded sub nom.* *Gillette v. Franchise Tax Bd.*, 291 P.3d 327 (Cal. 2013).

In *Gillette*, taxpayers claimed a refund for taxes paid under California's apportionment formula, which considers the same three factors as the MTC, of which California had been a member during all times at issue in the case, but double-weights the sales factor.¹⁰³ The taxpayers' challenge centers on the state's denial of their election to use the standard three-factor formula provided for in the MTC. As the taxpayers pointed out—and the court agreed—the equally-weighted, three-factor apportionment formula “is one of the Compact's key mandatory provisions designed to secure a baseline level of uniformity in state income tax systems, a central purpose of the agreement.”¹⁰⁴ California had amended its apportionment formula provision in 1993, but the court held that the state could not unilaterally alter or amend terms of the MTC after having entered into it.¹⁰⁵ Rather, if the state wished to require a different apportionment calculation for multistate taxpayers, the legislature's only course of action—at least with respect to superseding that specific, mandatory apportionment provision of the MTC—would have been to repeal and withdraw from the MTC altogether.¹⁰⁶

In a move that was not entirely surprising but that nevertheless sent shockwaves through the state and local tax world, California did just that: only a few weeks after the court's initial decision in the *Gillette* case, California withdrew from the MTC, choosing to retain its franchise tax apportionment and other California-specific provisions rather than adhere to the uniformity provisions that its membership in the MTC required under the court's decision. California's repeal of the MTC is significant not only to California, but also to other MTC states, including Texas.¹⁰⁷

Many of the most hotly contested Texas franchise tax cases decided during the Survey period involved the applicability and the calculation of the cost of goods sold (“COGS”) deduction. These cases illustrate not only the complexity of the COGS deduction but also bring to light many lingering questions about the proper calculation of the tax. These cases are of particular note in light of the comptroller's agreement to allow taxpayers to amend franchise tax returns to change between cost of goods sold and compensation deductions.¹⁰⁸

Taylor & Hill, Inc. v. Combs was a trigger for addressing this issue. The case involved a taxpayer's attempt to claim a compensation deduction

103. *Id.* at 607, 610.

104. *Id.* at 606.

105. *Id.* at 610, 616.

106. *Id.* at 616–17.

107. In a case that seems destined to explore the limits of the *Gillette* opinion's analysis outside of California, *Graphic Packaging Corp. v. Combs*, No. D-1-GN-12-003038 (3rd Dist. Ct., Travis County, Tex. filed Sept. 27, 2012), addresses whether the taxpayer had a right to file its 2010 margin tax report and refund claims for 2008 and 2009 using the evenly weighted three-factor apportionment formula in the MTC.

108. See discussion of proposed amendments to Rule 3.588, *infra* note 122 (“Cost of Goods Sold” Rule).

even though it had previously claimed the COGS deduction.¹⁰⁹ The comptroller had argued that the taxpayer was not entitled to a COGS deduction for its engineers' wages and benefits, *and* that the company could not amend its tax report to claim a deduction for compensation. However, the court concluded that the taxpayer is a temporary employment services company and is entitled to claim the compensation deduction to compute taxable margin.¹¹⁰

A number of taxpayers have also challenged the comptroller's interpretation of statutory inclusions and exclusions, including with respect to certain flow-through funds, in the context of calculating total revenue. Titan Transportation, L.P. v. Combs, for example, involves a taxpayer's claim that it should be allowed to deduct from total revenue amounts it paid to independent subcontractors for hauling work done in connection with improvements to real property.¹¹¹ The court ruled in the comptroller's favor on the issue of whether the taxpayer was entitled to a COGS deduction pursuant to § 171.1011(g)(3), although the judge denied the comptroller's request to require a 100% apportionment factor instead of the 20.18% that the comptroller had previously agreed to accept.¹¹²

Titan, like many contractors, subcontracts with independent contractors. Titan agrees to pay its subcontractor owner/operators a portion of the revenues that Titan receives from its customers. Titan claimed that the amounts it pays over to its subcontractors are "flow-through funds that are mandated by contract to be distributed to other entities," including "subcontracting payments handled by the taxable entity to provide services, labor, or materials," in connection with improvements to real property, and, therefore, that the amounts qualify for exclusion from total revenue under Tax Code § 171.1011(g)(3).¹¹³

