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TAXATION

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The Texas economy generally continued to outperform most of the country during the Survey period, allowing the Texas legislature the luxury of avoiding the need to raise substantial, new taxes. Local jurisdictions, however, continued to push property values in order to support the *ad valorem* tax base, and the comptroller's office adopted some overly aggressive interpretations of law in taxpayer disputes. As always, judicial decisions often offered the final answers to taxpayers and taxing jurisdictions—at least pending action in the 2015 legislative session.¹

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1. Because Susan Combs was Comptroller during the Survey period, this article generally refers to Comptroller Combs rather than to her successor, Comptroller Hegar.

I. SALES TAX

A. REPORTED CASES²

During the Survey period, the comptroller's office continued its recent efforts to chip away at a number of established sales and use tax exemptions, including by focusing on exemptions traditionally available to certain industries and for certain transactional structures. Taxpayers prevailed in some important cases but saw mixed results and losses in other cases, and several decisions are headed for appeal. Significantly, some of the comptroller's most recent victories have limited applicability and should not adversely affect cases in which the fact patterns differ materially from the fact patterns at issue in the reported cases. Although the same is, of course, true of taxpayer victories as well, the Texas Supreme Court made clear that taxpayers are entitled to statutory exemptions despite whether the comptroller agrees with the underlying legislative policy.

In *Combs v. Roark Amusement & Vending, L.P.*, Roark Amusement sought a refund of sales taxes paid on plush toys used as prizes in coin-operated crane machines.³ Under section 151.006(a)(3) of the Texas Tax Code, tangible personal property acquired for the purpose of transferring it as an integral part of a taxable service qualifies for the sale-for-resale exemption.⁴ Section 151.0101(a) defines "taxable service" to include "amusement services,"⁵ and section 151.335(a) exempts from taxation "amusement services provided through coin-operated machines."⁶ The comptroller argued that the amusement service provided by the coin-operated machines was not a taxable service under section 151.006 because of the exemption provided by section 151.335(a).⁷ The court dismissed this argument, correctly acknowledging the essential difference between exclusions from tax, pursuant to which items or entities are never subject to tax in the first place, and exemptions from tax, pursuant to which items that might otherwise be taxable by their nature are exempted by a specific provision. "Indeed, there would be no need to provide an exemption for this particular service if it were not a taxable service in the first instance."⁸

The comptroller argued as well that for the sale-for-resale exemption to apply, the mere chance to win a toy does not suffice; rather, the comptroller argued, a toy must be transferred to the purchaser with each transaction.⁹ Section 151.302(b) provides that tangible personal property is not considered resold unless the care, custody, or control of the property is "transferred to the purchaser

2. Two important cases decided during this article's Survey period, *Verizon Business Network Serv., Inc. v. Combs*, No. 07-11-00025-CV, 2013 WL 1343530 (Tex. App.—Amarillo 2013, pet. dismissed) (mem. op.), and *Combs v. Health Care Servs. Corp.*, 401 S.W.3d 623 (Tex. 2013), are discussed in the previous issue of the Taxation edition of the SMU Law Review. See Cynthia M. Ohlenforst et al., *Taxation*, 66 SMU L. REV. 1181 (2013).

3. *Combs v. Roark Amusement & Vending, L.P.*, 422 S.W.3d 632, 633 (Tex. 2013).

4. TEX. TAX CODE ANN. § 151.006(a)(3) (West 2013).

5. *Id.* § 151.0101(a).

6. *Id.* § 151.335(a).

7. *Roark Amusement & Vending*, 422 S.W.3d at 636.

8. *Id.*

9. *Id.* at 637.

of the service.”¹⁰ The court reasoned that the comptroller’s interpretation of this section placed too much emphasis on the word “the’ . . . the commonest article of speech.”¹¹ Rather, taking into account the economic realities of operating a game of chance and finding that all of the toys in the coin-operated machines eventually went to a purchaser, the court concluded that the taxpayer had satisfied the requirements to qualify for the sale-for-resale exemption.¹² Significantly, the court made clear that statutory exemptions must be honored: “The Comptroller cannot through rulemaking impose taxes that are not due under the Tax Code; the question of statutory construction presented in this case ultimately is one left to the courts.”¹³

In *DTWC Corporation v. Combs*, another case examining the reach of the sale-for-resale exemption, DTWC brought a claim for refund of sales taxes paid for hotel consumables, which included sundry complimentary items that hotels provide to their guests with their rooms, such as soap, shampoo, pens, and notepads.¹⁴ Reversing the district court, the Austin Court of Appeals held that the sale-for-resale exemption applies to these items.¹⁵ The comptroller argued that because the sale of the use of a room—and therefore the hotel consumables included with the room—is subject to the hotel tax and not the sales tax, the hotel’s purchases of the hotel consumables do not qualify for the sale-for-resale exemption.¹⁶ The court correctly dismissed this argument, finding that there is no requirement that the resale transaction be subject to the sales tax in order for the

10. TEX. TAX CODE ANN. § 151.302(b) (West 2013) (emphasis added). Another case filed during the Survey period and still pending at the time this article went to press may address the “care, custody, or control” element in the software context. See *Softlayer Tech., Inc. v. Combs*, No. D-1-GN-13-000673 (201st Dist. Ct., Travis County, Tex. filed Feb. 22, 2013). In addressing whether the purchase of software installed on its own servers qualifies for the sale-for-resale exemption, *Softlayer* argues that because the “care, custody, and control” of the software were transferred to its customers upon the purchase of services, the software was transferred and therefore exempt as a sale for resale. The comptroller’s challenge to the resale exemption in this context contradicts the comptroller’s former, long-standing recognition that software loaded on a buyer’s servers may qualify for the exemption. See, e.g., *Tex. Comptroller Pub. Accounts STAR Sys. No. 9703063L* (Mar. 17, 1997, *superseded* on Oct. 26, 2010), available at <http://cpastar2.cpa.state.tx.us/index.html> (last visited Feb. 11, 2015) (finding that software that is available on a taxpayer’s mainframe for use by the taxpayer’s clients qualified for the resale exemption). Comptroller policy interpretations that appear to erode years of authority and industry practice will continue to trigger taxpayer disputes regarding not only software but also other items and issues.

11. *Roark Amusement & Vending*, 422 S.W.3d at 637.

12. *Id.* (explaining that “in the area of tax law, like other areas of economic regulation, a plain-meaning determination should not disregard the economic realities underlying the transaction in issue”). Note, however, that this statement does not constitute an adoption of a formal substance-over-form rule, which would require either a legislative amendment or adoption of a specific administrative rule.

13. *Id.* at 638. In other recent tax cases, the Texas Supreme Court has affirmed the courts’ role in applying the plain meaning of statutory language in the face of an incompatible agency position. See *Combs v. Health Care Servs. Corp.*, 401 S.W.3d 623, 630 (Tex. 2013) (stating that “a precondition to agency deference is ambiguity; ‘an agency’s opinion cannot change plain language.’ There is no ambiguity about this ambiguity requirement.”); *Tracfone Wireless, Inc. v. Comm’n on State Emergency Commc’ns*, 397 S.W.3d 173, 182–83 (Tex. 2013) (stating that “agency deference does not displace strict construction when the dispute is not over how much tax is due but, more fundamentally, whether the tax applies at all”).

14. *DTWC Corp. v. Combs*, 400 S.W.3d 149, 150 (Tex. App.—Austin 2013, no. pet.).

15. *Id.* at 156.

