



2005

## Taxation

Cynthia M. Ohlenforst

Jeff W. Dorrill

J. Blake Rice

Sarah J. Butcher

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

---

### Recommended Citation

Cynthia M. Ohlenforst, et al., *Taxation*, 58 SMU L. Rev. 1159 (2005)  
<https://scholar.smu.edu/smulr/vol58/iss3/26>

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\*

Jeff W. Dorrill\*\*

J. Blake Rice\*\*\*

Sarah J. Butcher\*\*\*\*

IN what is becoming an increasingly commonplace scenario, Texas taxpayers, administrators and legislators once again found themselves caught this year in the uncertainty of a not yet “fixed” tax system. This Survey period, which included the interim between a fourth special legislative session and the beginning of the regular 2005 session, witnessed multiple proposals, debates, and politicking about reforming Texas taxes. The uncertainty concerning what tax changes may be enacted in 2005 is the backdrop against which interpretation of the existing law continued to develop through a series of court cases and administrative decisions, as well as revision of some administrative rules.<sup>1</sup>

## I. SALES TAX

### A. APPLICATION OF THE TAX

Out-of-state printing services continue to present a challenge to taxing authorities. Following recent legislative changes that impacted the taxability of out-of-state printing,<sup>2</sup> the courts continue to refine the analysis of such services. In *May Department Stores Co. v. Strayhorn*, the appellant sought a refund for use taxes assessed on out-of-state printing services used to produce advertising materials that were subsequently mailed to Texas.<sup>3</sup> The comptroller argued that the printing charges were for the sale of tangible personal property and were subject to use tax. The comp-

---

\* B.A., Loyola University; M.A., University of Dallas; J.D., Southern Methodist University. Partner, Hughes & Luce, LLP, Dallas, Texas; cindy.ohlenforst@hughesluce.com.

\*\* B.B.A., J.D., Baylor University. Partner, Hughes & Luce, LLP, Dallas, Texas; dorrilj@hughesluce.com.

\*\*\* B.A., Trinity University; J.D., University of Chicago. Associate, Hughes & Luce, LLP, Dallas, Texas; riceb@hughesluce.com.

\*\*\*\* B.A., Rhodes College; J.D., The University of Texas. Associate, Hughes & Luce, LLP, Dallas, Texas; sarah.butcher@hughesluce.com.

1. The Survey period includes November 2003 through November 2004. *United Servs. Auto Ass'n v. Strayhorn*, 124 S.W.3d 722 (Tex. App.—Austin 2003, pet. denied), decided during this Survey period, was included in the previous survey article, Cynthia M. Ohlenforst et al., *Taxation*, 57 SMU L. REV. 1241, 1244 (2004).

2. See TEX. TAX CODE ANN. § 151.011(a) (Vernon Supp. 2004-05).

3. No. 03-03-007290CV, 2004 WL 1898244, at \*1 (Tex. App.—Austin Aug. 26, 2004, pet. denied) (not designated for publication).

troller further asserted that May made a taxable use of the materials in Texas in the manner described in Comptroller's Rule 3.346(b)(3)(A), which provides that use tax is due on taxable items purchased outside this state "if the taxable items are delivered at the direction of the purchaser to recipients in Texas designated by the purchaser."<sup>4</sup> The court rejected May's argument that Rule 3.346(b)(3)(A) conflicted with the Texas Tax Code, which does not include "distribution" in the definition of taxable use.<sup>5</sup> The court noted that the comptroller had amended Rule 3.346(b)(3)(A) based on *D.H. Holmes Co. v. McNamara*, a United States Supreme Court decision dealing with the interpretation of the Louisiana use tax statute that specifically included "distribution" in the definition of taxable use.<sup>6</sup> However, the Austin court reasoned (stretched to conclude?) that the Supreme Court's ruling in *D.H. Holmes* did not turn on the issue of distribution,<sup>7</sup> and therefore concluded that the Texas rule comports with the Texas Tax Code's plain meaning," which is broad enough to encompass the mailing of items to Texas."<sup>8</sup> Alternatively, May had argued that Rule 3.346(b)(3)(A) did not apply because advertising materials, not printing services, were delivered to Texas; the court dismissed this argument, stating that the printing was inextricably intertwined with the advertising materials, and without the printing, the advertising materials would not exist.<sup>9</sup> May also argued that the printing was exempt from Texas use tax because May manufactured the advertising materials from raw materials out-of-state and then delivered the advertising into Texas in the same manner as the taxpayer in *Sharp v. Morton Buildings, Inc.*<sup>10</sup> The court rejected May's analogy to *Morton Buildings* for two reasons: (1) the court reasoned that the comptroller was taxing May for the transformation of the materials instead of the raw materials themselves; and (2) the court noted that the taxpayer in *Morton Buildings* was conducting the manufacturing, whereas the printers, not May, undertook the transformative act of printing the advertising materials.<sup>11</sup> In rejecting each of May's arguments and upholding the lower court's summary judgment order for the comptroller, the court has further encouraged the comptroller to pursue use taxes on materials printed out-of-state and delivered to in-state residents.

One of the more interesting sales tax cases during the past year, *Alpine Industries, Inc. v. Strayhorn*, explored some of the constitutional nexus

---

4. See 34 TEX. ADMIN. CODE §3.346(b)(3)(A) (West 2005) (Comptroller of Pub. Accounts, Use Tax).

5. *May Dep't Stores Co.*, 2004 WL 1898244, at \*5.

6. *Id.* (citing *D.H. Holmes Co. v. McNamara*, 486 U.S. 24, 27 (1988)).

7. *Id.* (citing *D.H. Holmes Co.*, 486 U.S. at 27)).

8. *Id.*

9. *Id.* at \*6.

10. *Id.* at \*7; *Sharp v. Morton Bldgs., Inc.*, 953 S.W.2d 300, 303 (Tex. App.—Austin 1997, pet. denied).

11. *Id.* at \*8.

issues that direct sales organizations present.<sup>12</sup> The comptroller determined that Alpine was required to collect sales tax for its independent distributors pursuant to section 151.024 of the Tax Code and Comptroller Rule 3.286(a)(1)(D), which provide that the comptroller may (if the comptroller determines it is necessary for the efficient administration of the Texas sales tax) treat representatives, canvassers, and salesmen as agents of their employers, distributors, or dealers and may regard such employers, distributors, or dealers as retailers for the purposes of the Texas sales tax.<sup>13</sup> Alpine submitted six arguments supporting its appeal: (1) the comptroller failed to prove sufficiently Alpine was a direct sales organization; (2) the sales tax in question violated the commerce clause of the U.S. Constitution; (3) the comptroller failed to make an individualized determination that Alpine is such an organization and that treating Alpine as a retailer is necessary for efficient administration of tax code Section 151; (4) the sales tax violated the due process clause of the U.S. Constitution; (5) the sales tax violated the equal protection clauses of the U.S. Constitution and Texas Constitution; and (6) the comptroller failed to sufficiently prove that she was entitled to summary judgment on her counterclaim because she refused to issue sales tax permits to each of Alpine's independent salespersons.<sup>14</sup> The court found that the comptroller's summary judgment evidence from Alpine's internal manual sufficiently established that Alpine was a direct sales organization that sells its products through a network of independent salespersons who function in the same way as representatives, canvassers, and salesmen function.<sup>15</sup> Next, the court rejected Alpine's argument that the comptroller failed to establish a sufficient Texas nexus because Alpine had no real estate, employees, inventory, bank accounts, offices or other assets in the state.<sup>16</sup> Rather, noted the court the comptroller had provided evidence showing that the appellant had a network of as many as 20,000 independent salespersons in Texas who made sales of over 32 million dollars from 1994-1998; the court concluded that this network, even though it was comprised of independent salespersons, established a sufficient nexus between Alpine's sales and the state of Texas.<sup>17</sup> The court also summarily dismissed Alpine's arguments regarding the lack of an individualized determination of the necessity of treating Alpine as a retailer, due process, equal protection, and the comptroller's failure to issue sales tax permits.<sup>18</sup> The case thus bolsters the previously-articulated comptroller policy of

---

12. See *Alpine Indus., Inc. v. Strayhorn*, No. 03-03-00643-CV, 2004 WL 1573159, at \*1 (Tex. App.—Austin July 15, 2004, pet. filed).

13. See TEX. TAX CODE ANN. § 151.024 (Vernon 2002); 34 TEX. ADMIN. CODE § 3.286(a)(1)(D) (West 2005) (Comptroller of Pub. Accounts, Seller's & Purchaser's Responsibilities); *Alpine Indus., Inc.*, 2004 WL 1573159, at \*1-2.

14. *Alpine Indus., Inc.*, 2004 WL 1573159, at \*1.

