Texas Taxes Quarterly Update

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Table of Contents

Introduction

These materials cover critical recent and ongoing developments in Texas sales tax, Texas franchise tax, tax administration, jurisdiction, and procedure during the first quarter of 2020. They include the Comptroller's extensive changes to his franchise tax apportionment rule and developments during the 2021 legislative session, along with other important Texas sales tax and franchise tax developments.

The TXCPA provides these materials to its participants in its Texas Taxes: Quarterly Updates webcasts. Members of the TXCPA may attend the quarterly webinars free of charge. The TXCPA has agreed to provide access to the quarterly webinars to members of the Tax Section of the State Bar for a nominal charge. The sessions covering 2021 developments are scheduled to occur on the following dates from 12:00 p.m. through 1:00 p.m.:

Period Covered	Webcast Date	Registration Links
First Quarter 2021	Apr. 8, 2021	Click Here to Register
Second Quarter 2021	Jul. 8, 2021	Click Here to Register
Third Quarter 2021	Oct. 14, 2021	Click Here to Register
Fourth Quarter 2021	Jan. 13, 2022	Click Here to Register

Attendees can also register through the TXCPA website at https://www.tx.cpa/education/cpe.

I. Franchise Tax

COVID-19 Deadline Relief

Automatic Franchise Tax Extension. On February 25, 2021, the Comptroller announced that the due date for Report Year 2021 Texas franchise tax reports is automatically extended for all taxpayers to June 15, 2021. The automatic extension includes both the report deadline and the payment deadline. The Comptroller granted the extension "[i]n response to the recent winter storm and power outages in the state" and to "align[] the agency with the Internal Revenue Service (IRS), which . . . extended the April 15 tax-filing and payment deadline to June 15 for all Texas residents and businesses."[1]

Further Extension Requests. Franchise taxpayers who need an extension beyond the June 15 due date must timely request the extension and make estimated tax payments. The timeframe for further extensions depends on whether the taxpayer requesting the extension is required to pay franchise tax by electronic funds transfer (EFT):

Extensions for Non-EFT Taxpayers. Non-electronic funds transfer (non-EFT) taxpayers who cannot file by June 15 may file an extension request on or before June 15. They must pay 90 percent of the tax due for the current year, or 100 percent of the tax reported as due for the prior year, with the

[1] Texas Comptroller, *Texas Comptroller's Office Extends Franchise Tax Deadline* (Feb. 25, 2021), *available at* https://comptroller.texas.gov/about/media-center/news/2021/210225-franchise-tax.php.

extension request. Non-EFT taxpayers who request an extension have until Nov. 15 to file their report and pay the remainder of the tax due.

Extensions for EFT Taxpayers (Two-Step). On or before June 15, taxpayers who are mandatory EFT payers may request an extension of time to file to Aug. 15. They must pay 90 percent of the tax due for the current year, or 100 percent of the tax reported as due for the prior year, with the extension request. On or before Aug. 15, EFT taxpayers may request a second extension of time to file their report and must pay the remainder of any tax due with their extension request. The Aug. 15 extension request extends the report due date to Nov. 15. Any payments made after Aug. 15 will be subject to penalty and interest.

Cost of Goods Sold (COGS)

Satellite Radio Service Not Engaged in Sale of Goods. In *Hegar v. Sirius XM Radio, Inc.* the court found that Sirius was not engaged in the sale of goods and was therefore ineligible to claim the cost of goods sold subtraction.[2] Sirius provides subscription-based satellite radio service, producing most of its radio content exclusively for customers, transmitting content to satellites, and then receiving and unscrambling the satellite signals in its customers' vehicles.

Sirius paid car manufacturers to install satellite-enabled radios in vehicles, hoping to later sell subscriptions to those vehicles' owners. Sirius claimed that it was entitled to amend its cost of goods sold subtraction to include the payments to manufacturers to subsidize the installation of the satellite radios.[3]

To claim the cost of goods sold subtraction, a taxable entity must sell "goods," which are real or tangible personal property.[4] The subtraction is generally unavailable to an entity selling only services. "Tangible personal property" is defined as "personal property that can be seen, weighed, measured, felt, or touched or that is perceptible to the senses in any other manner."[5] This includes "films, sound recordings, videotapes, live and prerecorded television and radio programs, books, and other similar property embodying words, ideas, concepts, images, or sound."[6] A taxpayer engaged in the sale of goods is entitled to include all direct costs of producing the goods in its cost of goods sold subtraction.[7]

The court rejected Sirius XM's argument that it sold "live and prerecorded . . . radio programs" that were "produced" by its unscrambling of the satellite signals in the vehicles.[8] The court relied on the

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2 *Hegar v. Sirius XM Radio, Inc.*, Cause No. 03-18-00573-CV (Tex. App.—Austin, May 1, 2020, pet. filed) (pending before the Texas Supreme Court, No. 20-0462). The Third Court of Appeals also rejected an argument by Sirius that it was entitled to apportion its Texas receipts using the location where it produced its content. See **Apportionment** below**.**

3 Sirius also paid a share of revenue to these manufacturers. Slip op. at 6.

4 Tex. Tax Code § 171.1012(a)(1).

5 Tex. Tax Code § 171.1012(a)(3)(A)(i).

6 Tex. Tax Code § 171.1012(a)(3)(A)(ii).

7 Tex. Tax Code § 171.1012(c).

8 Slip op. at 18–19.

Texas Supreme Court's finding in *American Multi-Cinema* that "property with a physical or demonstrable—that is, tangible—presence must be transferred."[9] The Attorney General filed a supplemental brief in *Sirius* XM's case just after the *American Multi-Cinema* Texas Supreme Court Opinion was published, noting that Sirius XM had "analogized satellite radio to the exhibition of films" in Sirius XM' briefing to the Texas Supreme Court.[10] The Court reasoned that, just like AMC's theatergoers, Sirius' customers did not transfer property with a physical or demonstrable form to its customers, but merely provided them temporary access to creative content.[11] Sirius XM has petitioned the Supreme Court for review, and amicus curiae briefs have been submitted by Tax Executives Institute (TEI), Texas Taxpayers and Research Association (TTARA), and Council on State Taxation (COST).