16. *Id.* at 153.

initial sale transaction to qualify for the sale-for-resale exemption.¹⁷ The court also dismissed the comptroller's argument that no consideration was given for the use of the consumables as required by the definitions of "sale" and "purchase" under section 151.005(1), finding that the fee for the room included the use of the room and its amenities, including the hotel consumables.¹⁸

The comptroller also argued that DTWC did not qualify for the exemption because it was not in the business of selling hotel consumables.¹⁹ The court correctly noted that the sale-for-resale exemption does not require that the business seeking the exemption be *in the business* of selling the particular items at issue; instead, the exemption requires only that the items are bought and resold "in the normal course of business."²⁰ Finally, the court dismissed the comptroller's argument that the hotel consumables were subject to use tax under section 151.154(a), which requires tax to be paid for "any use of the taxable item other than retention, demonstration, or display while holding it for sale," because the court found that, although the items did bear the hotel's name and logo and thereby served some marketing function, the items were stored in a locked room until made available for use by the hotel guests.²¹

Coming on the heels of a handful of years in which the comptroller has closely scrutinized convenience store and gas station taxpayers, *FM Express Food Market, Inc. v. Combs* involves a convenience store's challenge to the comptroller's ability to estimate the amount of taxes at issue in an audit when she is not satisfied with the documentary evidence supplied by the taxpayer.²² The comptroller audited FM Express for sales tax compliance. Because FM Express had failed to keep adequate records of its sales, the auditor estimated FM Express's sales tax liability from records kept by FM Express's suppliers.²³ FM Express argued that section 111.0042 of the Tax Code and Rule 3.282(c) permitted only two methods to determine a taxpayer's tax liability—a detailed auditing procedure and a sample and projection auditing method—and that the auditor's use of the estimated auditing method is therefore prohibited.²⁴ Relying on precedent as well as on its reading of section 111.008(a), which permits the comptroller, in certain circumstances, to "compute and determine the amount of tax to be paid from the information contained in the report or from any other information available to the comptroller," the Austin Court of Appeals upheld the comptroller's use of an

17. *Id.*

18. *Id.* at 153–55; Tex. Tax Code Ann. § 151.005(1) (West 2013) (stating that "[s]ale' or 'purchase' means any of the following when done or performed for consideration: (1) a transfer of title or possession of tangible personal property . . ."). The comptroller's argument that no consideration was paid for the items reflects a continuing effort to apply a too-narrow construction to the term "consideration."

19. *DTWC*, 400 S.W.3d at 155.

20. *Id.*

21. *Id.* at 156.

22. *FM Express Food Market, Inc. v. Combs*, No. 03-12-00144-CV, 2013 WL 1188055, at *1 (Tex. App.—Austin Mar. 15, 2013, no pet.) (mem. op.).

23. *Id.*

24. *Id.* at *3; TEX. TAX CODE ANN. § 111.0042 (West 2013) (providing guidelines for when the sample auditing method is appropriate); 34 TEX. ADMIN. CODE § 3.282(c) (2013) (Tex. Comptroller Pub. Accounts, Auditing Taxpayer Records) (permitting detailed and sample and projection auditing methods).

estimated auditing procedure.²⁵ The comptroller is authorized to take certain measures to ensure that she is able effectively and efficiently to accomplish her tax administration duties. However, perhaps because many comptroller representatives, including at the audit level, have heavy workloads, there appears to be an increasing number of cases in which auditors reject evidence and documentary support that was maintained in the ordinary course of taxpayers' business, demanding instead nonexistent records that taxpayers are not required to maintain.

Convenience stores and gas stations were not the only targets of aggressive audit focus during the Survey period. It seems nearly impossible these days to say "aircraft" without triggering audit attention. It is certainly true that some taxpayers' transactions differ from those that, pursuant to the comptroller's previous and long-established interpretations, are nontaxable. However, it is equally true that the comptroller's office has simply changed its interpretation—apparently to increase revenue—without regard for the fact that there has been no change in statutory law or judicial interpretation to transform aircraft transfers made via nontaxable methods (e.g., capital contributions) into taxable transactions. Of the disproportionate number of audits devoted to aircraft sales, several involved disputed exemptions. In *Energy Education of Montana, Inc. v. Texas Comptroller of Public Accounts*, for example, the Austin Court of Appeals addressed the interplay of the sales tax and use tax as applied to the out-of-state purchase of an aircraft that was later used in Texas.²⁶ EEM purchased an aircraft in Montana and then flew the aircraft to California for several days before hangaring the aircraft for three years in Texas.²⁷ In its claim for refund, EEM argued that the aircraft was exempt from taxation under former section 151.328(a)(4) of the Tax Code, which exempted an aircraft "sold to a person for use and registration in another state or nation before any use in this state other than flight training . . . and the transportation of the aircraft out of this state."²⁸ EEM asserted that its facts met the plain meaning of the statutory language in former section 151.328(a)(4), thereby exempting the airplane from both sales and

25. *FM Express Food Market*, 2013 WL 1188055, at *3; TEX. TAX CODE ANN. § 111.008(a) (West 2013); see *Alon USA, LP v. Texas*, 222 S.W.3d 19, 34 (Tex. App.—Austin 2005, pet. denied) (stating that when "the tax cannot be determined with reasonable mathematical certainty from the available records, and the taxing authority declares the tax due from all information available that it deems reasonable, the burden to show that the determination was unreasonable, excessive, or that it was reached capriciously or arbitrarily, shifts to the complainant").

26. *Energy Educ. of Mont., Inc. v. Tex. Comptroller of Pub. Accounts*, No. 03-10-00644-CV, 2013 WL 1831453, at *1 (Tex. App. Austin Apr. 25, 2013, pet. denied) (mem. op.). Also, in two district court cases involving aircraft, the plaintiffs argued that the sale-for-resale exemption applies to an aircraft purchased for the purpose of leasing it. See *Caledon Aviation, LLC v. Combs*, No. D-1-GN-12-001550 (261st Dist. Ct., Travis County, Tex. Nov. 17, 2014) (concluding that the sale for resale exemption did not apply to Caledon); *Johnson v. Combs*, No. D-1-GN-13-002485 (126th Dist. Ct., Travis County, Tex. filed July 21, 2013). The *Johnson* case was still pending at the time this article went to press.

27. *Energy Educ. of Mont.*, 2013 WL 1831453, at *1.

28. *Id.* at *2; Act of May 9, 1995, 74th Leg., R.S., ch. 147, § 1, 1995 Tex. Gen. Laws 994, 995 (amended 2007) (current version at TEX. TAX CODE ANN. § 151.328(a)(4) (West 2013)). The current version of section 151.328(a)(4) expressly states that for the exemption to apply the sale must occur in Texas. TEX. TAX CODE ANN. § 151.328(a)(4) (West 2013). The court also dismissed EEM's argument that EEM's use of the aircraft in Texas was exempted by Rule 3.927(c)(9), which provides that "Texas sales or use tax" is not due on an aircraft meeting the section 151.328(a)(4) requirements.

use tax, because the airplane was sold (albeit outside of Texas) and was registered and used outside of Texas for several days before it was flown to Texas. The court stated, somewhat confusingly, that while this section provides an exemption from sales tax, it was not meant to exempt aircrafts used in Texas from the use tax:

This provision does not create an exemption to the use tax because the use tax and the exemption are mutually exclusive: An aircraft that is used in Texas, subjecting it to the use tax, could not have been sold for use in another state; likewise, an aircraft that was sold for use in and used in another state would not be subject to the use tax so no exemption from the use tax is needed.²⁹

The comptroller's and court's focus on the distinction between use tax and sales tax exemptions in this context appears to mark another shift in comptroller analysis and a retreat from prior, published rulings. This case is undoubtedly just one more in what is likely to be a long line of cases exploring—and exhausting—the bounds of existing authority regarding the out-of-state purchase of big-ticket items. The significance of these cases (reminiscent of the old law school adage that bad facts make bad law) is in part that the comptroller seeks not only to raise the bar on statutory exemptions and exclusions regarding aircraft but also to use these cases as a tool to raise the bar in other areas, too. (Indeed, Texas has previously focused rapt attention on jewelry and art purchases; if Texas had more coastline, one might expect to see dozens of yacht cases winding their way through the courts.)

B. LEGISLATION

Former Governor Rick Perry spent much of his considerably long tenure as Texas governor advancing his particular brand of “econovangelism” to businesses, focusing in large part on economic incentives to attract businesses to the state and a consistent—and comparatively low—overall tax burden to retain them once they are here. The 2013 legislative session saw the passage of a few significant economic development programs that Governor Perry may well add to a growing list of what he may consider signature achievements, including programs clearly designed to embrace the continuing shift in Texas away from an oil and gas economy toward a new technology economy. For a longtime governor with obvious national aspirations, increasing the perception of Texas as a business-friendly and forward-looking state with a reasonable and certain tax regime may add important conservative bona fides that Governor Perry surely hopes will go a long way toward increasing his influence in the upcoming GOP presidential primary battle.