15. *Id.* at \*3.

16. *Id.* at \*6.

17. *Id.* (citing *Tyler Pipe Indus., Inc. v. Wash. State Dep't of Revenue*, 483 U.S. 232 (1987), and *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960)).

18. *Id.* at \*4, \*7-8.

subjecting direct sellers with in-state distribution networks to Texas sales tax obligations.

In *USA Waste Services of Houston, Inc. v. Strayhorn*, the court examined the application of the resale exemption to cleanup services provided by a waste removal company that accidentally spilled waste on a customer's property. Appellant USA Waste Services ("USAWS") operated a waste removal business, and in the course of removing waste for customers, USAWS employees occasionally accidentally spilled liquid onto a customer's property. When customers called to complain about the spills, USAWS used an independent company to provide cleanup services for the spills. The comptroller assessed sales tax on USAWS for the purchase of these services, and USAWS protested the assessment by claiming that the services were exempt under the "sale for resale" exemption.<sup>19</sup> The court disagreed, finding that the spill cleanup services were not an integral part of USAWS's waste removal services.<sup>20</sup> In reaching this conclusion, the court noted USAWS did not order steam cleaning every time a spill occurred, and USAWS's own safety manager admitted that spills occurred only "sometimes."<sup>21</sup> Nor was the court persuaded by USAWS's alternative argument that the comptroller's construction of the "sale for resale" exemption in the case was inconsistent with its construction of the exemption in other situations.<sup>22</sup> USAWS cited a number of examples to support this argument, but the court found each example to be distinguishable from USAWS's situation.<sup>23</sup> The court reasoned that the spill cleanup services were "more analogous to a construction company paying for a plant that it accidentally backed over with one of its trucks" and that the plant replacement "is not an integral part of its service, but is instead intended to make the customer whole."<sup>24</sup>

Last year's Survey article highlighted the legislature's enactment of provisions that may impact sales tax rebate contracts between a municipality and certain businesses.<sup>25</sup> Attorney General Abbott addressed this legislation in an opinion that points out that although the bill will allow the comptroller to disregard outlets, offices, facilities or other locations as a place of business of the retailer if the entity exists to avoid tax or to rebate to the entities a portion of the tax imposed by Chapter 321 of the Tax Code, the bill will not void sales tax rebate contracts between municipalities and these entities.<sup>26</sup> However, the new provisions may result in making contracts between a municipality less attractive to some entities; nonetheless the rebate mechanism ought to remain available for those who are legitimately doing business in the taxing jurisdiction. Attorney

---

19. *USA Waste Servs. of Houston, Inc. v. Strayhorn*, 150 S.W.3d 491, 493 (Tex. App.—Austin 2004, pet. denied).

20. *Id.* at 496.

21. *Id.*

22. *Id.* at 497.

23. *Id.*

24. *Id.*

25. See TEX. TAX CODE ANN. §321.002(a)(3) (Vernon Supp. 2004-05).

26. Op. Tex. Att'y Gen. No. GA-0137 (2004), available at 2004 WL 77808.

General Abbott also said that the bill will not prohibit municipalities from executing new contracts.<sup>27</sup>

The petitioner in Hearing No. 42,539 licensed skyboxes in a basketball arena from a municipality and then sublicensed the same skyboxes for a fee that included the price of tickets to events held in the arena as well as additional fees for the sublicense.<sup>28</sup> The case is interesting for its analysis of the comptroller's viewpoint, although the language used in the particular contract (including the licensing provisions) and the omission from the decision of some key points make it unlikely that similarly situated taxpayers will view the decision as precedent.<sup>29</sup> The taxpayer remitted sales taxes based on the face amount of the admission tickets sold to sublicensees, but not on additional amounts. The taxpayer pointed out that the additional fees were payments for nontaxable rentals of real property or for nontaxable sales of intangible rights and that—if the payments were for amusement services—they were for amusement services “exclusively provided” by a municipality and therefore exempt.<sup>30</sup> In dismissing the taxpayer's arguments, the administrative law judge concluded that “the Comptroller's policy” is to treat both the charge for the use of a facility and the price of the admission ticket as “part of the total charge for the amusement service.”<sup>31</sup> The limited fact discussion and the judge's summary dismissal of the taxpayer's invocation of *Rylander v. San Antonio SMSA Ltd. Partnership* leave many open questions.<sup>32</sup>

A hearing that highlights the comptroller's renewed attention to determining when “care, custody, and control” is relevant to resale transactions, Hearing No. 43,728, denied the taxpayer's claimed resale exemption. Specifically, the comptroller found that the taxpayer could not claim a resale exemption for telephone equipment that it purchased for guest use in its hotel rooms.<sup>33</sup> While the equipment proved necessary to the taxpayer's provision of a taxable service, the taxpayer did not transfer the care, custody and control of the phone equipment to the guests. The comptroller found that the burden of maintaining and repairing the telephone equipment fell on the taxpayer.<sup>34</sup> The administrative law judge refused to treat the “availability” of the telephone equipment in the hotel rooms as a transfer to the guests of “custody” of the telephones, as the guests used the equipment for only a limited period of

---

27. *See id.*

28. Tex. Comptroller Pub. Accounts STAR System No. 200406701H (June 8, 2004), at <http://aixtcp.cpa.state.tx.us/star/>.

29. The taxpayer sued in district court after losing its battle in the comptroller's administrative hearing process.

30. Tex. Comptroller Pub. Accounts STAR System No. 200406701H (June 8, 2004), at <http://aixtcp.cpa.state.tx.us/star/>.

31. *Id.*

32. *Rylander v. San Antonio SMSA Ltd. P'ship*, 11 S.W.3d 484 (Tex. App.—Austin, 2000, no pet.).

33. Tex. Comptroller Pub. Accounts STAR System No. 200404637H (April 29, 2004), at <http://aixtcp.cpa.state.tx.us/star/>.

34. *Id.*

time.<sup>35</sup> Hearing No. 41,730, another hearing dealing with a denied resale exemption, focused on a private club that claimed its purchase of lockers was exempt because, after the locker installation, the club rented the lockers to its members and charged sales tax on the rental fee.<sup>36</sup> (Neither party in this decision questioned the status of the lockers as tangible personal property). As in the decision above, the comptroller concluded that the taxpayer did not transfer care, custody, and control of the lockers to its members.<sup>37</sup> In examining which party maintained custody of the property, the comptroller found that while the members had custody of the contents of the lockers, their “use” of the lockers was not synonymous with “custody.”<sup>38</sup> In addition, the taxpayer controlled the members’ access to the clubhouse, the locker room, and the locker themselves.<sup>39</sup> Unfortunately, there appears to be continuing confusion regarding these care, custody, and control issues — particularly in the service and software context, and in situations in which more than one party has at least some degree of care, custody, or control over property.

The comptroller relied upon legislative history and court cases from other states to dismiss the taxpayer’s claims in Hearing No. 43,999.<sup>40</sup> The taxpayer had argued that because telecommunications involved a product perceptible to the senses, as defined by section 151.009, and because the transmissions start with electrical impulses, also defined as tangible personal property in Rule 3.295, the necessary equipment used in the manufacturing of its telecommunications product should be tax-exempt.<sup>41</sup> The comptroller found that telecommunications was legislatively treated as a service rather than tangible personal property and that the taxpayer’s network equipment did not become tangible personal property because of the involvement of electricity in the telecommunications process.<sup>42</sup>

As in most Survey periods, several hearings focused on the taxability of various services. Hearing No. 41,876 concluded that the service of hauling goods to be recycled was a taxable real property service.<sup>43</sup> The taxpayer had argued that because it took title to the paper it removed for recycling purposes and later resold the paper, it was not performing a taxable service. The comptroller treated this type of service differently from one in which a customer contracts with the taxpayer to pick up records, deliver them to another location and then destroy them; accord-

---

35. *Id.*

36. Tex. Comptroller Pub. Accounts STAR System No. 200401396H (Jan. 5, 2004), at <http://aixtcp.cpa.state.tx.us/star/>.

37. *Id.*

38. *Id.*

39. *Id.*

40. Tex. Comptroller Pub. Accounts STAR System No. 200403704H (Mar. 26, 2004), at <http://aixtcp.cpa.state.tx.us/star/>.

41. *Id.*

42. *Id.* This brief reference to a single case cannot do justice to the number and complexity of telecommunications tax issues that flow through the cases and legislative processes; those are issues for another day.

