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Texas Comptroller of Public Accounts STAR System

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To: Denise Stewart, Director, Audit Division

From: Teresa Bostick, Director, Tax Policy Division

Subject: Policy Change – Treatment of Net Losses from the Sale of Investments and Capital Assets in Apportionment

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We have revised the policy regarding the treatment of net losses from the sale of investments and capital assets in calculating gross receipts for apportionment purposes.

Background

Section 171.105(b) [ENDNOTE 1] provides direction in determining a taxable entity's gross receipts from its entire business (gross receipts everywhere) for use in calculating taxable margin.

"If a taxable entity sells an investment or capital asset, the taxable entity's gross receipts from its entire business for taxable margin includes only the net gain from the sale."

In *Hallmark Mktg. Co., v. Hegar*, Hallmark argued that a net loss from the sale of investments and capital assets should not be included in the gross receipts everywhere calculation. 2016 Tex. LEXIS 314 (Tex. 2016). The Texas Supreme Court agreed, noting that the specific language in Section 171.105(b), "only the net gain," does not require a taxable entity to include a net loss from the sale of investments and capital assets in its calculation of gross receipts everywhere.

Although the "net gain" language only appears in Section 171.105 for gross receipts everywhere, we will also apply the *Hallmark* decision to the calculation of Texas receipts. There must be symmetry between

Texas receipts and gross receipts everywhere.

Revised Policy

A net loss from the sale of all investments and capital assets is not included in gross receipts everywhere and a net loss from the sale of all Texas investments and Texas capital assets is not included in Texas receipts.

To calculate gross receipts everywhere, all gains and losses from all sales of investments and capital assets within the accounting period are added together to determine the net gain or net loss. If the combination results in a net loss, the entity's gross receipts everywhere are zero. If the combination results in a net gain, the net gain is the entity's gross receipts everywhere.

If the entity has Texas and out-of-state sales of investments and capital assets, a separate calculation is made to determine Texas receipts by adding together Texas gains and losses. If the combination of Texas gains and losses results in a net loss, the entity's Texas receipts are zero. If the combination of Texas gains and losses results in a net gain, the Texas net gain is reported as Texas receipts.

In no instance, however, is an overall apportionment factor of greater than 1 allowed.

For a combined group, all gains and losses from the sale of investments and capital assets for all members of the combined group are added together to determine the net gain or net loss.

Example 1

	Sale Price	Adjusted Basis	Gain (Loss)	TX Receipts
Entity #1				
Capital Asset A	$9,000	$15,000	($6,000)	($6,000)
Entity #2				
Capital Asset B	29,000	53,000	(24,000)	(24,000)
Capital Asset C	17,000	27,000	(10,000)	(10,000)
Capital Asset D	310,000	318,000	(8,000)	0
Entity #3				
Investment A	126,000	100,000	26,000	0
Totals	$491,000	$513,000	$(22,000)	($40,000)

Capital Assets A, B, and C were sold in Texas. Capital Asset D was sold in Oklahoma. Investment A was sold to an out-of-state payor. Combining all gains and losses results in a net loss of $22,000 and gross receipts everywhere are zero. The combining of the Texas transactions results in a net loss of $40,000 and Texas receipts are zero.

Example 2

	Sale Price	Adjusted Basis	Gain (Loss)	TX Receipts
Entity #1				
Capital Asset A	$9,000	$15,000	($6,000)	0
Entity #2				
Capital Asset B	29,000	53,000	(24,000)	0

Capital Asset C	17,000	27,000	(10,000)	0
Capital Asset D	310,000	262,000	48,000	48,000
Entity #3				
Investment A	126,000	145,000	(19,000)	0
Totals	$491,000	$502,000	$(11,000)	$48,000

Capital Asset D was sold in Texas. Capital Assets A, B, and C were sold in Oklahoma. Investment A was sold to an out-of-state payor. Combining all gains and losses results in a net loss of $11,000 and gross receipts everywhere are zero. The combining of the Texas transactions results in a gain of $48,000 and is included in Texas receipts. However, if after totaling *all* Texas receipts and *all* gross receipts everywhere (not just the receipts from the sales of investments and capital assets) the overall result is an apportionment factor greater
than 1, the apportionment factor is reduced to 1.

Example 3

	Sale Price	Adjusted Basis	Gain (Loss)	TX Receipts
Entity #1				
Capital Asset A	$9,000	$15,000	($6,000)	($6,000)
Entity #2				
Capital Asset B	29,000	53,000	(24,000)	(24,000)
Capital Asset C	17,000	27,000	(10,000)	(10,000)
Capital Asset D	310,000	262,000	48,000	0
Entity #3				
Investment A	126,000	100,000	26,000	0
Totals	$491,000	$457,000	$34,000	($40,000)

Capital Assets A, B, and C were sold in Texas. Capital Asset D was sold in Oklahoma. Investment A was sold to an out-of-state payor. The combined group includes the $34,000 net gain in gross receipts everywhere; however, Texas receipts are zero because the netting of Texas gains and losses results in a net loss.

Example 4

	Sale Price	Adjusted Basis	Gain (Loss)	TX Receipts
Entity #1				
Capital Asset A	$9,000	$15,000	($6,000)	($6,000)
Entity #2				
Capital Asset B	29,000	53,000	(24,000)	0
Capital Asset C	17,000	27,000	(10,000)	0
Capital Asset D	310,000	262,000	48,000	48,000
Entity #3				
Investment A	126,000	100,000	26,000	0

Totals	$491,000	$457,000	$34,000	$42,000

Capital Assets A and D were sold in Texas. Capital Assets B and C were sold in Oklahoma. Investment A was sold to an out-of-state payor. The $34,000 net gain is included in gross receipts everywhere and the $42,000 gain is included in Texas receipts. However, if after totaling *all* Texas receipts and *all* gross receipts everywhere (not just the receipts from the sales of investments and capital assets) the overall result is an apportionment factor greater than 1, the apportionment factor is reduced to 1.

The revised policy is effective for all open periods within the statute of limitations. Rule 3.591 and any other Comptroller guidance will be amended to reflect this revised policy.

ENDNOTE:
1. Unless otherwise indicated, all references herein to “Section” are to the Texas Tax Code, and all references to “Rule” are to Title 34 of the Texas Administrative Code.

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