House Bill 1223 created an exemption, codified in section 151.359 of the Tax Code, from state (but not local) sales tax for certain tangible personal property purchases made in connection with either building or refurbishing data centers in Texas.³⁰ In order to qualify for the exemption, a data center must be at least 100,000 square feet of space in a single building or portion of a single

29. *Energy Educ. of Mont.*, 2013 WL 1831453, at *4.

30. Tex. H.B. 1223, 83rd Leg., R.S. (2013); see TEX. TAX CODE ANN. § 151.359 (West 2013).

building—meaning that this exemption is functionally reserved for big players.³¹ The data center must be specifically built or refurbished primarily to house servers and related equipment for processing, storing, and distributing data.³² One requirement that has caused some confusion—and prompted the comptroller to issue emergency clarifying interpretations—provides that the data center must be used by a single qualifying occupant and that the occupant (or the owner or operator of the data center, if the occupant is a lessee) must create at least twenty full-time, permanent jobs that meet certain pay criteria.³³ Qualification for the exemption also requires a commitment to invest at least \$200 million in the data center over a five-year period following the data center's qualification for the incentive.³⁴

House Bill 800, which touches on both sales tax and franchise tax, modified the Tax Code to give taxpayers the option to select either a sales tax exemption or a franchise tax credit with respect to certain research and development costs.³⁵ Under the sales tax option, taxpayers may claim an exemption with respect to the sale, storage, or use of depreciable tangible personal property used in activities that meet the Internal Revenue Code's definition of "qualified research" (including, for instance, certain experimentation undertaken to make technological discoveries).³⁶ Under the franchise tax option, taxable entities may generally claim a credit against franchise tax liability in the amount of five percent of the difference between qualified research expenses (defined by reference to the same Internal Revenue Code provision cited under the sales tax option) in the report year and fifty percent of the average qualified research expenses incurred in the three tax periods preceding the report year.³⁷ Importantly, both the sales tax provisions and the franchise tax provisions make clear that a business claiming an incentive under one Tax Code chapter is ineligible to receive the incentive under the other chapter.³⁸

Amendments to section 151.3186 of the Tax Code by House Bill 1133 entitle providers of cable television, Internet access, or telecommunications services to a refund of sales tax paid on certain tangible personal property directly used by the providers or their subsidiaries in providing their services.³⁹ The bill specifically excludes from the refund property used in providing data processing or information services, indicating that the legislature may have been sensitive to the notion of giving businesses in the data center space double benefits.⁴⁰ On the other hand, providers of such services qualify for the resale exemption with respect

31. See TEX. TAX CODE ANN. § 151.359(a)(2) (West 2013).

32. *Id.* § 151.359(a)(2)(B).

33. See *id.* §§ 151.359(a)(2)(C), (d)(2)(A); 34 TEX. ADMIN. CODE § 3.335 (2013) (Tex. Comptroller Pub. Accounts, Property Used in a Qualifying Data Center; Temporary State Sales Tax Exemption).

34. TEX. TAX CODE ANN. § 151.359(d)(2)(B) (West 2013).

35. Tex. H.B. 800, 83rd Leg., R.S. (2013).

36. TEX. TAX CODE ANN. § 151.3182 (West 2013).

37. *Id.* § 171.654.

38. *Id.* §§ 151.3182(b)(2), 171.653.

39. Tex. H.B. 1133, 83rd Leg., R.S. (2013); see TEX. TAX CODE ANN. § 151.3186(b) (West 2013).

40. See TEX. TAX CODE ANN. § 151.3186(c) (West 2013).

to certain of their purchases of services and tangible personal property.⁴¹ Interestingly, an early draft of this House Bill 1133 provision appeared to contemplate an unlimited sales tax refund for qualifying providers.⁴² However, apparently because the associated fiscal note would have been far too expensive—both monetarily and politically—the refund as enacted is capped at an aggregate fifty million dollars, to be pro rated among eligible providers if total claimed refunds exceed that maximum amount.⁴³

C. COMPTROLLER RULES

The comptroller amended Rule 3.313, which concerns cable television services.⁴⁴ The amendment addresses changes in the kinds of services cable television providers offer and in how they offer those services⁴⁵ including through bundled transactions. Bundling of services—both taxable and nontaxable—is an old phenomenon, but the increasing frequency of marketing bundles that may include, for example, cable, Internet, telephone, and home security services renewed attention to this issue, including to local tax sourcing rules for services that can be accessed from multiple locations, such as services offered through mobile devices.⁴⁶

The comptroller also amended Rule 3.365, which concerns the sales tax holiday for clothing, shoes, and school supplies, to adjust the dates that the sale is offered in 2015 to August 7th through August 9th.⁴⁷

II. FRANCHISE TAX

A. REPORTED CASES

Following the handful of recent, significant cases challenging the franchise tax on constitutional grounds, this Survey period seemed relatively quiet in terms of reported appellate decisions. However, district courts continue to see a number of cases about the franchise tax—which in many ways is still largely uninterpreted following its 2006 overhaul.

In *Combs v. Newpark Resources, Inc.*, Newpark sought a refund of franchise taxes it paid under protest after the comptroller denied its cost-of-goods-sold deduction.⁴⁸ Newpark's business involves the manufacture of, sale of, and services

41. See *id.* § 151.006 (defining “sale for resale”).

42. See Tex. H.B. 1133, 83rd Leg., R.S. (as introduced, Feb. 8, 2013).

43. See TEX. TAX CODE ANN. § 151.3186(d) (West 2013).

44. Tex. Reg. 770 (2014) (codified as an amendment to 34 TEX. ADMIN. CODE § 3.313 (Tex. Comptroller Pub. Accounts, Cable Television Service and Bundle Cable Service)).

45. *Id.*

46. *Id.* For a rule relating to bundled services that has been on the books for a while, see 34 TEX. ADMIN. CODE § 3.330(d)(2) (Tex. Comptroller Pub. Accounts, Data Processing Services) (addressing the bundling of taxable and nontaxable data processing services and providing that the entire charge for certain bundled services is presumed taxable unless the taxable services are *de minimis*. Importantly, the rule also provides guidance on how to rebut the presumption).

47. Tex. Reg. 7624 (2013), adopted 39 Tex. Reg. 1479 (2014) (codified as an amendment to 34 TEX. ADMIN. CODE § 3.365 (Tex. Comptroller Pub. Accounts, Sales Tax Holiday—Clothing, Shoes and School Supplies)); see also Tex. S.B. 485, 83rd Leg., R.S. (2013).

48. *Combs v. Newpark Res., Inc.*, 422 S.W.3d 46, 48 (Tex. App.—Austin 2013, no pet. h.).

related to drilling mud, which is used to cool and lubricate a drill as it removes rock and dirt from a well hole.⁴⁹ NES, one of Newpark's subsidiaries, removes from the drill site and disposes of the rock and dirt extracted from the well hole.⁵⁰ Newpark's customers generally contract with Newpark for its services as an "integrated service package" rather than purchasing individual services from each of Newpark's subsidiaries.⁵¹

The comptroller argued that section 171.1014(e)(1) of the Tax Code requires that each member of a combined group be considered separately to determine its eligibility for the cost-of-goods-sold deduction, and therefore because NES itself does not sell any goods, it cannot qualify for the cost-of-goods-sold deduction.⁵² The court, recognizing that section 171.1014(e) is an accounting mechanism used to determine the *amount* of each member's cost of goods sold, concluded that section 171.1014(e) should not be construed "as an additional substantive limitation that would require each member's business activity to be viewed in complete isolation from the combined group."⁵³ Contrary to the comptroller's assertion, the court, relying on section 171.1014(d-1) and the overall structure of section 171.1014, concluded that eligibility for the cost-of-goods-sold deduction must be determined in the context of the combined group's overall business.⁵⁴ This case is striking in part because, since the adoption of the revised franchise tax in 2006, taxpayers have pointed out that requiring a single deduction election with respect to an entire combined group could effectively cause certain entities in a group to lose most of the benefit of their entity-level deductions. The court's acknowledgment in this case that the comptroller must evaluate a business's eligibility to contribute to its combined group's cost-of-goods-sold deduction by reviewing the business's activities in context rather than in isolation is a reassuring limitation on the comptroller's interpretation of the statutory requirement that all entities in a combined group share a single deduction election.