43. Tex. Comptroller Pub. Accounts STAR System No. 200401407H (Jan. 14, 2004), at <http://aixtcp.cpa.state.tx.us/star/>.

ing to the comptroller's administrative law judge, the objective of the taxpayer's service was not to move paper from one location to another for recycling, but merely to remove garbage or waste from its customers' premises, regardless of whether the taxpayer had subsequent plans for the paper.<sup>44</sup> In Hearing No. 38,774, the comptroller found that the fact that model homes would eventually be used as residences brought certain purchases for the structures within the tax-exemption for real property services purchased by a contractor as part of an improvement of real property with a new structure to be used as a residence.<sup>45</sup> The comptroller concluded, however, that the exemption did not apply to services performed in maintaining the real property while the structures were being used for other purposes.<sup>46</sup>

In Hearing No. 42,864, the comptroller determined that in order for the repaving of a parking lot in concrete to constitute new nontaxable construction, the existing asphalt must be removed down to the dirt.<sup>47</sup> The taxpayer's attempt to show that the asphalt was removed down to the dirt, by issuing an invoice nearly four years after the transaction occurred, was insufficient evidence that the transaction was new construction.<sup>48</sup> Additionally, the comptroller found that if only part of the existing parking lot was removed and repaved, a taxable remodeling service occurred.<sup>49</sup> It remains difficult to determine with certainty what the comptroller will consider nontaxable new construction instead of taxable remodeling. Carried to its logical extreme, the comptroller's insistence that all of a structure be taken down to ground would mean that the complete rebuilding of an apartment complex would be remodeling if even a portion of the foundation remained, although that result appears unjustified.

Hearing No. 43,494 addressed an exemption claimed for items necessary and essential for the production or broadcast of a television station licensed by the FCC.<sup>50</sup> The taxpayer claimed that a helicopter it purchased, and on which it installed cameras for sending live feed to the television station, was exempt from tax because the helicopter was adapted to its exclusive use as a camera platform and was used directly in the production of the taxpayer's news broadcasts. The comptroller disagreed, finding that not only was the helicopter not "necessary and essen-

---

44. *Id.*

45. Tex. Comptroller Pub. Accounts STAR System No. 200309201H (Sept. 24, 2003), at <http://aixtcp.cpa.state.tx.us/star/>.

46. For another services decision, see Hearing No. 41,466 (Tex. Comptroller Pub. Accounts STAR System No. 200404596H (Apr. 14, 2004), at <http://aixtcp.cpa.state.tx.us/star/>). (Taxpayer's provision of services to help determine the losses of individual policyholders so they could obtain a fair settlement from their insurance providers was taxable service, even though taxpayer did not provide the service to the insurance companies themselves).

47. Tex. Comptroller Pub. Accounts STAR System No. 200401397H (Jan. 7, 2004), at <http://aixtcp.cpa.state.tx.us/star/>.

48. *Id.*

49. *Id.*

50. Tex. Comptroller Pub. Accounts STAR System No. 200407790H (July 12, 2004), at <http://aixtcp.cpa.state.tx.us/star/>.



tial” to the production of broadcasts because its use was elective and restricted to certain occasions, but also that it was used for transportation activities and therefore, according to the judge, it was excluded from the exemption. This decision adopts a narrower definition of “necessary and essential” than the comptroller has articulated in the past and is unfairly limiting. Under the “optional” standard articulated in this decision, items that a taxpayer could conceivably get by without (e.g., a *new* computer) would not meet the necessary and essential test; however, the comptroller has not previously adopted such a narrow test. The case is also a good reminder that purchasing equipment for a helicopter or car separately from the helicopter or car purchase may facilitate qualifying the equipment for exemption.

In Hearings No. 39,781 and 41,577, the comptroller examined claims for exemptions from tax for purchases of repair and replacement parts for pollution control equipment and purchases of environmental repair services.<sup>51</sup> The taxpayer produced alumina at its plant. The production process included moving the materials through the plant on conveyor belts. When the conveyors moved the materials through the plant, a dust pollutant was agitated and released into the air. The taxpayer used baghouse dust collectors to capture the dust and deposit it back onto the conveyors. While the comptroller allowed refunds for the replacement parts and repairs to the baghouse dust collectors, it refused to grant the conveyors the same treatment.<sup>52</sup> The comptroller found the conveyors at issue to be the cause of the pollution, rather than equipment used to control the pollutant dust particles; the purchase of replacement parts and their repair did not qualify for either exemption.<sup>53</sup> This hearing also addressed the question of whether cranes that operated on a rail-type system fell under the definition of “rolling stock.” The comptroller concluded that rolling stock must be traditional railroad equipment or equipment mounted on rails that connect to traditional railroads.<sup>54</sup> Because the cranes were not mounted on rails connected to traditional railroad lines, the comptroller treated them as taxable as intra-plant transportation.<sup>55</sup>

Multiple letters addressed the comptroller’s analysis of hotel occupancy tax. The comptroller asserts that when a hotel bills the entire amount of a package deal to a guest in a lump sum, the entire amount is subject to hotel tax, even if there is an internal record that breaks the lump sum into separate amounts. However, the comptroller recognized that no hotel

---

51. Tex. Comptroller Pub. Accounts STAR System No. 200401485H (Jan. 13, 2004), at <http://aixtcp.cpa.state.tx.us/star/>.

52. *Id.*

53. In another hearing, Hearing No. 43,251, the comptroller denied an exemption claim, holding that a microchip identification system for pets was not exempt as a therapeutic appliance because the medical devices exemption does not apply to pets. Tex. Comptroller Pub. Accounts STAR System No. 200310345H (Oct. 23, 2003), at <http://aixtcp.cpa.state.tx.us/star/>.

54. Tex. Comptroller Pub. Accounts STAR System No. 200401485H (Jan. 13, 2004), at <http://aixtcp.cpa.state.tx.us/star/>.

55. *Id.*

tax is due when a hotel provides a room or upgrade for awards points, unless additional consideration was also provided.<sup>56</sup> Moreover, if the amount that the hotel received from an awards fund for the room or upgrade had previously been paid to the fund by the hotel, then the hotel received no consideration at the time of booking and no tax would have been due.<sup>57</sup>

The comptroller also issued several letters concerning food and drink, including regarding baked goods sold in money-operated vending machines, and sales of doughnuts and other baked goods (once again noting that whether a bakery has eating facilities may determine the taxability of the items sold, and acknowledging the fact that reheating the baked goods for the customers did not make the sales taxable).<sup>58</sup>

Other letters addressed a variety of other issues. A reasonable, taxpayer-favorable letter provides that when new construction is interrupted by the initial but temporary occupation of the structure and construction resumes within a reasonable time under the terms of the original contract, the construction remains nontaxable new construction.<sup>59</sup> The comptroller treats internet cards and prepaid debit cards like gift certificates; tax should be collected only when purchases are made with the cards.<sup>60</sup> Neither the enrollment fee for the Medicare Prescription Drug Discount Card Program nor the transaction fee related to the sale of a nontaxable drug or medicine is taxable.<sup>61</sup> Writing or editing is not a taxable service, provided the processes are more than merely word processing services.<sup>62</sup> Doctors may claim a manufacturing exemption on equipment used to manufacture lenses for glasses if they are sold separately from the

---

56. Tex. Comptroller Pub. Accounts STAR System No. 200405578L (May 17, 2004), at <http://aixtcp.cpa.state.tx.us/star/>; Tex. Comptroller Pub. Accounts STAR System No. 200401318L (Jan. 8, 2004), at <http://aixtcp.cpa.state.tx.us/star/>.

57. Tex. Comptroller Pub. Accounts STAR System No. 200401343L (Jan. 23, 2004), at <http://aixtcp.cpa.state.tx.us/star/>.

58. Tex. Comptroller Pub. Accounts STAR System No. 200402375L (Feb. 4, 2004), at <http://aixtcp.cpa.state.tx.us/star/>. Another letter found that sushi rolled at the grocery store's premises is subject to tax while sushi rolled off premises is not, provided it is sold without utensils. (There's that eating utensil rule again.) Tex. Comptroller Pub. Accounts STAR System No. 200402371L (Feb. 3, 2004), at <http://aixtcp.cpa.state.tx.us/star/>. Personal chefs, take note: preparing meals at a client's home for consumption is not subject to tax, while catering services generally are taxable, although the caterers may claim exemptions for equipment used to cook. Tex. Comptroller Pub. Accounts STAR System No. 200405579L (May 17, 2004), at <http://aixtcp.cpa.state.tx.us/star/>. (Yes, we know that personal chefs won't really read this article. Why include these rulings? To show the difficulty involved in attempting to draw lines between taxable and nontaxable items, and because food is almost always worth discussing.)