Ready-Mix Concrete. U.S. Concrete manufactured and delivered ready-mixed concrete using mixer-trucks whose constantly rotating drums kept the product in an unhardened state on its way to its customers' job sites. U.S. Concrete argued that its mixer-trucks constituted manufacturing plants on wheels, and that the unhardened concrete becomes a good only when poured from the truck at a job site. Accordingly, U.S. Concrete argued that it was entitled to subtract all of its costs related to its mixer-trucks, mixer-truck drivers, and the dispatchers who oversaw orders for ready-mixed concrete.

The Comptroller disagreed and disallowed 70% of U.S. Concrete's mixer-truck costs, 41% of its mixer-truck driver costs as costs relating to distribution or rehandling and not costs of producing the ready-mixed concrete, and capped the company's dispatcher costs at 4% as indirect costs.

The court found for the Comptroller, rejecting U.S. Concrete's argument that unhardened concrete becomes a "good" for purposes of COGS only upon being poured from the truck at the job site because, even in its unhardened state, it is still personal property that can be seen, weighed, measured, felt, touched and otherwise perceive by the senses, and therefore constitutes a "good" well before it is delivered to job sites. The court also found that evidence in the record supported the Comptroller's distinction between costs that U.S. Concrete incurred related to its trucks manufacturing, and costs related to transportation.

The court further determined that U.S. Concrete's dispatchers were not directly involved in the manufacture of the ready-mixed concrete and therefore it could not subtract the costs related to the mixer-truck dispatchers. The Texas Supreme Court denied review on December 11, 2020, leaving the Third Court of Appeals' decision to stand.[12]

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9 *Sirius* XM slip op. at 19 (citing *Hegar v. American Multi-Cinema, Inc.*, No. 17-0464 (Tex. 2020)).

10 Appellant's Supplemental Brief at 1, *Sirius* XM *Radio, Inc.*, Cause No. 03-18-00573-CV (Tex. App.—Austin, May 1, 2020, pet. filed).

11 Slip op. at 20.

12 *U.S. Concrete v. Hegar*, 03-17-00315-CV, 2019 WL 1388714, at *3 (Tex. App.—Austin Mar. 28, 2019, pet. denied).

Nexus

On Feb. 5, 2021, the Comptroller adopted amendments to his administrative rule for franchise tax nexus.[13] The amendments continue to refine the Comptroller's implementation of *Wayfair*. The Comptroller replaced the phrase "is not doing business" with "does not have physical presence" to clarify that a limited partner can have economic nexus in Texas notwithstanding whether its limited partnership is doing business in Texas.

The Comptroller added guidance on the beginning date for nexus. This guidance addresses entities that get use tax permits but overcome the presumption that they have franchise tax nexus.

The Comptroller has added a definition of gross receipts derived from the franchise tax statute:

> For purposes of this subsection, gross receipts means all revenue reportable by a taxable entity on its federal return, without deduction for the cost of property sold, materials used, labor performed, or other costs incurred.[14]

Apportionment

Single-Factor Formula. An entity apportions its taxable margin to Texas by multiplying it by an apportionment fraction. The apportionment fraction is determined using only gross receipts. The numerator is the entity's gross receipts from business done in Texas and the denominator is the entity's entire gross receipts.

Gross Receipts. The statutory definition of gross receipts means all revenues reportable by the entity on its federal tax return without deduction for the cost of the property sold, materials used, labor performed, or other costs incurred, unless otherwise provided.[15]

Like the Comptroller's nexus rule, the Comptroller's apportionment rule clarifies that in most cases, total gross receipts will equal total revenue as calculated under the revised franchise tax, except for three specific circumstances:[16]

- The entity is a health care provider or institution that takes the revenue exclusion for uncompensated care;
- The entity is a law firm that takes the revenue exclusion for pro bono services; or
- The entity is a broker or dealer that accounts for loans and securities as inventory for federal income tax purposes, or "Securities Available for Sale" or "Trading Securities" or the entity is

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13 Adopted Amendments to Rule 3.586, 46 Tex. Reg. 935 (Feb. 5, 2021).

14 Comptroller Rule 3.586(f)(1); *see also* Tex. Tax Code § 171.1121(a).

15 Tex. Tax Code §171.1121(a).

16 34 Tex. Admin. Code § 3.591(b)(4).

a financial institution that categorizes a loan or security as "Securities Available for Sale or "Trading Securities" under Financial Accounting Standard No. 115.[17]

For the first two circumstances, total gross receipts is not reduced by the revenue exclusion. For the third circumstance, the entity will report the gain on the sale of securities as revenue, but it should report the gross proceeds, from the sale of total gross receipts.[18]

Texas Gross Receipts. Once "gross receipts from everywhere" is established, taxpayers must determine the gross receipts apportioned to Texas. Taxpayers determine Texas gross receipts by applying the general and specific rules that the Legislature, the courts and the Comptroller have fashioned over time.