The court next addressed whether NES's disposal services qualified for the cost-of-goods-sold deduction.⁵⁵ Although the cost-of-goods-sold deduction generally applies to the sale of real or tangible property, section 171.1012(i) specifically provides that a "taxable entity furnishing labor or materials to a project for the construction, improvement, remodeling, repair or industrial maintenance . . . of real property is considered the owner of that labor or materials and may include the costs . . . in the computation of costs of goods sold."⁵⁶ Because it was

49. *Id.*

50. *Id.*

51. *Id.* This common business practice of bundling items for sale often triggers tax controversies. See discussion *supra* note 46 and accompanying text.

52. *Newark Res.*, 422 S.W.3d, at 51; TEX. TAX CODE ANN. § 171.1014(e) (West 2013) (stating that "a combined group that elects to subtract costs of goods sold shall determine that amount by determining the cost of goods sold for each of its members . . . as if the member were an individual taxable entity . . .").

53. *Newpark Res.*, 422 S.W.3d at 52.

54. *Id.* The court's conclusion gives appropriate attention to section 171.1014(d-1). See TEX. TAX CODE ANN. § 171.1014(d-1) (West 2013) (stating that a "member of a combined group may claim as cost of goods sold [certain] costs . . . if the goods for which the costs are incurred are *owned by another member of the combined group*" (emphasis added)).

55. *Newpark Res.*, 422 S.W.3d at 53-57.

56. Compare TEX. TAX CODE ANN. § 171.1012(a)(1) (West 2013) (defining "goods" to mean

undisputed at trial that Newpark's well drilling was a project for the construction and improvement of real property, the court turned to the issue of whether NES's activities constituted labor sufficiently related to the construction and improvement of real property.⁵⁷ Although noting that certain labor could be too far removed from the construction and improvement of real property to qualify for the deduction, the court found that the disposal services at issue were essential to the drilling operation and therefore qualified for the deduction.⁵⁸

In *American Multi-Cinema, Inc. v. Combs*, the district court addressed whether AMC's costs for acquiring the rights to show movies may be included in its cost of goods sold.⁵⁹ The court—perhaps unsurprisingly—agreed with AMC's position that the language of section 171.1012 of the Tax Code plainly applies to AMC's activities.⁶⁰ In determining the cost of goods sold that may be subtracted to compute a taxpayer's taxable margin, "goods" are defined as "real or tangible personal property sold in the ordinary course of business," and "tangible personal property" includes "personal property that can be seen . . . or that is perceptible to the senses" and "films" that are "reasonably likely . . . [to] be mass-distributed."⁶¹ The court did, however, reject AMC's alternative argument, which relied on a recent amendment to section 171.1012 that even more clearly applied to AMC's activities, on the grounds that the amendment was not in effect for the years at issue in this case.⁶² The amendment, described by the legislature as a clarification of law, is codified in section 171.1012(t); this subsection explicitly provides that, for a movie theater, the cost of goods sold "shall be the costs . . . in relation to the acquisition, production, exhibition, or use of the film . . . including expenses for the right to use the film."⁶³

In *Rent-A-Center, Inc. v. Combs*, a case on appeal at the time this article went to press, Rent-A-Center argued that it was entitled to the special half-percent tax rate that applies to taxpayers "primarily engaged in retail or wholesale trade."⁶⁴ Section 171.0001 of the Tax Code defines retail trade and wholesale trade with reference to the "1987 Standard Industrial Classification Manual published by the federal Office of Management and Budget."⁶⁵ Rent-A-Center argued that its activities fell within multiple categories of retail trade as described in the SIC Manual and that

"real or tangible personal property"), *with id.* § 171.1012(i). The court also determined that section 171.1012(e) permits "the party that supplies labor or materials to the construction, improvement, remodeling, repair, or industrial maintenance of real property [to] deduct its labor or material expenses as a cost of goods sold, *assuming those expenses would qualify as the cost of selling real property.*" *Newpark Res.*, 422 S.W.3d at 53 (emphasis added).

57. *Newpark Res.*, 422 S.W.3d at 56–57.

58. *Id.* at 57.

59. *Am. Multi-Cinema, Inc. v. Combs*, No. D-1-GN-12-003831 (200th Dist. Ct., Travis County, Tex. Sept. 18, 2013).

60. *Id.*

61. TEX. TAX CODE ANN. §§ 171.1012(a)(1), (3) (West 2013); *see also* Plaintiff's Trial Brief, *Am. Multi-Cinema, Inc. v. Combs*, No. D-1-GN-12-003831, at *3–10 (200th Dist. Ct., Travis County, Tex. Sept. 17, 2013).

62. *Am. Multi-Cinema*, No. D-1-GN-12-003831, at *1 (200th Dist. Ct., Travis County, Tex. Sept. 18, 2013).

63. TEX. TAX CODE ANN. § 171.1012(t) (West 2013).

64. *Rent-A-Center, Inc. v. Combs*, No. D-1-GN-11-001059 (250th Dist. Ct., Travis County, Tex. Dec. 11, 2012).

65. TEX. TAX CODE ANN. §§ 171.0001(12), (18) (West 2013).

its rent-to-own contracts were essentially installment contracts.⁶⁶ The court, however, ruled in favor of the comptroller, who had argued that the majority of Rent-A-Center's revenue came from rentals and fees and not from sales.⁶⁷ The legislature has already weighed in on this issue by enacting House Bill 500, which added to the definition of "retail trade" in the franchise tax "activities involving the rental or leasing of . . . furniture that are classified as Industry 7359 of the 1987 Standard Industrial Classification Manual," which covers "Equipment Rental and Leasing, Not Elsewhere Classified."⁶⁸

In another case on appeal at the time this article went to press, *Gulf Chemical & Metallurgical Corp. v. Combs*, the district court denied Gulf Chemical's claim for refund under Texas's former franchise tax.⁶⁹ Gulf argued that, for apportioning its franchise tax liabilities among the states in which it operated, it should be allowed to offset its gross receipts with credits that it provided to customers for precious metals that Gulf acquired as a by-product of the services it provided.⁷⁰ The court, however, ruled in favor of the comptroller, who had argued that the plain language of the then-applicable statute and administrative rule required Gulf to use the same accounting method in its state return as it had used in its federal return.⁷¹

In *Winstead PC v. Combs*, the district court agreed with the taxpayer and properly invalidated Rule 3.589(e)(2)(D) to the extent that it prohibits a taxpayer from deducting as compensation the cost of any benefits that are deductible for federal income tax purposes.⁷² Section 171.1013(b)(2) of the Tax Code provides that "the cost all benefits, to the extent deductible for federal income tax purposes . . . provide[d] to [a taxpayer's] officers, directors, owners, partners, and employees" may be subtracted as compensation in determining a taxpayer's taxable margin.⁷³

66. Plaintiff Rent-A-Center, Inc.'s Trial Brief, *Rent-A-Center, Inc. v. Combs*, No. D-1-GN-11-001059, at *8-11 (250th Dist. Ct., Travis County, Tex. Jan. 17, 2013). This case is one of many pending challenges to the comptroller's interpretation of the retail-or-wholesale category. The comptroller's overly narrow interpretation in some cases appears to be not only revenue-motivated but also triggered by a dazzling array of companies claiming to be wholesalers and retailers.

67. *Rent-A-Center*, No. D-1-GN-11-001059; Defendant's Trial Brief, *Rent-A-Center, Inc. v. Combs*, No. D-1-GN-11-001059 (250th Dist. Ct., Travis County, Tex. Jan. 17, 2013), at *5.

68. See discussion *infra* note 79 and accompanying text.

69. *Gulf Chem. & Metallurgical Corp. v. Combs*, No. D-1-GN-11-003174 (261st Dist. Ct., Travis County, Tex. Oct. 16, 2012). A potentially significant case dealing with the apportionment rules under Texas's current franchise tax regime that was also on appeal at the time this article went to press is *Graphic Packaging Corp. v. Hegar*, 03-14-00197-CV (Tex. App.—Austin filed Apr. 2, 2014). At the trial court level, Graphic Packaging relied in part on the California case *Gillette Co. v. Franchise Tax Bd.*, 144 Cal. Rptr. 555 (2012), *vacated*, *Gillette Co. v. Franchise Tax Bd.*, 147 Cal. Rptr. 3d 603 (2013), to argue that it should be allowed to use the Multistate Tax Compact's three-factor apportionment method. Plaintiff's Original Petition, *Graphic Packaging Corp. v. Combs*, No. D-1-GN-12-003038, at *7-9 (353rd Dist. Ct., Travis County, Tex. Sept. 27, 2012). The trial court, however, ruled against Graphic Packaging. *Graphic Packaging*, No. D-1-GN-12-003038, at *1 (353rd Dist. Ct., Travis County, Tex. Mar. 18, 2014).