59. Tex. Comptroller Pub. Accounts STAR System No. 200312323L (Dec. 12, 2003), at <http://aixtcp.cpa.state.tx.us/star/>.

60. Tex. Comptroller Pub. Accounts STAR System No. 200403419L (Mar. 2, 2004), at <http://aixtcp.cpa.state.tx.us/star/>.

61. Tex. Comptroller Pub. Accounts STAR System No. 200405590L (May 24, 2004), at <http://aixtcp.cpa.state.tx.us/star/>.

62. Tex. Comptroller Pub. Accounts STAR System No. 200311212L (Nov. 7, 2003), at <http://aixtcp.cpa.state.us/star/>.

doctor's services.<sup>63</sup>

## B. LEGISLATIVE DEVELOPMENTS

In November 2004, Congress passed the Internet Access Nondiscrimination Act extending the moratorium on state and local Internet access taxes for another four years. The legislation also extends the grandfather clause permitting Internet access taxes imposed and enforced prior to October 1, 1998. The definition of exempt Internet access has been expanded to include telecommunications services "to the extent such services are purchased, used, or sold by a provider of Internet access to provide Internet access."<sup>64</sup> The bill further states that taxation for services using Voice Over Internet Protocol remain unaffected.<sup>65</sup> Otherwise exempt Internet access services could be taxed if bundled with taxable services unless the provider can reasonably identify the charges for the Internet access from books and records kept in the regular course of business.<sup>66</sup> In addition, the moratorium amends the definition of "tax on Internet access" specifically to include taxes imposed on either the provider or buyer of Internet access.<sup>67</sup> Texas municipal access line fees will remain unaffected.<sup>68</sup>

Texas continues to move toward compliance with the Streamlined Sales and Use Tax Agreement but continues to face challenges in compliance. As noted in last year's Survey,<sup>69</sup> the Texas legislature modified certain sourcing rules in an effort to move closer to the destination-sourcing required by the Streamlined Sales Tax Agreement. However, the comptroller has delayed applying these new sourcing rules for local sales tax.<sup>70</sup> During the delay for implementing these rules the comptroller intends to develop online and printed resources to help taxpayers understand the changes.<sup>71</sup> The comptroller notice further provides that taxpayers who already switched over to the new short form may continue to use it during the delay period.<sup>72</sup> However, the new sourcing rules do not reach all services; the 2003 sourcing legislation does not apply to certain services that first became taxable in 1987.<sup>73</sup>

---

63. Tex. Comptroller Pub. Accounts STAR System No. 200309098L (Sept. 8, 2003), at <http://aixtcp.cpa.state.us/star/>.

64. Internet Access Bill, S. 150, 108th Cong. § 2 (2004).

65. *See id.* § 6.

66. *See id.* § 4.

67. *See id.* § 2.

68. *See id.* § 3.

69. *See* Ohlenforst et al., *supra* note 1, at 1248-49.

70. Tex. Comptroller Pub. Accounts Notice: *Delay in Implementation of Changes to Local Sales and Use Taxes*, at [http://www.window.state.tx.us/taxinfo/sales/localtax\\_change.html](http://www.window.state.tx.us/taxinfo/sales/localtax_change.html) (last visited May 9, 2005).

71. *Id.*

72. *Id.*

73. *See, e.g.*, TEX. TAX CODE ANN. § 323.203(l) (Vernon Supp. 2004-05).

## C. REGULATORY DEVELOPMENTS

The comptroller amended several sales tax rules during the Survey period. Some of the regulatory changes reflect prior legislative changes, whereas others set forth comptroller policies. Rule 3.325 was amended to clarify the comptroller's position (which was codified by the Legislature in 2003) on refunds of taxes paid in error by taxpayers with and without sales and use tax permits.<sup>74</sup> The changes reflect the comptroller's policy that a person without a permit who paid taxes in error to a permitted seller may only request a refund from said seller, whereas a permit holder who has paid tax in error directly to the comptroller may request a refund from the comptroller.<sup>75</sup> A permit holder who erred in paying tax to another permitted seller has the option of requesting a refund from either the seller or the comptroller.<sup>76</sup> Motor vehicle sales and use tax Rule 3.96 was altered to correspond with changes made by 2003 legislation which imposed a surcharge on the purchase of diesel-powered vehicles with a gross registered weight in excess of 14,000 pounds.<sup>77</sup>

Rule 3.318 was amended: (1) to conform with prior legislation which changed the name of the Texas Natural Resource Conservation Commission to the Texas Commission on Environmental Quality; and (2) to clarify that the water-related exemption applies to equipment, services, or supplies used solely for certain water-related qualified conservation activities.<sup>78</sup> The comptroller also finalized revisions to Rule 3.331 concerning the exemption for intercorporate services.<sup>79</sup> The comptroller added a provision to Rule 3.5 which provides that, if the comptroller's office denies a waiver request for a penalty and the taxpayer contests the denial, then the standard of review will be based on the same factors considered by the comptroller's office in issuing the denial.<sup>80</sup> The comptroller also amended rules concerning certain exempt medical devices,<sup>81</sup> the application of the manufacturing exemption to pharmaceutical biotechnology

---

74. 29 Tex. Reg. 2606-08 (2004), *adopted* 29 Tex. Reg. 5415 (2004) (codified at 34 TEX. ADMIN. CODE § 3.325).

75. 34 TEX. ADMIN. CODE § 3.325(a)(1)-(2) (West 2005) (Comptroller of Pub. Accounts, Refunds, Interest, & Payments Under Protest (TAX CODE ANN. § 111.104(d) (Vernon 2002 & Supp. 2005)).

76. *Id.* § 3.325(a)(3).

77. 29 Tex. Reg. 7657 (2004), *adopted* 29 Tex. Reg. 5410 (2004) (codified at 34 TEX. ADMIN. CODE § 3.96(a)-(b), (f)).

78. 29 Tex. Reg. 7657 (2004), *adopted* 29 Tex. Reg. 9551 (2004) (codified at 34 TEX. ADMIN. CODE § 3.318(a)(7), (b)).

79. 29 Tex. Reg. 5415-16 (2004) (codified at 34 TEX. ADMIN. CODE § 3.331(c)).

80. 29 Tex. Reg. 2602-03 (2004), *adopted* 29 Tex. Reg. 4551 (2004) (codified at 34 TEX. ADMIN. CODE § 3.5(b)(8)). Regardless of the factors listed in this rule, many comptroller auditors and tax division attorneys appear extremely reluctant to recommend penalty waiver.

81. 29 Tex. Reg. 7647-50 (2004), *adopted* 29 Tex. Reg. 10581 (2004) (codified at 34 TEX. ADMIN. CODE § 3.284(11)(a)).

cleanrooms,<sup>82</sup> the exemption for certain low-cost newspapers,<sup>83</sup> the comptroller's authorization of the use of electronic signatures on resale certificates,<sup>84</sup> and taxation of customs brokers.<sup>85</sup>

## II. FRANCHISE TAX

Taxpayers continue to fare poorly both with administrative law judges and in Austin courts regarding their challenges to the franchise tax. *Anderson-Clayton Brothers Funeral Home, Inc.*<sup>86</sup> illustrates the continuing difficulty that taxing authorities face in attempting to apply consistent principles for taxing trusts and partnerships. Anderson-Clayton, a group of affiliated funeral homes, deposited proceeds from certain pre-paid funeral benefits into trusts. The parties agreed that the subsequently-earned investment earnings on the pre-paid funeral benefits came from out-of-state corporations. Anderson-Clayton asserted that the out-of-state corporations were the payors so that, pursuant to Texas' long-established "location of payor rule," the earnings should be treated as non-Texas receipts. The comptroller, on the other hand, asserted that the earnings were derived from the Texas trusts and should be treated as Texas receipts, thereby increasing the proportion of Anderson-Clayton's receipts that are subject to franchise tax. The parties focused on the interpretation of section 171.1121(b), which requires a corporation to use the same "accounting methods" to apportion taxable earned surplus as used in computing its reportable taxable federal income.<sup>87</sup> Anderson-Clayton asserted that, because the trusts were ignored for federal income tax purposes, this rule required ignoring the trusts for sourcing purposes and looking to the non-Texas investment vehicles. The court, while acknowledging that the comptroller's position regarding the statute had continued to evolve during the appeal, nonetheless gave great credence to her argument that section 171.1121(b) is limited to accounting methodologies and that the source of the earnings ought to be determined by reference to Texas tax and trust law.<sup>88</sup> At some points, although not consistently throughout the litigation, the comptroller also attempted to rely on section 171.1121(c) which prohibits consolidated reporting.<sup>89</sup> As in other circumstances involving partnerships and trusts, the comptroller appears to have difficulty in finding a consistent argument for determining the receipts and income of entities that hold interests in partnerships and

---

82. 29 Tex. Reg. 7652-57 (2004), adopted 29 Tex. Reg. 9551 (2004) (codified at 34 TEX. ADMIN. CODE § 3.300(a)(14), (f), (k)(3)(F)).