Comptroller Adopts Sweeping Apportionment Rule Amendments. On January 15, 2021, the Texas Comptroller adopted broad amendments to his Rule 3.591 governing franchise tax apportionment. In doing so, the agency rewrote numerous detailed rules for sourcing dozens of different types of receipts. Notably, for receipts from services that don't fall under one of the specific rules, the Comptroller's rule codifies the "end-product act" test which first appeared in a 1980 Comptroller Hearing[19] and was recently employed by the Third Court of Appeals in *Hegar v. Sirius XM Radio, Inc.*[20] The Comptroller intends to apply the adopted rule retroactively except for a few provisions which he concedes are changes in policy.

The adopted rule also:

- Codifies recent policy excluding net losses from sales of investments and capital assets (prospectively)
- Distinguishes between financial derivatives sold for hedging and securities treated as inventory, but sources both categories to the location of the payor
- Restricts transportation companies who elect to apportion revenue using mileage from including uncompensated mileage (prospectively)
- Increases Texas' census-based apportionment to 8.7% (prospectively)
- Changes terminology throughout

The Comptroller has formally adopted these changes which were published in the January 15, 2021 issue of the Texas Register. Because some of the changes explicitly take effect in report year 2021, the Comptroller is poised to apply the other provisions retroactively. He signaled this intention by asserting in the proposed rule that they "reflect current guidance," while simultaneously admitting that the amendments require that he "supersede prior inconsistent rulings."[21]

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17 Tex. Tax Code §171.106(f-1) (as amended by HB 4611, 81st Reg. Sess. 2009).

18 Tax Policy News, Texas Comptroller (June 2009).

19 Comptroller Hearing 10,028 (1980).

20 *Hegar v. Sirius XM Radio, Inc.*, Cause No. 03-18-00573-CV (Tex. App.—Austin, May 1, 2020, pet. filed) (pending before the Texas Supreme Court, No. 20-0462).

21 45 Tex. Reg. 8104, 8107.

End-Product Act

Texas Tax Code Section 171.103(a)(2) provides that receipts from "each service performed in this state" are sourced to Texas. For many years the Comptroller was relatively consistent in using the cost of performance method to source receipts from services. Under this method, taxpayers apportion their receipts to Texas based on the relative cost of providing the services in Texas as contrasted with the cost of providing services everywhere. The Texas Comptroller has decided to follow a number of states who have amended their statutes to adopt a sourcing method referred to as "market-based" sourcing. Under market-based sourcing, taxpayers apportion receipts to the location of the benefit of the services received by their customers. In other words, sourcing under this methodology is based on the state in which the services are delivered rather than the state in which the services are performed.

The Comptroller justifies his rule amendment by using the 1980 administrative decision referenced above. Under his new change in policy, the Comptroller provides general rules for sourcing receipts from performing services to the location of the "receipts-producing, end-product act."[22] Under this test, if there is a receipts-producing, end-product act, the location of other acts will not be considered even if they are essential to the performance of the receipts-producing acts. The Comptroller's justification for disregarding essential activities is that to source receipts otherwise would devolve into using factors like property and payroll as proxies because "no activity of a corporation that generates services receipts is any more important than any other activity, since all are essential to the end-product performance of the service that is sold."[23]

"If there is not a receipts-producing end-product act, the location of all essential acts may be considered."[24] For example, receipts from sales of admissions to live or pre-recorded events are sourced to the location whether the recipients observe the performance, not where a live performance was rehearsed, or where a pre-recorded performance was recorded, or the place where the admission fee was paid.[25]

If services are performed both inside and outside Texas for a single charge, the receipts can be apportioned to Texas based on the fair value of the service performed in Texas. To determine fair value, the relative value of each service provided on a standalone basis may be considered. Multi-state services can be apportioned based on hours worked. If costs are used as a proxy for value, taxpayers may only include direct costs, not overhead. The rule provides examples for attorneys (based on hours billed from in-state and out-of-state offices) and landscapers (based on number of customer's locations landscaped in-state and out-of-state, disregarding travel costs).

The Comptroller has issued inconsistent guidance when applying his end-product act rule. This has resulted in taxpayers with similar facts filing franchise tax reports using inconsistent sourcing

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22 Rule 3.591(e)(26)(A).

23 45 Tex. Reg. 8107 (quoting Comptroller Decision No. 10,028).

24 Rule 3.591(e)(26)(A).

25 Rule 3.591(e)(26)(A)(i).

methods. Since the Comptroller intends to apply his end-product act changes retroactively, we are interested to see how these changes will be applied during audits of taxpayers for prior periods.

Net Gains or Losses from Sales of Capital Assets or Investments

The Comptroller has fundamentally changed the calculation for apportioning gains and losses from the sale of non-inventory assets. Under his prior policy, net losses, in the aggregate, would offset net gains, in the aggregate, subject to certain limits. Under his new policy, net losses arising from individual sales of capital assets or investments are simply ignored. Thus, only the net gains are included in gross receipts. This transaction-level computation applies prospectively beginning with report year 2021.[26] We anticipate that taxpayers with high volumes of sales of investments and capital assets may face challenges obtaining the information necessary to apply a transaction-level analysis.

Transportation

Under the adopted rule, taxpayers may elect to apportion transportation services receipts using one of two formulas:

(A) *gross receipts* from Texas intrastate transportation / gross receipts from transportation

OR

(B) *Compensated mileage* from Texas intrastate transportation / total compensated mileage

After proposing to do away with mileage-based apportionment altogether, the Comptroller acquiesced to public comments and retained the mileage option, but modified it. Under the new mileage option, taxpayers may no longer include "uncompensated mileage," which appears designed to exclude trips taken without cargo.[27] Previously, taxpayers electing to use mileage-based apportionment had a potential further option between including only miles from paid trips (with passengers or cargo) in the numerator and denominator or including all mileage in the apportionment factors (which would include "empty miles" trips without passengers or cargo).