70. Plaintiff's Trial Brief, *Gulf Chem. & Metallurgical Corp. v. Combs*, No. D-1-GN-11-003174, at *1-2 (261st Dist. Ct., Travis County, Tex. Oct. 11, 2012).

71. *Gulf Chem.*, No. D-1-GN-11-003174, at *1; Defendant's Trial Brief, *Gulf Chem. & Metallurgical Corp. v. Combs*, No. D-1-GN-11-003174, at *5 (261st Dist. Ct., Travis County, Tex. Oct. 11, 2012).

72. *Winstead PC v. Combs*, No. D-1-GN-12-000141 (201st Dist. Ct., Travis County, Tex. Mar. 18, 2013).

73. TEX. TAX CODE ANN. § 171.1013(b)(2) (West 2013).

Relying on Rule 3.589(e)(2)(D), which excludes from the term “benefits” “working condition amounts provided so employees can perform their jobs,” the comptroller had assessed a deficiency for amounts that Winstead had subtracted in calculating its taxable margin for parking expenses, attorney occupation taxes, and continuing education expenses, all of which, Winstead pointed out, were properly deductible for federal income tax purposes.⁷⁴

B. LEGISLATION

Though the franchise tax has been the target of much vitriol—from both taxpayers and elected officials—since the 2006 overhaul that gave rise to its current margin-based formulation, the legislature has been reluctant to adopt sweeping changes. Indeed, every legislative session since 2006 has opened amid rumors that the tax would be significantly overhauled or scrapped entirely in favor of something new and better. The 2013 legislative session, however, unlike most of the earlier sessions, enacted some truly significant changes to the tax.

House Bill 500 amended the franchise tax in a number of respects, including by temporarily reducing the tax rate from one percent (one-half percent for certain retailers and wholesalers) to 0.975% (0.4875% for certain retailers and wholesalers) in 2014 and, subject to the comptroller’s certification that sufficient revenue will be available, to 0.95% (0.475% for certain wholesalers and retailers) in 2015.⁷⁵ As small business advocates have long pointed out, businesses earning merely one dollar more than the previous small business threshold (under which no tax was due) lost the entire benefit of the tax relief intended for small businesses; to eliminate that cliff rule, the legislature enacted what effectively constitutes a guaranteed minimum one-million-dollar deduction from total revenue in determining an entity’s taxable margin.⁷⁶ Importantly, the 2013 legislature left intact a taxable entity’s option to elect to deduct cost of goods sold or compensation, so taxable entities generally are still entitled to elect (subject to Tax Code restrictions) whichever deduction—thirty percent of total revenue, cost of goods sold, compensation, or the new one-million-dollar deduction—is most favorable.⁷⁷

House Bill 500 also amended the retail and wholesale trade provisions.⁷⁸ These provisions had been the subject of extensive discussion and negotiation in 2006, when the legislature first enacted the margin tax, and many taxpayers had argued the result was unfair. The bill added to the definition of “retail trade” activities qualifying taxable entities for the favorable half-percent rate, including certain auto repair services and rental activities that the comptroller had argued were not

74. Plaintiff’s Original Petition, *Winstead PC v. Combs*, No. D-1-GN-12-000141, at *4 (201st Dist. Ct., Travis County, Tex. Mar. 18, 2013).

75. Tex. H.B. 500, 83rd Leg., R.S. (2013); see TEX. TAX CODE ANN. §§ 171.0022, 171.0023 (West 2013).

76. See Tex. H.B. 500, 83rd Leg., R.S. (2013); TEX. TAX CODE ANN. §§ 171.0022, 171.0023, 171.101(a)(1) (West 2013). Technically, the Tax Code doesn’t include a thirty percent deduction; instead, it provides that one of the options for determining a taxable entity’s margin is by reference to seventy percent of the taxable entity’s total revenue from its entire business.

77. See *id.*; see also Ohlenforst, *supra* note 2, at 1196-97 (discussing the comptroller’s policy changes allowing taxpayers to change their deduction election).

78. Tex. H.B. 500, 83rd Leg., R.S. (2013).

previously expressly covered by the provision.⁷⁹ Further, the legislature created essentially a *de minimis* standard for combined groups that would qualify for the favorable half-percent rate if they were not required to include an entity that provides retail or wholesale electric utilities.⁸⁰ The revised law makes clear that retailers and wholesalers can keep their favorable half-percent franchise tax rate, provided that less than five percent of the combined group's total revenue is attributable to the types of prohibited electric utility activities described in the section.⁸¹

The legislature also made a handful of other, more modest changes to the franchise tax, including adoption of specific provisions for apportioning receipts from Internet hosting: Only receipts from Internet hosting customers located in Texas will be treated as Texas receipts.⁸² This sourcing rule reflects the recognition that Texas must recognize that Internet hosting and other high-tech businesses can and will leave the state if it is overly aggressive in trying to source such activities to Texas. House Bill 500 also provided exclusions from total revenue for certain industries: Pharmacy networks may exclude from total revenue certain reimbursements for payments to pharmacies in the pharmacy network;⁸³ transporters of aggregates and barite exclude from total revenue certain subcontracting payments for delivery or transportation services;⁸⁴ and the long-cited but arguably under-defined "landman services" was defined to include performing title searches and undertaking certain negotiations, and taxable entities engaged in providing landman services now have explicit confirmation that they are permitted to exclude from total revenue subcontracting payments made for such services.⁸⁵ Also, in keeping with the heavy incentives push from the session, certain businesses relocating their main offices to Texas—generally for the first time—may deduct from their apportioned margin certain costs of the relocation.⁸⁶

III. PROPERTY TAX

A. REPORTED CASES

Although taxpayers during this Survey period struggled with some of the perennial procedural foot-faults that derailed taxpayers in cases described in earlier Survey articles (see *infra* Part IV), this Survey period offered a handful of

79. See TEX. TAX CODE § 171.0001(12); see also *supra* note 68 and accompanying text. In some early margin tax audits, the comptroller's auditors disallowed the half-percent rate if the Standard Industrial Classification or North American Industry Classification System code listed on a company's federal income tax return related to anything other than traditional retailer or wholesaler activities. Fortunately, the comptroller abandoned that formulaic approach; however, she continued to challenge frequently the lower rate when entities provided services in addition to selling tangible personal property.

80. See TEX. TAX CODE ANN. § 171.1014(j) (West 2013).

81. *Id.*

82. *Id.* § 171.106(g).

83. *Id.* § 171.1011(g-4).

84. *Id.* § 171.1011(g-10).

85. *Id.* § 171.1011(g-11).

86. *Id.* § 171.109.

other interesting property tax cases, including appeals from appraisal review board determinations brought by the appraisal districts rather than by the taxpayers. Exemption issues continue to be a hot topic as the Texas real estate market, and consequently property values, makes further leaps out of the depths of the past few years of economic uncertainty. This Survey period also saw the return of many taxpayers' favorite appeal method, sometimes reserved for when all else has failed: the section 25.25 challenge to correct appraisal rolls.