Titan argues in the alternative that, if it is not permitted to exclude subcontract amounts from total revenue, it should be permitted to include them in its COGS deduction, claiming that it furnishes "labor or materials to a project for the construction, improvement, remodeling, repair or industrial maintenance . . . of real property," and is therefore the owner of such labor and should be permitted to deduct the labor costs as part of its COGS deduction.¹¹⁴

In a number of contexts, the comptroller seems to have attempted to fill a perceived gap where no new legislation has been enacted by announcing changes in policy and working to amend rules. One change involves the comptroller's recent announcement that she now agrees that taxpayers may change their election, or may make an initial election, to

109. Taylor & Hill, Inc. v. Combs, No. D-1-GN-10-004429 (53rd Dist. Ct., Travis County, Tex. July 7, 2011).

110. *Id.*

111. Titan Transp., L.P. v. Combs, No. D-1-GN-11-002866 (353rd Dist. Ct., Travis County, Tex., filed Sept. 15, 2011).

112. *Id.*

113. *Id.*; TEX. TAX CODE ANN. § 171.1011(g)(3) (West Supp. 2012).

114. *Titan Transp., L.P.*, No. D-1-GN-11-002866.

use the COGS or the compensation deduction by amending their franchise tax reports.¹¹⁵ Since the new policy took effect, several comptroller hearings that had denied taxpayers' attempts to change their elections after the due date, have been partially superseded.¹¹⁶ The comptroller has indicated that she intends to amend the Reports and Payments rule to reflect the new policy, though she has not yet proposed an amendment of that rule.¹¹⁷

The comptroller did recently amend the Total Revenue rule to codify her view that, to be considered flow-through funds, taxes collected by a taxable entity must be imposed on a third party and remitted by the taxable entity.¹¹⁸ The apparent purpose of the comptroller's amendment was to make clear her position that taxes actually imposed on a taxable entity may not qualify as flow-through funds and may not be excluded from total revenue.¹¹⁹

Among the most widely discussed of the comptroller's recent actions was the amendment to the Cost of Goods Sold rule.¹²⁰ Beginning a few years ago—in a series of public statements by various comptroller representatives in panel discussions and other presentations—the comptroller has taken the position that only the labor costs attributable to people who physically work on a good may be included in a taxable entity's cost of goods sold deduction.¹²¹ The clear implication of these statements is that the comptroller's then-view—with which many tax practitioners strongly disagreed—was that supervisory labor is not allowable as part of a taxable entity's COGS deduction.

Though the comptroller issued a proposed draft amendment of the Cost of Goods Sold rule to codify this position, a series of discussions with and comments from the state bar and taxpayer advocacy groups have successfully tempered the position that was ultimately adopted. Key to the final, adopted revisions to the COGS rule is the comptroller's shift toward adoption of certain categories of costs and taxpayers may capitalize under analogous Internal Revenue Code provisions, including section 263A. The final, amended rule provides that taxpayers may include in their COGS deductions “all ‘direct labor costs; all indirect labor costs, other than service costs, that are capitalized under IRC § 263A; and ser-

115. See Tex. Comptroller Pub. Accts. 201206444L (June 20, 2012) for a statement of the new policy.

116. See, e.g., Tex. Comptroller of Pub. Accts. Hearing Nos. 104,062; 105,037; and 105,876 (partially superseded Aug. 1, 2012).

117. See 34 TEX. ADMIN. CODE § 3.584 (2013) (Tex. Comptroller of Pub. Accounts, Margin: Reports and Payments).

118. 37 Tex. Reg. 1675 (2012), adopted 37 Tex. Reg. 7487 (2012) (codified at 34 TEX. ADMIN. CODE § 3.587 (2013) (Tex. Comptroller of Pub. Accounts, margin: Total Revenue)).