Census-Based Percentage Apportionment

Census-based percentage apportionment to Texas increases from 7.9% to 8.7%. This applies to sales of securities through an exchange to unidentified payors, and advertising where audiences cannot otherwise be determined.[28]

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26 Rule 3.591(e)(2)(A), (C).

27 Rule 3.591(e)(33).

28 Rule 3.591(e)(1), (25).

Sourcing Rules for Various Categories of Receipts

The Comptroller has adopted new rules or modified existing rules for sourcing of receipts from various other types of transactions. Many of the more significant new apportionment provisions are summarized in the following table:

Type of Receipts	Sourcing Rule	Rule Subsection
Advertising	Regardless of the type of media in which an advertisement is transmitted, advertising receipts are sourced to the location of the audience. If the audience locations cannot be reasonably determined, taxpayers may use the fixed 8.7% census-based figure. For report year 2020 and earlier, advertisers may use the physical location of radio or TV station transmitters.	Rule 3.591(e)(1)
Computer Hardware and Software	Hardware and software receipts are sourced as the sale of tangible personal property if the hardware is sold with software installed on it. Digital property transferred by "fixed physical media" (e.g., compact disc) is sourced as the sale of tangible personal property. Digital property not transferred by fixed physical media is sourced as the sale of an intangible to the location of payor. Digital property as a service is sourced under the end-product act rule.	Rule 3.591(e)(3)
Financial Derivatives	Gross receipts from the settlement of financial derivative contracts (hedges, options, swaps, futures, forward contracts, etc.) are sourced to the location of payor.	Rule 3.591(e)(10)
Internet Hosting (Cloud Computing)	Internet hosting receipts are generally sourced to the customer location. New guidance also distinguishes between purchasing access to a computer service and purchasing or leasing hardware or digital property.	Rule 3.591(e)(13)
Loan Servicing	Gross receipts from loan servicing are sourced to the location of real property secured by the loan. If the loan is not secured by real property, receipts are sourced based on the end-product act.	Rule 3.591(e)(16)
Loans and Securities Held as Inventory	Loans and securities held as inventory are sourced to the location of payor.	Rule 3.591(e)(17)
Single-Member LLCs	Single member LLCs sold by the sole member are sourced to the location of payor.	Rule 3.591(e)(27)

Vocabulary Changes

Along with the substantive changes to apportioning receipts, the proposed rule adopts a new set of apportionment vocabulary. Many of these changes appear aimed at improving clarity and readability:

Old Term	New Term
Intangibles	Intangible Assets
Computer Program	Digital Property
Receipts	Gross Receipts
Revenue	Gross Receipts
Gross Receipts Everywhere	Gross Receipts from an Entity's Entire Business
Apportioned	Sourced
Legal Domicile of Payor	Location of Payor
Commercial Domicile	Principal Place of Business

Commodity Hedging Receipts. In a recent hearing, the Comptroller held that a packaged food company must exclude the gross proceeds from commodity hedging transactions from the denominator of its Texas apportionment factor. The taxpayer purchased futures contracts in order to protect against price increases in the raw materials it used to manufacture its products. These were "notional contracts" in which neither party actually owned the commodity, and the taxpayer settled the contracts for net gains. For federal tax purposes, the taxpayer treated the proceeds as an adjustment to cost of goods sold. For Texas franchise tax, the taxpayer included the proceeds in its apportionment factor denominator, but excluded them from the numerator, because the commodities exchanges were located outside Texas.

Under Tex. Tax Code § 171.106(f), when calculating apportionment of margin to Texas, "if a loan or security is treated as inventory of the seller for federal income tax purposes, the gross proceeds of the sale of that loan or security are considered gross receipts." A comptroller auditor found that the taxpayer did not treat the commodity hedges as inventory because the taxpayer reported the proceeds of settling the commodities hedges on Line 2 (cost of goods sold) instead of Line 1 (income/loss). The Comptroller has also found that reporting gains and losses on Form 1120, Line 8, as capital gains or losses shows that the securities are held for the taxpayer's own investment, and therefore are not treated as inventory.[29]

A similar issue is pending before the Travis County District Court in *Equistar Chemicals, LP v. Hegar*.[30] Equistar entered into commodities futures contracts to hedge against fluctuations in oil prices. Equistar filed refund claims, amending its apportionment calculation by including the proceeds from these hedging transactions in its calculation of its apportionment factor. Equistar

[29] Comptroller Hearing Nos. 114,432; 114,433; 114,434; 114,435 (Aug. 15, 2019).
[30] D-1-GN-18-004006 (126th Dist. Ct., Travis County, filed Aug. 2, 2018).

followed a Comptroller rule that requires apportioning a set rate of 7.9% of securities sold through an exchange for which a buyer cannot be identified.[31]

Equistar's district court case has been stayed pending a final appellate decision in *CITGO Petroleum Corporation v. Hegar*. In that case, CITGO Petroleum Corporation seeks to recover a portion of the Texas franchise tax is paid on its report year 2008 and 2009 franchise tax reports. CITGO Petroleum Corporation refines crude oil and sells gasoline, diesel fuel, jet fuel, lubricants, petrochemicals, and other petroleum-based industrial products. Its affiliate, CITGO Trading Company, L.P. bought and sold commodity futures contracts and options on commodity futures contracts to mitigate the risks associated with potential price fluctuations in CITGO Petroleum Corporation's inventory and the crude oil it refines to produce its inventory. CITGO Trading elected mark-to-market treatment under IRS § 475 which resulted in the sale of its securities receiving the same federal tax treatment as the sale of securities inventory. The Travis County District Court rendered a judgment against Citgo and Citgo has appealed to the Third Court of Appeals.[32]

Satellite Radio Subscription Service Receipts. In *Hegar v. Sirius XM Radio, Inc.*, the court rejected the taxpayer's apportionment methodology based upon the location where the satellite radio service produced its subscription content.[33] The taxpayer produced its subscription content primarily from studios located outside Texas, transmitting its programs to satellites from facilities outside Texas.