In *Texas Student Housing Authority v. Brazos County Appraisal District*, the Amarillo Court of Appeals addressed the exempt status of a college dormitory used for various activities during summer months.⁸⁷ At issue was a dormitory used during the academic year to house Texas A&M University and Blinn College students that was also used during the summer months as housing for various athletic camps, a 4-H competition, a medical program, and a cheer camp.⁸⁸

The student housing authority asserted that the dormitory was exempt from *ad valorem* taxes under, among other provisions, section 53.46 of the Education Code, which exempts property "held for educational purposes only" and "devoted exclusively to the use and benefit of students, faculty, and staff members of an accredited institution of higher education."⁸⁹ After determining that Texas A&M is an institution of higher education, the court analyzed which of the participants in the various summer programs were students of the university and looked at the relationships between the university and the organizations conducting the summer programs.⁹⁰ The court acknowledged that the term "student" encompasses "more than the traditional, full-time student enrolled in regular classes," but limited the term to participants in programs conducted by organizations having a relationship with Texas A&M that was "forged or supported by legislative mandate."⁹¹ Under this analysis, the 4-H competition and medical program, which had such legislatively mandated relationships with Texas A&M, qualified under section 53.46. However, the cheer camp and a hockey camp, which were conducted by an unrelated out-of-state, for-profit corporation and an unrelated charitable organization, did not meet the section 53.46 requirements.⁹² The court therefore held that the property qualified for the exemption only in the year when neither the cheer camp nor hockey camp was held.⁹³ Because this analysis resolved the exemption issue for all years at issue, the court declined to address whether participants of the other athletic camps, which were officially sanctioned by Texas A&M, are "students" under section 53.46.⁹⁴ The court also dismissed the student housing authority's alternative arguments that the dormitory qualified for an exemption under article XI, section 9 of the Texas Constitution and section 11.11(a) of the Tax Code, both of which require

87. *Tex. Student Hous. Auth. v. Brazos Cnty. Appraisal Dist.*, 440 S.W.3d 779 (Tex. App.—Amarillo 2013, pet. filed).

88. *Id.* at 781–85.

89. *Id.* at 787; see TEX. EDUC. CODE ANN. § 53.46 (West 2013).

90. *Tex. Student Hous. Auth.*, 440 S.W.3d at 788–89. (Surely even Tea-Sips would concede that Texas A&M is an institution of higher education.)

91. *Id.* at 787–88.

92. *Id.* at 788–89.

93. *Id.* at 796–97.

94. *Id.* at 789.

that the property be used for a public purpose, under a similar analysis as for section 53.46, finding that activities conducted by organizations unaffiliated with Texas A&M did not serve a public purpose.⁹⁵

Another case, *Brazos County Appraisal District v. Bryan-College Station Regional Association of Realtors, Inc.*, involved an exemption that relates to property of nonprofit community business organizations pursuant to section 11.231 of the Tax Code.⁹⁶ To qualify for an exemption under section 11.231, an organization must be a “nonprofit community business organization” that primarily performs one of the following functions: “(1) promoting the common economic interests of commercial enterprises; (2) improving the business conditions of one or more types of business; or (3) otherwise providing services to aid in economic development.”⁹⁷

The appraisal district argued that a nonprofit community business organization as defined in section 11.231 is not an “institution . . . engaged primarily in public charitable functions,” as used in article VIII, section 2 of the Texas Constitution.⁹⁸ In so arguing, the appraisal district urged the court to follow the line of cases that had interpreted the former language of article VIII, section 2 that allowed an exemption for “purely public” charities.⁹⁹ Finding that the amendment to the cited constitutional provision was meant to broaden the category of activities eligible for exemption, the court rejected the appraisal district’s argument and relied on the Texas Supreme Court’s interpretation of “charitable purposes” in *Boyd v. Frost National Bank* to determine that the association qualified for the exemption.¹⁰⁰ Citing the Restatement (Second) of Trusts, *Boyd* found that “charitable purposes” include “the relief of poverty, the advancement of education, the advancement of religion, the promotion of health, governmental or municipal purposes, and other purposes the accomplishment of which is beneficial to the community.”¹⁰¹ The court in *Bryan-College* further commented that the exemption set forth in article VIII, section 2 is likely broader than the analysis of the language in the trust that the court in *Boyd* analyzed: “[T]he phrase ‘public charitable function’ [in the Texas Constitution] includes, at a minimum, everything that the Supreme Court has considered in *Boyd* to be a ‘charitable purpose.’”¹⁰²

Appraisal districts got in on the action during the Survey period, including in *Harris County Appraisal District v. Houston 8th Wonder Property, L.P.*, in which the Houston Court of Appeals considered an appeal by an appraisal district.¹⁰³ In

95. *Id.* at 790–96.

96. *Brazos Cnty. Appraisal Dist. v. Bryan-College Station Reg’l Assoc. of Realtors, Inc.*, 419 S.W.3d 462 (Tex. App.—Waco 2013, pet. denied).

97. TEX. TAX CODE ANN. § 11.231(b), (d) (West 2013).

98. *Bryan-College Station Reg’l Assoc. of Realtors*, 419 S.W.3d at 464; see also Tex. Const. art. VIII, § 2. In 1999, the Texas Constitution was amended to replace the phrase “purely public charity” with the phrase at issue in this case, “engaged primarily in public charitable functions.” *Bryan-College Station Reg’l Assoc. of Realtors*, 419 S.W.3d at 464.

99. *Bryan-College Station Reg’l Assoc. of Realtors*, 419 S.W.3d at 465.

100. *Id.* at 464–65; see also *Boyd v. Frost Nat’l Bank*, 196 S.W.2d 497 (Tex. 1946). In *Boyd*, the court interpreted “charitable purposes” in the context of a trust created in a will. *Id.*

101. *Boyd*, 196 S.W.2d at 502.

102. *Bryan-College Station Reg’l Assoc. of Realtors*, 419 S.W.3d at 465.

103. *Harris Cnty. Appraisal Dist. v. Houston 8th Wonder Prop., L.P.*, 395 S.W.3d 245, 248–49

seeking a reduction to the value of the former site of Six Flags Astroworld, 8th Wonder had asserted at the ARB hearing that gave rise to this court case that (i) the value of the property was over market value and (ii) the value was unequal as compared with other properties.¹⁰⁴ At trial, 8th Wonder argued that it had presented evidence on, and the ARB's order addressed, only the latter of these two grounds, and therefore the trial court did not have jurisdiction to hear the appraisal district's appeal of the former ground, market value.¹⁰⁵

The court of appeals reversed the trial court's dismissal of the appraisal district's appeal, concluding that the requirements of sections 42.02 and 42.06 are the only requirements that the appraisal district must fulfill in order to appeal an ARB order and that those requirements were fulfilled.¹⁰⁶ In addition, the court noted that 8th Wonder had included market value in its protest and that the ARB order stated that it reduced both appraised and market values of the property at issue.¹⁰⁷ According to the court's decision, only property owners are required to exhaust administrative remedies before having the right to appeal: "Unlike the property owner, the appraisal district had no prior administrative remedy to exhaust at the ARB stage of the proceeding. As the entity responsible for the initial property valuation, the appraisal district had no right to initiate the protest procedure and no control over what objections would be presented . . ." ¹⁰⁸ The procedures applicable to the appraisal district "began with its right of 'appeal' to the district court for a trial de novo."¹⁰⁹ Finally, citing sections 42.26(a)(1) and (2) of the Tax Code, which address the circumstances when market value is used to determine appraisal ratios pursuant to a claim of unequal appraisal, the court of appeals determined, contrary to 8th Wonder's assertion, that market value was indeed relevant to the issue of unequal appraisal.¹¹⁰

Because no Survey period would be complete without an addition to the be-careful-what-you-wish-for file, *Houston Cement Co. v. Harris County Appraisal District* merits discussion.¹¹¹ This case addressed a taxpayer challenge to the value of its inventory after it had entered into written agreements with the appraisal district concerning the appraised value of certain property.¹¹² Houston Cement later

(Tex. App.—Houston [1st Dist.] 2012, pet. denied). The court of appeals also addressed two issues related to expert testimony that are not discussed in this article.

104. *Id.* at 249.

105. *Id.* at 250–52.

106. *Id.* at 248. "A chief appraiser who wishes to appeal such an order of the ARB must (1) obtain written approval of the board of directors of the appraisal district, (2) file a written notice of appeal within 15 days of receipt of the notice from the ARB determining the taxpayer protest, and (3) deliver a copy of the notice of appeal to the property owner whose property is involved in the appeal." *Id.* at 249–50; TEX. TAX CODE ANN. §§ 42.02, 42.06 (West 2013). The court of appeals subsequently determined that the dismissal of the appraisal district's appeal was harmless because the appraisal district was permitted to present its arguments and evidence related to market value without substantive limitation, and the trial court determined the value of the property in de novo proceedings. *Houston 8th Wonder*, 395 S.W.3d at 252–53.

107. *Houston 8th Wonder*, 395 S.W.3d at 250.

108. *Id.* at 251.

109. *Id.*

110. *Id.* at 251–52; see TEX. TAX CODE ANN. §§ 42.26(a)(1), (2) (West 2013).