119. See *id.*

120. See 34 Tex. Admin. Code § 3.588 (2013) (Tex. Comptroller of Pub. Accounts, Margin: Cost of Goods Sold).

121. See *id.* Section 171.1012(c) of the tax code allows, as a cost of goods sold, direct costs of acquiring or producing goods and contains no such “work directly on goods” limitation on deductible labor. See Tex. Tax Code Ann. § 171.1012(c) (West 2008).

vice costs that are allocable to the acquisition or production of good, subject to a four percent cap.”¹²²

III. PROPERTY TAX: CONTINUING CONFUSION

OWNERSHIP AND STANDING, LEGISLATION

Though appraisal districts and taxpayers have not yet had a chance to extensively litigate and appeal disputes arising from the many significant property tax changes enacted during the 2009 legislative session, this survey period did see a number of familiar, recurring issues in the property tax context. As is typically the case, questions relating to the ownership of property about which there is an appraisal dispute wound their way through the courts, and in a couple of instances made their way to the supreme court. Refreshingly, the supreme court managed to rule in the taxpayers' favor on both of the cases with the following fact patterns.

In *Reddy Partnership/5900 North Freeway LP v. Harris County Appraisal District*, the supreme court held that, because a misnomer in the taxpayer's pleading was not misleading to the opposing party, the later correction of the pleadings to reflect the taxpayer's correct legal name was sufficient to allow the taxpayer to sustain its dispute.¹²³ In an opinion on an interlocutory appeal, *Morris v. Houston Independent School District*, the supreme court held that taxpayers were allowed to assert non-ownership of property as an affirmative defense to imposition of tax even though the proceeding had begun with the taxpayers listed as plaintiffs and that, as part of that pleading, the taxpayers asserted nonownership as a basis for reimbursement of tax amounts paid under protest.¹²⁴

The 2011 legislative session was largely quieter on the property tax front than the previous session, which saw an especially intense flurry of activity centered around certain long-overdue property tax reforms.¹²⁵ One legislative change in House Bill 1887 addresses precisely the problem raised in the *Reddy Partnership* case, and may significantly reduce confusion and resulting disputes centered around property ownership and appeal rights.¹²⁶ That legislation provides that a notice of protest may not be found insufficient or untimely based on certain minor misidentifications of the taxpayer.¹²⁷ Several provisions in House Bill 1887 and in other bills changed certain property tax protest and appeal procedures,¹²⁸

122. See Preamble to May 16 Tex. Reg.; 3.388(b)(9), (d)(1), and (f).

123. *Reddy P'ship/5900 N. Freeway LP v. Harris Cnty. Appraisal Dist.*, 370 S.W.3d 373, 376-77 (Tex. 2012).

124. *Morris v. Houston Indep. School Dist.*, 388 S.W.3d 310, 313 (Tex. 2012).

125. See Ohlenforst, *supra* note 28, at 841 (discussing property tax legislation in the previous session).

126. Tex. H.B. 1887 § 10, 82d Leg., R.S. (2011).

127. *Id.*

128. See Tex. H.B. 533 § 2, 82d Leg., R.S. (2011) (establishing procedures for protesting penalties for delinquent filing of renditions); Tex. H.B. 2203 §§ 1, 4, 82d Leg., R.S. (2011) (extending through the end of 2013 the pilot program allowing taxpayers to appeal certain appraisal review board determinations to the State Office of Administrative Hearings).

the manners in which appraisal rolls may be corrected,¹²⁹ and the degree to which appraisal review boards may be influenced by budget-conscious chief appraisers of the boards' appraisal districts.¹³⁰

IV. PROCEDURE: INCREASING TAXPAYER BURDENS?

A SUCCESSOR LIABILITY, CLAIMS FOR REFUND, RULING LETTERS, INCONSISTENT COMPTROLLER POLICIES, LEGISLATION

Consistent with several past Surveys, this survey period includes at least one successor liability case. Tax Code § 111.020 provides that, in certain circumstances, “[t]he purchaser of a business or stock of goods” may become liable for certain taxes (including sales and franchise taxes) for which the seller was liable.¹³¹ Pursuant to this section, often referred to colloquially as a “successor-liability” provision, the comptroller frequently asserts that a buyer of a business must pay taxes that should have been paid by the seller of the business.¹³² Such assertions raise a host of issues, including what constitutes the sale of a business or stock of goods. In addition, the comptroller generally argues, as in *State v. BFI Waste Services of Texas, LP*, that the successor is not entitled to a redetermination hearing to contest the validity of the underlying assessment.¹³³ BFI challenged the comptroller's position by filing a plea to the jurisdiction and seeking dismissal of a collection suit against it, claiming that the state must first issue a tax assessment against BFI and provide it with an opportunity for an administrative hearing.¹³⁴