83. 29 Tex. Reg. 7652 (2004), adopted 29 Tex. Reg. 9551 (2004) (codified at 34 TEX. ADMIN. CODE § 3.299(a)(1)(B)).

84. 29 Tex. Reg. 7650-51 (2004), adopted 29 Tex. Reg. 9550-51 (2004) (codified at 34 TEX. ADMIN. CODE § 3.285(g)(4)).

85. 29 Tex. Reg. 7992-97 (2004) (codified at 34 TEX. ADMIN. CODE § 3.360(p)(10), (q)(9)).

86. 149 S.W.3d 166 (Tex. App.—Austin 2004, pet. filed).

87. See TEX. TAX CODE ANN. § 171.1121 (Vernon 2002).

88. See *Anderson-Clayton*, 149 S.W.3d at 173-79.

89. See TEX. TAX CODE ANN. § 171.1121(c) (Vernon 2002).

trusts. Nonetheless, in this case, the court ultimately accepted the comptroller's argument that section 171.1121(b) was not intended "to govern the *sourcing* of [the] gross receipts" and that the statute's reference to accounting methods related "primarily to the timing of revenue and income recognition" rather than to its sourcing.<sup>90</sup>

The *Anderson-Clayton* dissenting opinion noted that the legislature used the term "apportioned" throughout to refer to the allocation or attribution of receipts to Texas versus elsewhere,<sup>91</sup> and that the majority should not construe the subsection otherwise. The dissent concluded that because the trusts are ignored for federal tax purposes they should also be treated as if they did not exist for apportionment purposes,<sup>92</sup> so that the trusts should not be treated as the payors.

Hearing No. 43,065 addresses the revenues from a taxpayer's sale of geophysical data.<sup>93</sup> The sale of data at issue was pursuant to a master license agreement and involved data provided on magnetic tape for disk. The taxpayer argued that, under these circumstances, the receipts from its data sales should be treated no differently from the receipts for its licensing of its computer program. The hearing highlights the differences between revenues from a *license*, which are Texas receipts to the extent the license is used in Texas,<sup>94</sup> and gross receipts from the sale of an *intangible*, which are generally based on the location of payor rule,<sup>95</sup> which treats receipts from the sale of an intangible asset as allocable to the legal domicile of the payor. Relying in part on a 2002 letter ruling in which the comptroller concluded (somewhat oddly) that receipts from a seismic data work for a specific customer are sourced according to the location where the service is performed,<sup>96</sup> but that services that are not for a specific customer are sourced under the licensing rules, the administrative law judge concluded that the apportionment for the receipts from sales of geographical data at issue must be sourced based on the use of a license. (Query whether this case provides an opportunity for taxpayers to structure certain sales as licenses, and source receipts on usage rather than on the place where services are performed.) The administrative law judge also upheld the tax division's argument that the sourcing should be based

---

90. *Anderson-Clayton*, 149 S.W.3d at 174-75.

91. *Id.* at 180.

92. *Id.* at 181.

93. Tex. Comptroller Pub. Accounts STAR System No. 200409943H (Sept. 3, 2004), at <http://aixtcp.cpa.state.tx.us/star>. As indicated by the comptroller's raising (but later withdrawing) an argument concerning § 171.1121(c), which prohibits consolidated reporting, there is still some confusion and inconsistency in the comptroller's explanation of how the receipts of a separate entity like a trust (or partnership) are nonetheless treated as the receipts of the beneficiary (or partner).

94. TEX. TAX CODE ANN. § 171.1032(a)(4) (Vernon Supp. 2005-05); 34 TEX. ADMIN. CODE § 3.557(e)(25)(A)(iii) (West 2005) (Comptroller of Pub. Accounts, Earned Surplus, Apportionment).

95. See 34 TEX. ADMIN. CODE § 3.557(e)(6).

96. This conclusion would be consistent with the general rule for franchise tax that the sourcing of services is based on the location where the services were performed. See 34 TEX. ADMIN. CODE § 3.549(c)(38) (West 2004) (Comptroller of Pub. Accounts, Taxable Capital, Apportionment).

on the billing or ship-to address; while noting that the tax division provided no support for its claim that this mechanism is consistent with comptroller policy, the judge also noted that the taxpayer had not provided any authority for a contrary position.

Among the other franchise tax hearings issued during the Survey period are three that dealt with identifying unitary versus non-unitary income. Not surprisingly, given the trend of franchise tax decisions in recent years, the taxpayers lost all three because the administrative law judges held in each case that the taxpayer failed to carry its burden of proof. The decisions thus held that capital gains related to a Canadian tax refund,<sup>97</sup> receipts from the sale of stock,<sup>98</sup> and capital gains from the sale of an Internet subscriber list<sup>99</sup> were unitary income on the facts of the respective cases. The comptroller also issued several franchise tax letter rulings during the Survey period, including one that addressed the interplay with section 336 of the Internal Revenue Code.<sup>100</sup>

### III. PROPERTY TAX

#### A. APPLICATION OF THE TAX/EXEMPTIONS

In *West Orange-Cove Consolidated Independent School District v. Nelson*,<sup>101</sup> a Travis County district court ruled that the Texas public school finance system is unconstitutional for three reasons: (1) it violates Article VII, section 1-e of the Texas Constitution because the \$1.50 cap on maintenance and operation (“M&O”) property tax rates in the plaintiff school districts must be imposed to provide a constitutionally adequate education, thereby denying the school districts meaningful discretion in setting M&O property tax rates; (2) it violates the “general diffusion of knowledge” clause (or adequacy clause) set forth in Article VII, section 1 of the Texas Constitution because the constitutional mandate of adequacy exceeds the maximum amount of funding that is available under Texas’ current funding formulas for the plaintiff school districts; and (3) the system is financially inefficient, inadequate, and unsuitable, in violation of Article VII, section 1 of the Texas Constitution<sup>102</sup> because the system fails to recognize or cover the costs of meeting the constitutional mandate of adequacy.<sup>103</sup> The trial court ruled that it would enjoin the Texas public school financing system unless the Texas legislature revises the system to meet constitutional standards; however, the effective date of the injunc-

---

97. Tex. Comptroller Pub. Accounts STAR System No. 200402500H (Feb. 4, 2004), at <http://aixtcp.cpa.state.tx.us/star>.

98. Tex. Comptroller Pub. Accounts STAR System No. 200404592H (Apr. 16, 2004), at <http://aixtcp.cpa.state.tx.us/star>.

99. Tex. Comptroller Pub. Accounts STAR System No. 200405648 (May 13, 2004), at <http://aixtcp.cpa.state.tx.us/star>.

100. Tex. Comptroller Pub. Accounts STAR System No. 200405664L (May 19, 2004), at <http://aixtcp.cpa.state.tx.us/star>.

101. No. GV-100528 (250th Dist. Ct., Travis County, Tex. Nov. 30, 2004) (on file with author).

102. TEX. CONST. art. VIII, § 1.

103. *W. Orange-Cove Consol. Ind. Sch. Dist.*, No. GV-100528, at 7.

tion is October 1, 2005, giving the legislature one year to remedy the constitutional defects.<sup>104</sup> The state has appealed this decision to the Texas Supreme Court.<sup>105</sup>

The current school funding financing system was adopted in 1993, with slight modifications since then.<sup>106</sup> Under this system, public education is financed primarily with local funds raised from property taxes.<sup>107</sup> School districts may set two property tax rates each year, a M&O rate for regular operating expenses, and an interest and sinking fund rate for servicing debt.<sup>108</sup> M&O rates generally cannot exceed \$1.50 per \$100 taxable value.<sup>109</sup> The system relies on the “Foundation School Program” to attempt to provide constitutionally-permissible school financing throughout the state. Under Tier 1, school districts taxing at an M&O rate of \$0.86 per \$100 taxable value are entitled to a basic allotment of \$2,537 for each student in average daily attendance, subject to many adjustments.<sup>110</sup> If the \$0.86 tax rate fails to produce the \$2,537 allotment (as adjusted), the state makes up the difference.<sup>111</sup> Under Tier 2, the state guarantees a yield of \$27.14 per weighted student for every cent of tax beyond the \$0.86 tax rate up to the \$1.50 M&O tax rate cap, with the state making up the difference.<sup>112</sup> The finance system also established an equalized wealth level among school districts, requiring school districts with more than \$305,000 of property wealth per student to reduce their wealth by effectively paying to the state (or using other means) taxes on this excess wealth (this is commonly referred to as the Robinhood provision).<sup>113</sup> The state then distributes these recaptured funds to property-poor districts.<sup>114</sup>

With respect to the “meaningful discretion” ruling above, the court concluded that the state has not adjusted the funding formulas to keep pace with rising costs and school obligations, and thus school districts are forced to use a \$1.50 M&O tax rate.<sup>115</sup> In attempting to demonstrate the court’s position, the court noted that in 1994, only twenty-five school districts taxed at the \$1.50 rate and a substantial majority were below \$1.40; currently, almost all school districts are at \$1.40 or higher and almost 50% are at the \$1.50 rate.<sup>116</sup> The court also concluded that the school finance system is out of capacity—i.e., there are no other sources of funding to meet adequate standards of education.<sup>117</sup> The state argued that the

---

104. *Id.*

105. *Id.*

106. *Id.* at 8.