111. *Houston Cement Co. v. Harris Cnty. Appraisal Dist.*, No. 14-12-00491-CV, 2013 WL 3243281, at *1 (Tex. App.—Houston [14th Dist.] June 25, 2013, no pet.).

112. *Id.* at *1–2. An agreement between a property owner and the chief appraiser is final "if the agreement related to a matter which may be protested to the appraisal review board or on which a

argued that these (wished-for) agreements did not apply to certain inventory that was in transit and not yet located in Harris County on January 1 of the relevant tax years.¹¹³ However, the court found that Houston Cement's argument was contrary to the plain language of the agreements, which covered several types of property, including inventory, and dismissed Houston Cement's claim under section 25.25(c) of the Tax Code for lack of jurisdiction.¹¹⁴

Another section 25.25 case, *Bauer-Pileco, Inc. v. Harris County Appraisal District*, also addressed a taxpayer request to correct the appraisal rolls.¹¹⁵ Much like the taxpayer in *Houston Cement*, Bauer discovered, after filing its personal property renditions and paying taxes based on those renditions, that it had erroneously included in the renditions "inventory in transit" and "work in process" subaccounts as well as inventory accounts of a California company with which Bauer had recently merged.¹¹⁶ Bauer argued that section 25.25(c)(3), which provides for a correction to the appraisal rolls for "property that does not exist in the form or at the location described in the appraisal roll," entitled it to summary judgment.¹¹⁷

Bauer had property located in Texas other than the property at issue.¹¹⁸ The appraisal district argued that because Bauer had *some* personal property located in Texas, section 25.25(c)(3) did not apply; according to the appraisal district, Bauer's claim did not involve the form or location of the personal property (as required by section 25.25(c)(3)), but rather the value of the personal property.¹¹⁹ In what looked like a victory for the taxpayer, the Houston Court of Appeals initially ruled in favor of Bauer, but upon rehearing, the court changed its mind and ruled in favor of the appraisal district. Following the Dallas Court of Appeals' decision in *Titanium Metals Corp. v. Dallas County Appraisal District*, the Houston Court of Appeals concluded that the reference to the property's "form" in section 25.25(c)(3) permits courts to change only the description of the property's form in the appraisal roll and not, as Bauer had argued, to look behind the appraisal roll to the types of property included in a taxpayer's rendition.¹²⁰ The court reasoned that the complained-of errors affected the value of the property in the district, and could have been corrected pursuant to section 25.25(d).¹²¹ However,

protest has been filed but not determined by the board; or which may be corrected under section 25.25 or on which a motion for correction under that section has been filed but not determined by the board." TEX. TAX CODE ANN. § 1.111(e) (West 2013).

113. *Houston Cement*, 2013 WL 3243281, at *2.

114. *Id.* at *2-3; see TEX. TAX CODE ANN. § 25.25(c) (West 2013).

115. *Bauer-Pileco, Inc. v. Harris Cnty. Appraisal Dist.*, 443 S.W.3d 304, 306 (Tex. App.—Houston [1st Dist.] 2013, pet. filed).

116. *Id.* at 306-07.

117. *Id.* at 308; TEX. TAX CODE ANN. § 25.25(c)(3) (West 2013).

118. *Bauer*, 433 S.W.3d at 312.

119. *Id.* at *6-7. The appraisal district relied on a Dallas Court of Appeals case that interpreted section 25.25(c)(3) to apply "only when no property exists in the form or at the location described in the appraisal roll." See *Titanium Metals Corp. v. Dallas Cnty. Appraisal Dist.*, 3 S.W.3d 63, 66 (Tex. App.—Dallas 1999, no pet.).

120. *Bauer*, 443 S.W.3d at 312; *Titanium Metals*, 3 S.W.3d at 67.

121. *Bauer*, 443 S.W.3d at 310; TEX. TAX CODE ANN. § 25.25(d) (West 2013) (providing that a motion may be filed "[a]t any time prior to the date the taxes become delinquent . . . to change the appraisal roll to correct an error that resulted in an incorrect appraised value . . ."). Bauer did not timely file a motion under section 25.25(d). *Bauer*, 443 S.W.3d at 313.

the court stated that “broadly construing section 25.25(c)(3) to allow the type of complaint at issue here would be contrary to the legislative scheme of providing a taxing entity the ability to establish a final tax roll.”¹²² The court pointed out that the Tax Code permits a taxpayer to protest the inclusion of types of property in the appraisal roll in a timely filed administrative protest and that Bauer had missed the deadline to file a protest by several years.”¹²³

B. LEGISLATION

In the 2013 session, the legislature continued to tweak Texas property tax provisions, this time by focusing particular attention on qualifications and procedural standards for appraisal review boards.¹²⁴ Changes to these standards seemed to prompt as much discussion as the handful of substantive changes affecting the taxability of certain property. Following a long line of legislative amendments affecting the taxpayer experience at (and complaints about) the appraisal review board level, the legislature enacted new training requirements for chief appraisers,¹²⁵ authorized the comptroller to appoint eligible chief appraisers to replace ineligible chief appraisers,¹²⁶ required the comptroller to issue a model ARB hearing procedure manual,¹²⁷ and prohibited a former appraiser or taxpayer representative (including, presumably, contingency-fee consultants) from serving on appraisal review boards.¹²⁸

The protest and appeal procedures at and after the ARB phase were also a target of the legislature’s attention. House Bill 585 includes a new standard procedure for claiming an allocation for certain boats and aircraft used in interstate commerce and requires taxpayers owning those items to claim allocations annually, by May 1, on a form prescribed by the comptroller.¹²⁹ The legislature also created a new presumption that taxpayer claims for property tax refunds are denied after ninety days if the tax collector does not respond to the application.¹³⁰ Upon either an express or a deemed denial, taxpayers are entitled to bring suit in district court to compel payment of the claimed refund, and prevailing taxpayers may be awarded attorneys’ fees and court costs.¹³¹ Along the same lines, the legislature provided that taxpayers prevailing in appeals from the denial of certain property tax exemptions—including certain civic associations and nonprofit economic development organizations—may also recover attorneys’ fees.¹³²

Thanks to House Bill 316, taxpayers aggrieved by ARB determinations may now proceed to the State Office of Administrative Hearings (SOAH) to appeal those orders no matter where they live. The legislature made the SOAH option

122. *Id.* (internal quotation marks omitted).

123. *Id.*

124. See Tex. H.B. 585, 83rd Leg., R.S. (2013).

125. See TEX. OCCUPATIONS CODE ANN. § 1151.1581(f) (West 2013).

126. See TEX. TAX CODE ANN. § 6.0501(a) (West 2013).

127. See *id.* § 5.103(a).

128. See *id.* § 6.035(a-1).

129. Tex. H.B. 585, 83rd Leg., R.S. (2013); see TEX. TAX CODE ANN. § 21.09 (West 2013).

130. See TEX. TAX CODE ANN. § 31.11(j) (West 2013).

131. See *id.* § 31.11(k).

132. See *id.* § 42.29(a).

permanent and available across all counties (it had previously been available as a pilot program only in certain counties).¹³³

House Bill 585 also addressed long-standing taxpayer complaints about appraisal districts' apparent efforts to circumvent court orders or agreements lowering property values by hiking up appraisals in the year following a resolved valuation dispute.¹³⁴ The amendment to section 33.49 of the Tax Code requires appraisal districts to establish by clear and convincing evidence that a higher value is justified with respect to property whose value was lowered in the preceding year.¹³⁵

In keeping with the legislature's economic development theme for this session, several property tax incentives made their way to the governor's desk and into law. House Joint Resolution 133 and House Bill 3121 authorize an extension of the freeport exemption for goods detained in Texas for a short period of time from 175 days to a much longer 730 days for certain aircraft parts.¹³⁶ Voters approved the measure, which required constitutional approval, in a November 2013 election. House Bill 1897 provides a temporary exemption for landfill gas capture property and allows for taxpayers and appraisal districts to enter into agreements as to the exempt status of the pollution control equipment, subject to final ruling on the claimed exemption by the Texas Commission on Environmental Quality.¹³⁷ House Bill 2500 requires appraisal districts to use the cost method (together with certain adjustments and other limitations) to determine the value of certain solar equipment.¹³⁸

IV. PROCEDURE

Procedural pitfalls have tripped up many a taxpayer, including in property tax cases.¹³⁹ To successfully appeal to the district court, a taxpayer must comply with multiple formal procedural requirements to ensure that the case is not dismissed on jurisdictional or other summary judgment grounds.