The Comptroller audited Sirius, asserting that its subscription receipts should be apportioned to Texas based on the locations where the satellite transmissions were received by subscribers. The taxpayer's expert witnesses provided testimony that Sirius's apportionment methodology conformed to the "end product act test," focusing on the location where the receipt-producing activities occurred. Based on this test, the trial court found that the creation and broadcasting of original content from locations outside Texas supported sourcing the taxpayer's receipts outside Texas.

The Comptroller appealed this case to the Third Court of Appeals.[34] On May 1, 2020, the Third Court of Appeals reversed the trial court, finding that Sirius XM's satellite radio subscription receipts from subscribers in Texas must be apportioned to Texas regardless of the location from which the content was created or broadcast.[35]

Receipts from services are sourced to the Texas if a service "is performed" in Texas, so the parties took different positions what service Sirius XM actually sold. The Comptroller argued that Sirius provides the "service of unscrambling the radio signal" within each subscriber's vehicle, which occurs

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31 34 Tex. Admin. Code 3.591(e)(25).

32 *Citgo Petroleum Corporation v. Hegar*, No 03-21-00011-CV (Tex. App.—Austin Mar. 24, 2021).

33 *Hegar v. Sirius XM Radio, Inc.*, Cause No. 03-18-00573-CV (Tex. App.—Austin, May 1, 2020, pet. filed). The court also rejected an argument by Sirius that it qualified for the cost-of-goods-sold subtraction based on the determination that it sold services rather than goods. See **Cost of Goods Sold**, above.

34 *Hegar v. Sirius XM Radio, Inc.*, Cause No. 03-18-00573-CV (Tex. App.—Austin, May 1, 2020, pet. filed) (pending before the Texas Supreme Court, No. 20-0462).

35 Tex. Tax Code § 171.103(a)(2).

"at the radio receiver."[36] The Third Court observed Texas case law precedent, which found that a service is performed "where the act is done" to perform the service.[37] The Third Court accepted the Comptroller's position that the focus is on Sirius XM's "receipt-producing, end-product act."[38] The Third Court deferred to the Comptroller's interpretation of the franchise tax statute and applied the "end-product act" analysis to source the receipt based upon the locations where the satellite radio signals were receive, unscrambled, and played through the speakers in customers' vehicles.[39]

Sirius XM petitioned the Texas Supreme Court for review, and amicus curiae briefs have been submitted by Tax Executives Institute (TEI), Texas Taxpayers and Research Association (TTARA), and Council on State Taxation (COST). The Texas Supreme Court request additional briefing from the parties, a possible indication that the Texas Supreme Court is considering granting review. At the time of this update, the Comptroller received an extension until May 13, 2021 to file its Response Brief on the Merits.

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36 Slip op. at 5.

37 Slip op. at 9 (quoting *Humble Oil & Refining Co. v. Calvert*, 414 S.W.2d 172, 180 (Tex. 1967) (embedded quotation and citation omitted).

38 Slip op. at 10.

39 Slip op. at 12–14.

I. Sales Tax

Local Sales Tax Rule Revised

The Texas Comptroller has changed his local tax rule to undermine economic development agreements.[40] Local governments, like cities and counties, collect local taxes to finance their governmental operations. Generally, local governments receive local sales taxes based upon orders that local businesses receive within their boundaries. Local governments may also receive local use taxes when goods are delivered to customers within their boundaries. A seller collects local use taxes only when the local sales tax where the item is sold is less than the maximum rate (2%) and the local use tax is not of the same type (such as a city tax or a county tax) as the local sales tax that applied. This may occur, for example, when a seller receives an order outside city limits and sells the product for delivery to a customer residing within city limits.

Generally, local governments want businesses to relocate within their boundaries. In doing so, the relocated businesses provide jobs, goods, services and generate sales and property taxes for the local government's operations.

To induce a business to relocate to a particular city, the city may offer the business incentives, often in the form of shared local sales tax revenues. These offers are authorized under Chapter 380 of the Texas Local Government Code and are commonly known as "Chapter 380" agreements.

As an example, Apple decides to leave California and relocate its headquarters to Texas. To induce Apple to choose Austin, the City of Austin offers Apple a Chapter 380 agreement under which the City will give Apple one-half of the sales tax revenue Apple collects for the City for a five-year period.

Prior to the rule's amendment, whenever a customer places an order on the internet for a new iPhone, Apple would treat the order as received in Austin, and collect sales tax that it would split, for a five-year period, with the City of Austin under the Chapter 380 agreement. This result would follow regardless of where in Texas the customer lives.

Comptroller Hegar says that these types of arrangements are unfair to the local tax jurisdictions where the customers live, so he amended his rule to say the local tax revenue goes to the customer's location, where the item is shipped. Hegar penned an op-ed in the Dallas Morning News in an effort to justify his agency taking the initiative to change Texas' local sales tax rule without a change in the law. Hegar claims that taxpayers and cities use a Chapter 380 "loophole" to create sham facilities to "manipulate local sales taxes to their own benefit at the expense of other cities."[41]

When a Texas customer makes a purchase from a company's website, or by using its mobile app, Comptroller Hegar says the local tax should go to the location where that customer receives the

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40 Comptroller Rule 3.334.