107. *Id.*

108. *Id.* The interest and sinking fund rate is generally capped at \$0.50 per \$100 taxable value.

109. TEX. EDUC. CODE ANN. § 45.003(d) (Vernon Supp. 2004-05).

110. *Id.* §§ 42.101, 42.252(a)-(b) (Vernon Supp. 2004-05).

111. *W. Orange-Cove Consol. Ind. Sch. Dist.*, No. GV-100528, at 9.

112. TEX. EDUC. CODE ANN. § 42.302(a) (Vernon Supp. 2004-05).

113. *Id.* § 41.002 (Vernon Supp. 2004-05).

114. *See id.* § 41.003 (Vernon Supp. 2004-05).

115. *W. Orange-Cove Consol. Ind. Sch. Dist.*, No. GV-100528, at 31.

116. *Id.* at 31.

117. *Id.*



local option homestead exemption provides school districts with “meaningful discretion” because school districts could elect to revoke this exemption to raise more revenue or to lower their M&O tax rate. However, the court noted that only one of the plaintiff school districts offered this exemption and that less than one percent of school finance revenue was lost due to the optional homestead exemption.<sup>118</sup>

With respect to the “adequacy” issues, the court reviewed a study of Texas school funding prepared by an expert hired by the plaintiff school districts and a study prepared by an expert hired by the state. The court was highly critical of the study prepared on behalf of the state and generally accepted the conclusions of the study prepared on behalf of the plaintiffs.<sup>119</sup> The court concluded that many school districts lack sufficient funds to provide adequate education even while taxing at or near the \$1.50 M&O tax rate cap.<sup>120</sup>

In a case demonstrating the importance of careful drafting of leases of property by tax-exempt owners to taxable lessees, the Austin Court of Appeals in *Travis Central Appraisal District v. Signature Flight Support Corp.*<sup>121</sup> held that improvements constructed by lessees and sublessees on property owned by a municipality were treated for property tax purposes as municipal property, and thus exempt from tax.<sup>122</sup> The appraisal district asserted that these improvements were lessee or sublessee-owned property and thus taxable. Generally, only the fee simple interest in real property is subject to property tax in Texas.<sup>123</sup> Property owned by a municipality is exempt from property taxes if it is used for a public purpose.<sup>124</sup> The lessees/sublessees were not exempt; thus, the determination of the ownership of the lessee/sublessee constructed improvements was critical in deciding whether these improvements are subject to property tax.

Because the Tax Code does not define the term “owner,” the court looked to common law on the issue.<sup>125</sup> “The general rule is that improvements . . . belong to the landowner unless there is [(a)] an understanding between the parties that the improvements are not part of the land, or [(b)] evidence showing intent of the improver that the improvements remain personally with the right to be removed.”<sup>126</sup> Neither of these ex-

---

118. *Id.* at 34.

119. *Id.* at 61-64.

120. *Id.* at 59.

121. *Travis Cent. Appraisal Dist. v. Signature Flight Support Corp.*, 140 S.W.3d 833 (Tex. App.—Austin 2004, no pet.).

122. *Id.* at 845.

123. TEX. TAX CODE ANN. § 25 (Vernon 2001 & Supp. 2004-05). One exception to this rule in section 25.07 of the Tax Code provides that a leasehold interest in real property that is exempt from taxation is generally taxable. *Id.* § 25.07(a). However, this provision did not apply in *Signature Flight Support Corp.* because this statute exempts a public transportation facility owned by a municipality—the improvements at issue fit within this exception. *Id.* § 25.07(b).

124. *Id.* § 11.11(a).

125. *Signature Flight Support Corp.*, 140 S.W.3d at 839-40.

126. *Id.* at 838.

ceptions applied in *Signature Flight Support Corp.*<sup>127</sup> Moreover, the municipality's lease expressly provided that legal title to improvements constructed by the lessee shall vest in the city at the end of the lease term.<sup>128</sup> The court was not influenced by language in one of the subleases indicating that improvements would be owned by the sublessee because the sublessor could not convey to the sublessee more than the sublessor owned under its lease with the municipality.<sup>129</sup> Finally, the court rejected the appraisal district's position that the lessee was the equitable owner of the improvements.<sup>130</sup>

## B. PROCEDURE

In *Marubeni America Corp. v. Harris County Appraisal District*,<sup>131</sup> a Houston court of appeals held that mistakes the taxpayer allegedly made in calculating its inventory for purposes of preparing a rendition were not "clerical errors" within the meaning of section 25.25(c) of the Tax Code.<sup>132</sup> Under section 25.25(c), the appraisal review board, on motion of the appraisal district, or a taxpayer, may direct that the appraisal roll be changed for any of the five preceding years "to correct clerical errors that affect" a taxpayer's property tax liability.<sup>133</sup> The term "clerical error" is defined for this purpose as, among other things, "an error that is or results from a mistake or failure in writing, copying, transcribing, entering or retrieving computer data, computing or calculating."<sup>134</sup> In *Marubeni*, the taxpayer alleged that it rendered its 2001 inventory for more than double its actual value because the 2001 inventory report used to render such property was incorrect, both in terms of the amount of assets taxpayer had as of January 1, 2001 and the value of such assets.<sup>135</sup>

The taxpayer relied on *Comdisco, Inc. v. Tarrant County Appraisal District*<sup>136</sup> in support of its assertion that its alleged rendition error was a clerical error. In *Comdisco*, the taxpayer submitted information to a taxing unit listing the value of its property at \$13,000,000 instead of \$1,300,000. In rejecting the taxpayer's argument, the court in *Marubeni* concluded that while a decimal error is a clerical error, simply submitting improper figures based on allegedly incorrect information is not a clerical error.<sup>137</sup>

127. *Id.* at 839.

128. *Id.*

129. *Id.* at 839, 841-42.

130. *Id.* at 840.

131. *Marubeni Am. Corp. v. Harris County Appraisal Dist.*, No. 01-04-00107-CV, 2004 WL 2306712 (Tex. App.—Houston [1st Dist.] Oct. 14, 2004, no pet.).

132. *Id.* at \*3-4; TEX. TAX CODE ANN. § 25.25(c)(1) (Vernon 2001).

133. *Id.* at \*3-4.

134. TEX. TAX CODE ANN. § 1.04(18)(A) (Vernon 2001).

135. *Marubeni Am. Corp.*, 2004 WL 2306712, at \*1.

136. *Comdisco, Inc. v. Tarrant County Appraisal Dist.*, 927 S.W.2d 325, 328 (Tex. App.—Fort Worth 1996, writ ref'd).

137. *Marubeni Am. Corp.*, 2004 WL 2306712, at \*3. It appears that the taxpayer would have had a much better chance of prevailing if it could have traced exactly how the im-

*ABT Galveston Ltd. Partnership v. Galveston Central Appraisal District*<sup>138</sup> is more proof that taxpayers must comply with the administrative rules for contesting property taxes and values. In this case, ABT entered into a tax abatement agreement with tax units concerning a \$23 million automated grain bagging and loading facility to be constructed by ABT.<sup>139</sup> The abatement agreements were entered into in 1994 and provided for seven-year abatements of 100% of the value of the facility.<sup>140</sup> The abatement agreements provided that the tax units could terminate the agreements if ABT defaulted and did not cure within sixty days of notice.<sup>141</sup> These agreements also include what are commonly referred to as "clawbacks," whereby the taxpayer is required to pay back abated taxes if it defaults and does not cure.<sup>142</sup> ABT constructed the facility in early 1996 and filed in April 1996 for the tax abatement for the 1996 tax year.<sup>143</sup> By the end of 1996, ABT was in serious financial distress, and its lender began foreclosure proceedings.<sup>144</sup> ABT's lender ultimately sold the facility. During the last few months of 1996, each relevant tax unit sent ABT a letter informing it that ABT was in default of its tax abatement agreements. In December 1996, the tax assessor for the relevant tax units sent ABT tax bills showing a \$21.6 million taxable value for the facility and no exemptions. ABT's lender paid these tax bills in full, but later protested the taxes.<sup>145</sup>

ABT protested the 1996 taxes based on its belief that the appraisal district failed to give relevant notices, including: (1) notice of default of the tax abatement agreements; (2) the tax units decision to cancel the exemptions under the tax abatement agreements; (3) failure to give time to cure defaults; (4) failure to notify ABT of the removal of the tax exemption; and (5) failure to notify ABT of the appraised value of the facility. Section 11.43(h) of the Tax Code<sup>146</sup> requires an appraisal district to notify a property owner if the appraisal district determines that a previously allowed exemption should be cancelled within five days after the date he makes such cancellation.<sup>147</sup> Section 25.19 requires the appraisal district to deliver to the taxpayer by May 15 of each tax year or as soon thereafter as practicable, written notice of the appraised value of the taxpayer's property.<sup>148</sup>

The court concluded that ABT had been informed (apparently infor-

---

proper renditions were made. The court seemed frustrated with the taxpayer's lack of evidence in this regard. *Id.*

138. *ABT Galveston Ltd. P'ship v. Galveston Cent. Appraisal Dist.*, 137 S.W.3d 146 (Tex. App.—Houston [1st Dist.] 2004, no pet.).