133. Tex. H.B. 316, 83rd Leg., R.S. (2013); see TEX. GOV'T CODE ANN. § 2003.902 (West 2013).

134. See Tex. H.B. 585, 83rd Leg., R.S. (2013).

135. See TEX. TAX CODE ANN. § 33.49(a-3) (West 2013).

136. Tex. H.J.R. 133, 83rd Leg., R.S. (2013); Tex. H.B. 3121, 83rd Leg., R.S. (2013); see Tex. Const. art. VIII, § 1-j; TEX. TAX CODE ANN. § 11.251(l) (West 2013).

137. Tex. H.B. 1897, 83rd Leg., R.S. (2013); see TEX. TAX CODE ANN. §§ 11.311, 42.43(j) (West 2013).

138. Tex. H.B. 2500, 83rd Leg., R.S. (2013); see TEX. TAX CODE ANN. § 23.26 (West 2013).

139. Although discussed in the article for the previous Survey period, it is worth mentioning again that the comptroller recently has made several rule amendments that seek to require much more onerous information disclosure by taxpayers seeking guidance from the comptroller in order to receive a response upon which the taxpayer may then rely in a subsequent dispute between the taxpayer and the comptroller. The comptroller amended Rule 3.1 to provide specific guidelines for the public to request private letter rulings and general information letters and to distinguish between these two types of guidance, including by explicitly stating that only private letter rulings are binding. See 37 Tex. Reg. 9327 (2012), *adopted* 38 Tex. Reg. 384 (2013) (codified as an amendment to 34 TEX. ADMIN. CODE § 3.1 (Tex. Comptroller Pub. Accounts, Private Letter Rulings and General Information Letters)); Ohlenforst, *supra* note 1, at 1201. The comptroller also amended Rule 3.10 (Taxpayer Bill of Rights), leaving herself significant discretion in deciding whether, how, and when to respond to guidance requests. 37 Tex. Reg. 9330 (2012), *adopted* 38 Tex. Reg. 336 (2013) (codified as an amendment to 34 TEX. ADMIN. CODE § 3.10 (Tex. Comptroller Pub. Accounts, Taxpayer Bill of Rights)).

In *Harris County Appraisal District v. ETC Marketing, Ltd.*, the Houston Court of Appeals partially dismissed the taxpayer's appeal to the district court for failure to exhaust its administrative remedies.¹⁴⁰ After the appraisal review board determined that the appraised value of ETC's natural gas should not be changed, ETC appealed the ARB's order and added to its appeal the argument that the property should be removed from the appraisal rolls because it is in interstate commerce, an argument that ETC did not present at the ARB hearing.¹⁴¹ The court granted the appraisal district's partial plea to the jurisdiction, dismissing ETC's interstate-commerce argument, and remanded the case to the district court for further proceedings on ETC's other arguments.¹⁴²

Taxpayers in financial distress may take some solace from the Austin Court of Appeals's adherence to its precedent set in *Rylander v. Bandag Licensing Corp.*¹⁴³ In *Richmont Aviation, Inc. v. Combs*, the court reaffirmed that section 112.108 of the Tax Code, which seeks to bar judicial review except when the taxpayer has paid the taxes, posted a bond, or filed an oath of inability to pay, is unconstitutional as "an unreasonable financial barrier to access to the courts" and remanded the case for further proceedings.¹⁴⁴ The court also rejected the comptroller's argument that *In re Nestle USA, Inc.*¹⁴⁵ overruled *Bandag*, finding that the Texas Supreme Court in *Nestle* neither expressly mentioned *Bandag* nor expressly stated that the amendments to section 112.108 cured the section's "constitutional infirmity."¹⁴⁶

Finally, in *Assignees of Best Buy v. Combs*, the Austin Court of Appeals addressed a trial court's authority to appoint class counsel to represent individuals with respect to sales tax refund claims.¹⁴⁷ The refund claims related to rebates received by customers of Best Buy and other retailers.¹⁴⁸ Pursuant to a court-approved settlement agreement, Best Buy and the other retailers assigned their refund rights to the customers, i.e., the assignees; the settlement order also appointed counsel to present the assignees' individual claims for refund to the comptroller.¹⁴⁹ After the comptroller denied the refund claims, the assignees appealed to the district

140. *Harris Cnty. Appraisal Dist. v. ETC Mktg., Ltd.*, 399 S.W.3d 364, 366 (Tex. App.—Houston [14th Dist.] 2013, pet. denied).

141. *Id.*

142. *Id.* at 372-73.

143. *Rylander v. Bandag Licensing Corp.*, 18 S.W.3d 296, 296 (Tex. App.—Austin 2000, pet. denied).

144. *Richmont Aviation, Inc. v. Combs*, No. 03-11-00486-CV, 2013 WL 5272834, at *5-6 (Tex. App.—Austin Sept. 12, 2013, pet. denied) (internal quotations omitted); see TEX. TAX CODE ANN. § 112.108 (West 2013).

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

146. *Richmont Aviation*, 2013 WL 5272834, at *5 n.3. Taxpayers should note, though, that the court's decisions do not preclude the comptroller from taking collection action while the court case is pending.

147. *Assignees of Best Buy v. Combs*, 395 S.W.3d 847 (Tex. App.—Austin 2013, pet. denied). For a discussion of the trial court's decision, see Ohlenforst, *supra* note 1, at 1199-200.

148. *Id.* at 852-53. The assignees initially filed suit against Best Buy and other retailers to obtain a refund on the sales taxes attributable to their rebates. The settlement order from that proceeding led to this case. *Id.* at 854-55; see also *Levy v. OfficeMax, Inc.*, 228 S.W.3d 846, 848 (Tex. App.—Austin 2007, no pet.) (addressing whether retail customers "may pursue a class action against the retailer to obtain an assignment of refund rights attributable to the rebate in order to file a tax refund claim with the State").

149. *Assignees of Best Buy*, 395 S.W.3d at 853.

court, which dismissed the case for lack of jurisdiction.¹⁵⁰ The district court found that the assignees had not exhausted their administrative remedies because class counsel did not have the authority to file individual refund claims on behalf of each assignee.¹⁵¹

In affirming the trial court's determination, the court of appeals examined the trial court's power to enter an appointment order under Texas Rule of Civil Procedure 42, which provides the guidelines for when a trial court may allow a class action and appoint class counsel.¹⁵² The court distinguished *Best Buy* from non-tax cases that had permitted counsel to represent a class by pointing out that *Best Buy* involved appointment of counsel for individual claims, not a class claim.¹⁵³ The court was not persuaded that the Rule 42 purposes of efficiency, economy, and protection of the interests of absent class members were furthered by appointing class counsel, given that the claims were individual claims for refund pursued without the knowledge or consent of the absent members.¹⁵⁴

V. CONCLUSION

As part of the comptroller's administration of the state sales and franchise taxes, she and her staff have recently initiated several helpful comptroller-industry roundtable discussions of key issues. These discussions, a staple in some earlier years, offer both the payors and the administrators of the taxes to seek common ground in interpreting the law. Property tax administration, though largely a local matter in Texas, is clearly subject not only to increased legislative attention to procedure but also—like other Texas taxes—to judicial review. Elections (including of a new comptroller), legislative changes, and judicial decisions are once again changing the Texas landscape in 2015.

150. *Id.* at 856–57.

151. *Id.* at 857–58.

152. *Id.* at 864; Tex. R. Civ. P. 42.

153. *Assignees of Best Buy*, 395 S.W.3d at 864–67; *but cf.* *Allapattah Serv., Inc. v. Exxon Corp.*, 454 F. Supp. 2d 1185 (S.D. Fla. 2006) (involving counsel representing the class in a special claims process); *LaSala v. E*Trade Sec., LLC*, No. 05 Civ. 5869 (SAS), 2005 WL 2848853 (S.D.N.Y. Oct. 31, 2005) (involving class claims, not individual claims); *In re Austrian & German Bank Holocaust Litig.*, 317 F.3d 91 (2d Cir. 2003) (involving class claims).

154. *Assignees of Best Buy*, 395 S.W.3d at 867–68.