41 Glenn Hegar, *How Some Texas Cities and Retailers Are Using a Tax Loophole to Snatch Sales Tax Revenue from Other Communities*, DALLAS MORNING NEWS, Feb. 4, 2020, *available at* https://www.dallasnews.com/opinion/commentary/2020/02/04/how-some-texas-cities-and-retailers-are-using-a-tax-loophole-to-snatch-sales-tax-revenue-from-other-communities/.

product, since he or she lives there and receives the local governmental services there, which the local sales tax revenues should help fund. Instead, taxes have been split between the local government where the seller has its business and the seller itself.

Although the amended rule went into effect May 30, 2020, Comptroller Hegar has provided for a transition period through September 2021 before the new sourcing provisions go into effect. He did this to allow the e-retailers adequate time to adjust their systems to collect local tax at the rate in effect at their customer's location and to give interested parties a chance to get the Texas Legislature to craft a different solution during the regular session that began in January 2021.[42]

Insurance Services

Medical Billing Services. The Comptroller's Tax Policy Division issued a memorandum notifying the Audit Division that the Comptroller's new policy will treat medical billing services as taxable insurance services. These will include services performed prior to submitting a claim to an insurance company, to provide additional information, or to adjust a submitted billing. "Insurance services" are included in the exclusive lists of services subject to Texas sales tax.[43] The Comptroller's Rule 3.355 defines these services broadly to include "any activities to supervise, handle, investigate, pay, settle, or adjust claims or losses" and makes these services taxable regardless of whether the purchaser of the service is the insurance company, the policy holder, or others.[44] Medical billing services are not defined by the statute or the Comptroller's rule. Medical billing services involve assigning codes for the preparation of claims, verifying insurance eligibility, preparing claim forms for filing, filing claims, resubmitting and adjusting claims, reviewing and appealing denied claims, settling claims, and posting payment for claims.[45]

On March 19, 2020, the Comptroller announced that he would delay the implementation of his policy change "until after the 2021 legislative session, allowing industry time to seek a legislative change." He clarified that, in the meantime, "[m]edical billing services that occur before a claim is submitted do not fall under 'insurance claims adjustment or claims processing' and are not taxable as insurance services."[46]

Occasional Sale Exemption

Court Imposes Fraud Penalty on Aircraft Claim for Occasional Sale Exemption. The Third Court of Appeals recently upheld a trial court decision finding that the 50% fraud penalty applied to a taxpayer who had purchased an aircraft through a broker who claimed the occasional sale exemption. In *HB Aviation, LLC v. Hegar*, HB Aviation, LLC purchased a Cessna Citation Excel aircraft in 2009 from James Creech. James Creech habitually bought and sold aircraft and brokered

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42 45 Tex. Reg. 3505 (". . . giving interested parties an opportunity to seek a legislative change.").

43 Tex. Tax Code § 151.0101(a)(9).

44 Comptroller Rule 3.355(a)(8), (b).

45 Comptroller Letter No. 201911003L (Nov. 22, 2019).

46 Comptroller Letter No. 202003007L (Mar. 19, 2020).

aircraft transactions through his solely-owned corporation Jim Creech Aircraft Services.[47] James Creech entered into a "back-to-back" transaction, in which he ostensibly took title to the aircraft from the seller and immediately transferred it to the buyer. He made a roughly 1–1.5% profit on brokering the transactions, but the sale proceeds were never in his possession but passed from the buyer to an escrow agent to the seller. Mr. Creech, however, executed a "Statement of Occasional Sale" to support the exemption, and executed an "Aircraft Purchase & Sales Agreement." At his deposition James Creech testified that "on paper I've got title to the airplane, but I—I never really owned it" and confirmed that he had no understanding of Texas' occasional sale exemption. The Third Court found that the occasional sale exemption could not apply because there had never been a "sale" of the aircraft to James Creech. As a result, the Court found that statements in the Aircraft Purchase & Sales Agreement and the Statement of Occasional Sale were misrepresentations to the extent they characterized Mr. Creech as receiving title to the aircraft. Since HB Aviation submitted the Aircraft Purchase & Sales Agreement and the Statement of Occasional Sale to the auditor, and these documents contained these misrepresentations, the Third Court upheld the 50% fraud penalty.[48] HB Aviation filed a Motion for Rehearing asking the three-justice panel to reconsider the fraud penalty on January 21, 2021 and the Third Court denied the Motion for Rehearing on March 2, 2021.

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47 *HB Aviation, LLC v. Hegar*, No. 03-19-00414-CV (Tex. App.—Austin Nov. 11, 2020, no pet. h.).

48 *HB Aviation, LLC v. Hegar*, No. 03-19-00414-CV (Tex. App.—Austin Nov. 11, 2020, no pet. h.).

I. Legislation

Texas Legislature's 87th Regular Session Continues

The Texas Legislature meets for its regular session once every two years on odd-numbered years. The 87th Regular Session began on January 12, 2021. Legislators began pre-filing bills on November 9, 2020. Legislators were able to file new bills until March 12, 2021 and thereafter are generally limited to taking action on already-filed bills.[49] The legislature is set to adjourn sine die (i.e., without reconvening) on May 31, 2021.[50]

Below are brief descriptions of relevant tax bills and other bills that might affect your clients or your practice. Each bill number below is a hyperlink that should take you to the Texas Legislature Online webpage for the bill. You can click on these links during and after the legislative session to see the status of each bill. You can review the bill text by clicking one of the three icons on the "Text" tab under the word "Bill."

Sales Tax Bills

HB 288 – This bill would expand the sales tax base to make up for revenue lost by eliminating most school district property taxes. Legal, accounting, audit, engineering, real estate brokering and real estate agency services would all become taxable services. Tickets to high school and college sports events would be taxed as amusement services. The additional revenue would be deposited to a new "school district reimbursement trust fund" outside the state treasury to be used by the Comptroller to reimburse school districts. HB 288 was referred to the House Ways & Means Committee on February 25, 2021.