139. *Id.* at 147-48.

140. *Id.* at 148.

141. *Id.*

142. *Id.*

143. *Id.*

144. *Id.*

145. *Id.* at 149-50.

146. TEX. TAX CODE ANN. § 11.43(h) (Vernon Supp. 2004-05).

147. *Id.*

148. *Id.* § 25.19(a) (Vernon Supp. 2004-05).

mally) as early as June 1996 of the appraised value of the facility;<sup>149</sup> however, the court reasoned that even if such notices had not been sent, ABT had not pursued and exhausted its administrative remedies, and thus could not properly file suit.<sup>150</sup> Under section 41.44, a taxpayer must file a written protest with the appraisal review board within thirty days of receiving a notice of appraised value.<sup>151</sup> In addition, a taxpayer can also protest an appraisal district's failure to provide any notice to which the taxpayer is entitled, provided that the protest is filed before the date the taxes on the relevant property become delinquent.<sup>152</sup> However, ABT did not file its protest of the 1996 taxes until May 1998, well after the 1996 taxes were delinquent. A taxpayer's failure to exhaust administrative remedies deprives a trial court jurisdiction to hear the taxpayer's claims.<sup>153</sup>

The Fort Worth Court of Appeals in *Cooke County Tax Appraisal District v. Teel*<sup>154</sup> addressed whether taxpayers had complied with administrative procedures in order to challenge the improper denial of agricultural-use valuation on their property. In *Teel*, the taxpayers purchased property that qualified for agricultural-use property in December 1999 but with an effective date of January 6, 2000.<sup>155</sup> The appraisal district erroneously recorded the transfer date as December 15, 1999 and sent a notice of appraised value to the new owners showing full taxable value for the 2000 year.<sup>156</sup> The taxpayers protested and lost. The appraisal district then attempted to notify in writing the taxpayers of the denial of protest, but in spite of the post office's numerous attempts to deliver the notice to the taxpayers, it was not actually delivered to the taxpayers until July 2001.<sup>157</sup> The taxpayers filed a petition for review in district court within forty-five days after actual delivery of the denial of protest.<sup>158</sup>

The appraisal district first argued that the taxpayers failed to timely apply for the agricultural-use valuation and to file a timely protest. Applications for agricultural-use valuation must be filed on or before the date the appraisal review board approves the appraisal records.<sup>159</sup> Protests must be filed before June 1 or the 30th day after the date the notice was delivered to the taxpayer, whichever is later.<sup>160</sup> However, the tax-

---

149. *ABT Galveston Ltd. P'ship*, 137 S.W.3d at 153.

150. *Id.* at 154.

151. TEX. TAX CODE ANN. § 41.44(a)(1) (Vernon 2001).

152. *Id.* § 41.411(a).

153. *Id.* ABT may have claims against the tax units for failing to provide default notices, as such notices should have been sent by them and not by the appraisal district. See TEX. TAX CODE ANN. § 312 (Vernon 2002 & Supp. 2004-05).

154. *Cooke County Tax Appraisal Dist. v. Teel*, 129 S.W.3d 724 (Tex. App.—Fort Worth 2004, no pet.).

155. *Id.* at 726.

156. *Id.* at 727.

157. *Id.* at 730.

158. *Id.*

159. TEX. TAX CODE ANN. § 23.541(a) (Vernon 2001).

160. *Id.* § 41.44.

payers filed their protest under section 25.25(c) of the Tax Code, which allows taxpayers to protest, among other things, clerical errors for the current tax year or any of the five preceding tax years.<sup>161</sup> Moreover, the appraisal review board heard the matter and issued an order, which is the only prerequisite for appeal.<sup>162</sup> The appraisal district also asserted that the taxpayers did not timely file a petition for review in district court because of their position that the taxpayers had constructive receipt of earlier attempted deliveries of notice of denial of protest.<sup>163</sup> The court rejected this argument because the earlier notices were delivered to the wrong address, and an incorrect address overrides the presumption of delivery when a notice is sent by first-class mail.<sup>164</sup>

In *Pierce v. Pierce*, the Fifth Circuit Court of Appeals held that a property tax sale that occurred minutes after the debtor filed for bankruptcy was invalid.<sup>165</sup> In this case, the debtor, Pierce, failed to pay property taxes on her residence for the 1998 and 1999 tax years.<sup>166</sup> In 2000 the tax units obtained a default judgment against Pierce and began foreclosure proceedings.<sup>167</sup> The constable sold the property at a foreclosure sale but two days later received notice that the debtor had filed for bankruptcy thirty minutes before the tax sale.<sup>168</sup> Prior to the sale, the constable did not have actual or constructive notice of such bankruptcy filing.<sup>169</sup> The purchaser asserted that it obtained the mortgagee's security interest in the property because the mortgagee was a named co-defendant in the tax deficiency suit. The court rejected this argument, reasoning that the sale was invalid because the bankruptcy stayed the foreclosure proceedings, making them null and without legal effect.<sup>170</sup>

The Corpus Christi Court of Appeals held in *Rourk v. Cameron Appraisal District*<sup>171</sup> that travel trailers and park model recreational vehicles are personal property for property tax purposes, and thus generally exempt from taxation.<sup>172</sup> *Rourk* was a class action filed on behalf of individuals owning travel trailers and park model recreational vehicles situated on rented space in trailer parks or trailer courts in Cameron County, Texas.<sup>173</sup> The appraisal district attempted to impose property taxes on these properties. However, the taxpayers asserted that the trailers and vehicles were exempt under section 11.14(a) of the Tax Code,

---

161. *Id.* § 25.25(c)(1).

162. *Teel*, 129 S.W.3d at 728-29.

163. *Id.* at 729.

164. *Id.* at 730.

165. *Pierce v. Pierce*, No. 03-20347, 2004 WL 180408, at \*1 (5th Cir. Jan. 29, 2004) (not designated for publication).

166. *Id.*

167. *Id.*

168. *Id.*

169. *Id.*

170. *Id.*

171. *Rourk v. Cameron Appraisal Dist.*, 131 S.W.3d 285 (Tex. App.—Corpus Christi 2004, pet. filed).

172. *Id.* at 296-97.

173. *Id.* at 289.

which provides an exemption for “tangible personal property, other than manufactured homes that the person owns and that is not held or used for production of income.”<sup>174</sup>

The appraisal district first argued that the trailers and vehicles are taxable under Article VIII, section 1(d)(2) of the Texas Constitution, which provided during the relevant years that the Texas legislature could not exempt personal property used as residential dwellings.<sup>175</sup> The key issue in this regard is whether such trailer and vehicles are residential dwellings. The appraisal district asserted that the taxpayers admitted that the trailers and vehicles are residential dwellings because the taxpayers called such property “dwellings.” However, the court stated that a dwelling is not necessarily the same as a residential dwelling.<sup>176</sup>

The appraisal district then argued that section 11.14(a) is unconstitutional because it violates Article VIII, section 1(d)(2) of the Texas Constitution by exempting residential dwellings.<sup>177</sup> The court disagreed, reasoning that the Texas legislature’s intent was that only manufactured homes are within the meaning of Article VIII, section 1(d)(2).<sup>178</sup> Finally, the appraisal district argued that the trailers and vehicles at issue are not personal property but are instead improvements. The court rejected this argument, stating that the trailers and vehicles were transportable—merely holing up the vehicles to the site did not result in the vehicle owner’s ceding ownership to the park operators.<sup>179</sup>

In *Cordillera Ranch, Ltd. v. Kendall County Appraisal District*,<sup>180</sup> the San Antonio Court of Appeals held that each property owner in a wildlife management cooperative must independently qualify for open-space valuation as wildlife management property.<sup>181</sup> To qualify for open-space land appraisal as wildlife management property, the land must be actively used in at least three of the following seven ways: habitat control; erosion control; predator control; providing supplemental supplies of water; providing supplemental supplies of food; providing shelters; or making of census counts to determine population.<sup>182</sup> The specific issue for a wildlife co-op is whether each owner in the co-op must individually meet the three of seven tests, or whether the entire co-op must meet these tests. The court stated that exemptions must be construed strictly.<sup>183</sup> Given that there is no affirmative indication in the relevant statute that the tests would be judged based on the activities of a wildlife co-op as a whole, the court concluded that the statute should be interpreted against broadening

174. TEX. TAX CODE ANN. § 11.14(a) (Vernon Supp. 2004-05).

175. TEX. CONST. art. VIII, § 1(d)(2).

176. *Rourk*, 131 S.W.3d at 294.