The district court granted BFI's plea to the jurisdiction, but also ordered that the case be abated to allow the comptroller to assess the tax and allow BFI to request a redetermination.¹³⁵ The court of appeals concluded, however, that if the district court had no jurisdiction, then it had no authority to abate the state's claims.¹³⁶ Ultimately, the court of appeals held that the district court did have subject matter jurisdiction and remanded the case, though without meaningfully addressing BFI's assertion that it deserved an administrative hearing on the substantive tax issue.¹³⁷

Faced with more class action claims regarding taxes in recent years, courts also face procedural issues in that context. *Assignees of Best Buy, Office Max, and CompUSA v. Combs*, involved consumers seeking sales

129. See Tex. S.B. 1441 § 1, 82d Leg., R.S. (2011) (allowing an appraisal review board to correct incorrect property ownership records).

130. See Tex. H.B. 2387 § 1, 82d Leg., R.S. (2011) (allowing appraisal review boards to retain independent general counsel).

131. TEX. TAX CODE ANN. § 111.020 (West 2008).

132. *Id.*

133. See *State v. BFI Waste Servs., of Tex., LP*, No. 03-10-00504-CV, 2011 WL 1086585, at *1 (Tex. App.—Austin 2011, pet. denied) (mem. op.).

134. *Id.* at *1.

135. *Id.*

136. *Id.*

137. *Id.* at *2.

tax refunds from the comptroller on mail-in rebates from retailers.¹³⁸ The comptroller challenged the court's subject matter jurisdiction to appoint settlement-class counsel to represent the class in the individual refund claims. The court noted that, unlike many of the cases cited as authority by settlement-class counsel, which involved class claims for monetary relief, the Texas class action certification provisions and relevant cases do not support the assertion that trial courts have the power in the context "to establish an individual attorney-client relationship between class counsel and absent class members to allow class counsel to pursue individuals' claims in separate, non-class proceedings."¹³⁹

Bell Helicopter Textron, Inc. v. Combs focused on whether the comptroller should have calculated interest on the gross overpayment in each tax period rather than on the net overpayment.¹⁴⁰ Bell alleged that the state improperly netted Bell's tax deficiencies in each tax period against its overpayments in the same period before calculating the interest on each overpayment.¹⁴¹ Bell claimed the comptroller should have calculated interest on the gross overpayment in each tax period rather than on the net overpayment.¹⁴²

According to the court, there was no interest to be waived and no interest to include in the offset because, based on the relevant statutes, underpayments and overpayments in the same period will not have accrued interest at the time specified in the Tax Code for mandatory offsets.¹⁴³ The court concluded that the comptroller's netting method "is not only a reasonable construction of the relevant Tax Code provisions, it is dictated by the plain language of the statute."¹⁴⁴

As part of her stated plan to overhaul a number of out-of-date rules, the comptroller proposed revisions to the rule governing ruling letters issued by the comptroller. Throughout the terms of multiple comptrollers, taxpayers have sought and received—and, significantly, relied on—ruling letters. Faced with more ruling requests than staff time and (perhaps more significantly) with taxpayers relying on policies the comptroller no longer wishes to follow, the comptroller has adopted a new version of Rule 3.1.¹⁴⁵ As revised, Rule 3.1 adopts specific guidelines for the public

138. *Assignees of Best Buy, Office Max, and CompUSA v. Combs*, No. D-1-GN-10-001182, (Dist. Ct. Travis County, Tex, July 20, 2012).

139. The additional use of class action plaintiff lawyers to bring suits on behalf of taxing jurisdictions raises additional concerns, including about the difficulty of preserving taxpayer rights and sound tax policy in the context of such litigation.

140. *Bell Helicopter Textron, Inc. v. Combs*, 2011 WL 6938491, *1 (Tex. App.—Austin, 2011, no pet.) (mem. op.).

141. *Id.*

142. *Id.*

143. *Id.* at *3–4.