HB 89 / HB 1992 / SB 438 – These bills would exempt disinfectant cleaning supplies, face masks, and disposable gloves from sales tax for a limited period of time. These bills have been referred to the House Ways & Means Committee and Senate Finance Committee.

HB 174 / HB 406 – These bills would exempt college textbooks from sales tax for a week around the beginning of each fall and spring semester. These bills have been referred to the House Ways & Means Committee.

HB 211 / SB 216 / HB 1255 – These bills create a new sales tax that applies to e-cigarette vapor products. These bills have been referred to the House Ways & Means Committee and Senate Finance Committee.

HB 321 / HB 388 / HB 490 / SB 148 – These bills would create a sales tax exemption for feminine hygiene products. These bills have been referred to the House Ways & Means Committee and Senate Finance Committee.

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[49] Tex. Const. Art III, Section 5(b).

[50] Tex. Const. Art III, Section 24(b).

HB 322 / HB 387 – These bills would create a sales tax exemption for child and adult diapers. These bills have been referred to the House Ways & Means Committee

SB 60 / HB 524 – These bills would exempt firearm safety supplies from sales tax. These bills have been referred to the House Ways & Means Committee and Senate Finance Committee.

SB 140 / HB 447 – These bills would legalize cannabis and subject it to sales tax at a rate of 10%. We have included these bills as examples, but there are many other cannabis legalization bills, some of which may also have state tax implications. These bills have been referred to the Senate State Affairs Committee and House Licensing & Administrative Procedures Committee.

HB 592 – This bill would create a sales tax exemption for fees charged for animals adopted from animal rescue groups. Animal adoption fees imposed by nonprofit shelters are already exempt. This bill has been referred to the House Ways & Means Committee.

SB 153 / HB 3573 – This bill would exclude certain payment processing services from the definition of "data processing service." This applies broadly to any "processing of payment made by credit card or debit card." These bills have been referred to the House Ways & Means Committee and Senate Finance Committee.

SB 200 – This bill would remove "internet access services" from the list of taxable services. Texas is already prohibited from collecting tax on internet access services effective July 1, 2020 due to the federal Internet Tax Freedom Act. This bill has been referred to the Senate Finance Committee.

HB 940 – This bill would make beer sold on the Fourth of July exempt from sales tax. This bill has been referred to the House Ways & Means Committee.

SB 296 – This bill would require that resale and exemption certificate be provided to an auditor at or before the exit conference. Current law allows certificate to be submitted up until 60 days after written notice, which occurs after the audit concludes and the taxpayer petitions for redetermination. This bill has been referred to the Senate Finance Committee.

HB 1346 / SB 833 – These bills allow taxpayers without sales tax permits who file severance tax reports to file sales tax refund claims for tax paid in error to vendors. These bills have been referred to the House Ways & Means Committee, which scheduled a public hearing on April 6, 2021, and the Senate Finance Committee, which scheduled a public hearing for April 7, 2021.

HB 1696 – This bill would prevent the Comptroller from exempting marketplace providers and remote sellers from collecting use tax if the marketplace provider or remote seller annually has over $100,000 in sales or more than 200 sales transactions in Texas. HB 1696 has been referred to the House Ways & Means Committee.

HB 2088 – This bill allows certain municipalities to adopt a tax rate that would make the combined local tax rate 2.25%. The combined local tax rate is currently capped at 2%. HB 2088 has been referred to the House Ways & Means Committee.

HB 2398 / SB 477 – These bills continue implementation of the 2019 marketplace provider legislation concerning use tax collection by out of state sellers in response to the U.S. Supreme Court's decision in *South Dakota v. Wayfair.*[51] The bills provide for marketplace sellers who sell admission tickets to indicate to the marketplace provider whether sales taxes were paid on the original purchase of the ticket. They also require marketplace providers to collect the lead acid battery fee and the prepaid 9-1-1 service fee. HB 2398 was referred to the House Ways & Means Committee which held a public hearing on March 22, 2021 and reported favorably on a committee substitute. SB 477 was referred to the Senate Finance Committee which held a public hearing on March 30, 2021 and reported favorably without amendment.

HB 4357 – This bill adds a new category of taxable services called "information technology consulting and technical support services." These are defined as "services involving the application of information technology knowledge, including hardware or software architecture, software support, remote help desk services, technology-related training, and computer diagnostics and repair" provided either as part of a regular subscription services or in association with the sale of a taxable item. It also changes the definition of taxable computer program repair, maintenance, creation and restoration to exclude services sold as part of a subscription or in association with the sale of a taxable item. HB 4357 has been referred to the House Ways & Means Committee.

HB 4114 – This bill allows movie theaters forced to close during 2020 to retain sales tax on admissions and concessions sold from September 2021 through August 2023. HB 4114 has been referred to the House Ways & Means Committee.

HB 4013 – This bill provides that businesses may retain 1.25% of sales tax receipts if a majority of employees receive tips and are paid at least the federal minimum wage. HB 4013 has been referred to the House Ways & Means Committee.

HB 2626 – This bill provides that tangible personal property brought into the state by an affiliate of the purchaser is subject to use tax on the price paid by the purchaser. HB 2626 has been referred to the House Ways & Means Committee which held a public hearing on April 6, 2021.

Local Sales Tax Sourcing Bills

As discussed above, the Comptroller adopted amendments to Rule 3.334 but delayed the implementation of the changes to give interested parties an opportunity to seek a legislative change. The Comptroller's rules, if given effect, would change many online retailer sales to destination-based sourcing. The prior rules would allow many online retailer sales to be sourced to the place of business of the seller.[52]

HB 4072 – This bill requires destination-based sourcing for all sales. All sales of taxable items (not just sales through online retailers) would be considered consummated at the location in this state to

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[51] 504 U.S. 298 (2018).