177. *Id.*

178. *Id.* at 295.

179. *Id.* at 295, 297.

180. *Cordillera Ranch, Ltd. v. Kendall County Appraisal Dist.*, 136 S.W.3d 249 (Tex. App.—San Antonio 2004, no pet.).

181. *Id.* at 258.

182. TEX. TAX CODE ANN. § 23.51(7) (Vernon Supp. 2004-05).

183. *Cordillera Ranch*, 136 S.W.3d at 253.

the exemption.<sup>184</sup>

#### IV. PROCEDURE

##### A. OF SUCCESSOR LIABILITY, STATUTES OF LIMITATION, AND OTHER SAD STORIES . . .

Successor liability remains a trap for the unwary who fail to recognize that under Texas law, a purchaser of assets can be held liable as a successor for certain tax liabilities of the asset seller.<sup>185</sup> In Hearing No. 43,660, the administrative law judge held that a purchaser of inventory who continued to operate a convenience store at the same location as the seller was liable for the seller's tax liability, notwithstanding the fact that the sale did not include the sale of goodwill.<sup>186</sup> The tax division prevailed again in Hearing No. 43,978 in which the petitioner had purchased café inventory and restaurant equipment from an individual who subsequently declared bankruptcy. In neither of these cases was the seller able to present sufficient evidence or arguments to controvert the tax division's position that the buyer was responsible for taxes. The successor liability provisions can be particularly harsh in a case like Hearing No. 43,978 in which the predecessor's tax liability exceeded the purchase price that the buyer paid for the assets. The limitation on successor liability to the amount of purchase price is cold comfort for an asset buyer in this situation.

Taxpayers lost not only several successor liability cases but also several statute of limitations cases. In Hearing No. 42,309,<sup>187</sup> the taxpayer argued unsuccessfully that its audit constituted an administrative proceeding that should have tolled the statute of limitations, while in Hearing No. 43,276, a taxpayer lost its argument that statute of limitations should be open as to issues that were not involved in its deficiency determination.<sup>188</sup> However, there is some good news on the claim for refund front. In *Strayhorn v. Lexington Insurance Co.*, affiliated insurance companies argued that the unauthorized insurance premium tax does not apply to eligible surplus lines insurers.<sup>189</sup> Although the court held that the surplus lines policies must be issued through a licensed agent or be independently procured to avoid the tax issue, the court did not accept the comptroller's

---

184. *Id.* at 253-54. The taxpayer attempted to rely on state government publications which promote wildlife co-ops, but the court noted that "the agencies require individual assessment of each tract of land seeking to qualify for open-space exemption." *Id.* at 255. The court does note that "[w]here several tracts are under the same ownership, the owner may include his multiple [properties] in a single application" for open-space valuation. *Id.*

185. See TEX. TAX CODE ANN. § 111.020 (Vernon 2001).

186. Tex. Comptroller Pub. Accounts STAR System No. 200405699H (May 5, 2004), at <http://aixtcp.cpa.state.tx.us/star/>.

187. Tex. Comptroller Pub. Accounts STAR System No. 200404598H (April 7, 2004), at <http://aixtcp.cpa.state.tx.us/star/>.

188. Tex. Comptroller Pub. Accounts STAR System No. 200406697H (June 8, 2004), at <http://aixtcp.cpa.state.tx.us/star/>.

189. *Strayhorn v. Lexington Ins. Co.*, 128 S.W.3d 772 (Tex. App.—Austin 2004, pet. filed).

argument that the taxpayers failed to exhaust their administrative remedies. The insurance companies both filed protest letters with payment and moved forward in an administrative hearing. The comptroller argued that the protest, letters and payments set the stage for a protest suit under section 112.052 of the Tax Code, but the taxpayers failed to file suit within the ninety day period required by that statute.<sup>190</sup> Although the court refused to treat the insurer's protest letters by themselves as refund claims (because the letters did not specifically ask for a refund or seek return of the money under protest), the court concluded that the motions for rehearing that had been filed as part of the administrative hearing process did request a refund; the court therefore held that the insurers "substantially met the Tax Code requirements." This is an interesting decision and is well supported by the court's policy analysis; it is likely to give rise to numerous claims by other taxpayers that they have substantially complied with procedural requirements.<sup>191</sup>

*Wimmer v. Texas* reiterates the importance of a taxpayer's ability to carry its burden of proof once it reaches the courthouse. *Wimmer* was the owner of a business appealing from a summary judgment that granted the State of Texas and the City of Galveston a judgment for unpaid sales taxes, penalties, and interest, plus court costs and attorney's fees.<sup>192</sup> Although the case is a sales tax case, its relevance to this Survey is to demonstrate the burden of proof a taxpayer must meet to prevail in a tax collection case. *Wimmer* raised two substantive issues, and the court found against *Wimmer* on both arguments. First, *Wimmer* asserted, the state's evidence was conflicting and legally insufficient to justify the lower court's grant of summary judgment.<sup>193</sup> The court not only found that the state met its summary judgment burden by producing two certificates of delinquency from the office of the comptroller evidencing the amount of taxes owed along with penalties and interest, but also found *Wimmer's* evidence to the contrary was "no more than a vague allegation that the comptroller erroneously ascertained the amount of taxes due."<sup>194</sup> The court also dispensed with the taxpayer's alternative argument that the trial court improperly enjoined him from continuing to operate a business by finding that "the State established as a matter of law its entitlement to an injunction and the trial court properly exercised its jurisdiction in granting injunctive relief."<sup>195</sup> Finding for the state on all issues, the court affirmed the district court's judgment that *Wimmer* was liable for the amounts in question and that the district court properly granted injunctive relief.

---

190. *Id.* at 777 (citing TEX. TAX CODE ANN. § 112.052(b) (Vernon 2001)).

191. The comptroller revised several procedural rules, including those concerning refunds, during the Survey period. Taxpayers should review those rules in connection with administrative hearings, filing claims for refund and other administrative matters.

192. *Wimmer v. Texas*, No. 03-03-00135-CV, 2004 WL 210629, at \*1 (Tex. App.—Austin Feb. 5, 2004, pet. denied).

193. *Id.* at \*3.

194. *Id.* at \*3-5.

195. *Id.* at \*5-6.



While it is essential to provide adequate proof in tax cases, taxpayers who provide documentation to the comptroller's office should recognize the uncertainty that exists as to the comptroller's right to maintain the confidentiality of such materials. This uncertainty arises in part from opinions issued by the Attorney General during 2004 that appear to make it more likely that the comptroller's office may be required to release certain information in response to open records request.<sup>196</sup>

Even law review articles on taxes should end on a positive note. With that thought in mind, it is noteworthy that the comptroller adopted a tax amnesty program that began on March 11, 2004 and ended on March 31, 2004. Although other states periodically adopt amnesty programs, they are not often used in Texas. The relief available under the amnesty program was similar in many respects to that available under Texas' voluntary disclosure agreement program. However, the amnesty program was heavily publicized, applied to certain fact patterns that would not have been eligible for voluntary disclosure agreements, and moved on a faster track. These factors contributed to Texas receiving more than 265 million dollars from this program.<sup>197</sup>

As this survey article goes to press, the Texas legislature is once again in session and is once again struggling to revise the Texas tax system. Regardless of whether the legislators' struggles are successful, they are certain to produce new and different topics (and perhaps new and different taxes) for next year's Survey.

---

196. *See, e.g.*, Tex. Att'y Gen. ORD-2858 (2004).

197. Texas Comptroller Carole Keeton Strayhorn's e-Newsletter for Friday, June 3, 2005 (on file with SMU Law Review Association).