144. *Id.* (The court held that the plain language of TEX. TAX CODE ANN. § 111.104 (West 2012) requires that any tax overpayment be applied against a tax deficiency as of the date the tax deficiency became "due and payable.").

145. 34 TEX. ADMIN. CODE § 3.1 (2013) (Tex. Comptroller of Pub. Accounts, Private Letter Rulings and General Information Letters).

to request private letter rulings and general information letters.¹⁴⁶ The preamble to the proposed amendments provides that “[t]he purpose of the section is to distinguish between requests for taxability information that is already available in the form of rules, publications, and other agency resources and requests for taxability information in situations where guidance is not already provided by law or by the comptroller.”¹⁴⁷ The preamble also acknowledges that, according to *Entertainment Publications*,¹⁴⁸ the comptroller must follow the required statutory rulemaking process, which provides for public review and input, when issuing taxability guidance through statements of general applicability.¹⁴⁹ Taxability letters issued by the comptroller prior to the January 28, 2013 effective date remain eligible for detrimental reliance as provided for in Rule 3.10.¹⁵⁰ Unfortunately, the policies articulated in this rule appear designed to make it more difficult for taxpayers to secure and rely on comptroller rulings.

Additional amendments to Rule 3.10 (Taxpayer Bill of Rights) appear designed to reserve for the comptroller significant discretion in deciding whether, how, and when to respond to guidance requests, as well as to provide for much more onerous information disclosure by requesters before the comptroller will entertain a request.¹⁵¹

The comptroller also seeks to impose more onerous requirements on taxpayers who seek sales tax refunds. Accordingly, the comptroller proposed amendments to Rule 3.325 regarding refunds and payments under protest to require more information about specific transactions.¹⁵² The comptroller originally asserted that a refund request that fails to comply fully with the comptroller’s new requirements would not be considered a valid request, and would not toll the statute of limitations.¹⁵³ In response to significant, justified taxpayer concerns, the comptroller proposed yet another version of Rule 3.325.¹⁵⁴ Under revised Rule 3.325, taxpayer would have 180 days to provide comptroller-requested documentation.¹⁵⁵ Significantly, regarding tolling the statute of limitations, the amended rule identifies items that must be submitted with a refund claim in order to toll the statute of limitations.¹⁵⁶ Hopefully, the comptroller’s interpretations of the most recent version of the rule will recognize that a refund

146. 37 Tex. Reg. 9327 (2012) (codified at 34 TEX. ADMIN. CODE § 3.1).

147. 37 Tex. Reg. 9327, (2012).

148. *Combs v. Entm’t Publ’ns*, 292 S.W.3d 712, 721 (Tex. App.—Austin 2009, no pet.).

149. 37 Tex. Reg. 9327,

150. *Id.*

151. 37 Tex. Reg. 9330 (2012), *adopted* 38 Tex. Reg. 336 (2013) (codified at 34 TEX. ADMIN. CODE § 3.10 (2013) (Tex. Comptroller of Pub. Accounts, Taxpayer Bill of Rights)).

152. 37 Tex. Reg. 9065 (2012), *adopted* 38 Tex. Reg. 148 (2013) (codified at 34 TEX. ADMIN. CODE § 3.325 *2913(2013) (Tex. Comptroller of Pub. Accounts, Refunds and Payments Under Protest)).

153. *Id.*

154. 38 Tex. Reg. 148 (2013); *adopted* 37 Tex. Reg. 9068 (codified at 34 Tex. Admin. Code § 3.325).

155. *Id.*

156. *Id.*

claim may not meet all the requirements for the comptroller to pay the requested amount, but it may still toll the statute of limitations if it meets certain requests.¹⁵⁷

V. CONCLUSION

As this update illustrates, policy debates and statutory construction battles continue to play a key role in shaping Texas tax law. The legislature adds its voice too—seeking good policy, and reacting to both taxpayer and business demands and to requests from the comptroller and property tax jurisdictions for broader authority to audit taxpayers and to interpret the law.¹⁵⁸ So . . . more to come later.

157. *Id.*

158. Several 2011 legislative changes increased penalties in the sales tax context. *See, e.g.*, TEX. TAX CODE ANN. § 151.7075 (West Supp. 2012) (Failure to Produce Certain Records After Using Resale Certificate; Criminal Penalty).