[52] See **Local Sales Tax Rule Revised** above.

which the item is shipped or delivered, or at which possession is taken by the purchaser. HB 4072 was referred to the House Ways & Means Committee which held a public hearing on April 6, 2021.

HB 4261 / HB 3538 – These bills revert to the sourcing methods in place prior to the Comptroller's rule amendments and provides that sourcing is determined without regard to the method the purchaser uses to communicate the order to the retailer. Both bills have been referred to the House Ways & Means Committee.

HB 2410 / SB 1332 – These bills provide for destination-based sourcing for sales ordered over the internet, including those through marketplace sellers. HB 2410 has been referred to the House Ways & Means Committee. SB 1332 has been referred to the Senate Finance Committee.

HB 4457 – This bill sources sales not received at a place of business (a location operated by the seller where three or more orders are received annually) to the location where the item was stored immediately before shipment, delivery, or transfer of possession to the customer. HB 4457 has been referred to the House Ways & Means Committee.

HB 4260 / SB 1417 – These bills preserve the prior sourcing rules for purposes of economic development agreements entered into between retailers and local governments on or before August 31, 2019. SB 1417 has been referred to the Senate Finance Committee. HB 4260 has been referred to the House Ways & Means Committee.

Franchise Tax Bills

HB 209 / SB 358 – These bills provide a franchise tax credit for establishing a grocery store or healthy corner store in a food desert. HB 209 was referred to the House Ways & Means Committee and a public hearing was held on March 22, 2021 but it was left pending in committee. SB 358 was referred to the Senate Finance Committee on March 9, 2021.

HB 361 – This bill creates a franchise tax credit for four weeks of paid family care leave. The credit is the lesser of twice the costs attributable to the leave or the total tax due after applying all other credits. HB 361 has been referred to the House Ways & Means Committee.

HB 864 – This bill creates a franchise tax credit pilot program for taxable entities that contribute to an employee dependent care flex spending account. The credit is limited to entities with 500 or fewer employees and applies only to accounts for employees earning $65,000 per year or less. The credit is equal to the lesser of 50% of the contributions or $2,500 per employee but is capped at the entities' franchise tax liability. HB 864 has been referred to the House Ways & Means Committee.

HB 1195 / SB 372 – These bills provide that Payroll Protection Program (PPP) loan forgiveness is not included in total revenue and that qualifying expenses paid with PPP loan proceeds may nevertheless be included in determining compensation or cost of goods sold. HB 1195 was referred to the House Ways & Means Committee where a public hearing was held on March 15, 2021 before the bill was reported favorably as substituted. The committee substitute clarifies that the bill only applies to cancellation-of-debt income that is excluded from gross income for federal tax purposes

and that expenses paid with forgiven loan proceeds may be included in cost of goods sold or compensation subtractions only if the expenses are otherwise includable. The House voted overwhelmingly in support of the bill on April 1, 2021. SB 372 has been referred to the Senate Finance Committee which scheduled a public hearing for April 7, 2021.

HB 1671 – This bill would provide a five-year franchise tax exemption for new veteran owned businesses. HB 1671 has been referred to the House Ways & Means Committee.

HB 1751 – This bill provides a franchise tax credit of 7.5% of the cost of qualified equipment placed in service by an enterprise project. HB 1751 has been referred to the House Ways & Means Committee.

HB 2037 – This bill provides a franchise tax credit for research and development of energy storage technologies. HB 2037 has been referred to the House Ways & Means Committee.

HB 2704 – This bill would add limited liability companies to the list of entities eligible to be exempt from franchise tax as "passive entities." Limited partnership and trusts are currently eligible for exemption as passive entities. HB 2704 has been referred to the House Ways & Means Committee.

HB 3000 – This bill would eliminate the franchise tax after December 31, 2021 and would temporarily draw on the Economic Stabilization Fund (the Rainy Day Fund) to make up for the tax revenue lost during the 2022–2023 biennium. To pass, the bill requires a 2/3 vote in both chambers and requires that the General Appropriations Act for the upcoming biennium is at least 3% less than the 2020–2021 appropriations bill. HB 3000 has been referred to the House Ways & Means Committee.

HB 3404 – This bill would repeal the franchise tax effective January 1, 2022. HB 3404 has been referred to the House Ways & Means Committee.

HB 3380 – This bill would allow taxpayers to add certain production costs incurred in connection with research and development to qualify for the franchise tax R&D credit. HB 3380 has been referred to the House Ways & Means Committee. HB 3380 has been referred to the House Ways & Means Committee.

HB 3907 / SB 1654 – These bills create a franchise tax credit for eligible low-income housing projects. HB 3907 has been referred to the House Ways & Means Committee which held a public hearing on March 29, 2021 and reported favorably without amendments. SB 1654 has been referred to the Senate Finance Committee.

HB 4392 / HB 4431 – These bills create a franchise tax credit equal to 30% of the expenditures of making a film in this state. Both bills have been referred to the House Ways & Means Committee.

Other Important Pending Legislation

HB 70 / HJR 6 – These bills would require legislative approval of proposed agency rules with an anticipated economic impact greater than $20 million, as determined by the agency. HJR 6 proposed a constitutional amendment to authorize this. Both bills have been referred to the House State Affairs Committee.

HB 207 – This bill would increase the gasoline and diesel fuels tax rate from 20 to 22 cents/gallon and provide for future rate increases to be tied to inflation. HB 207 has been referred to the House Ways & Means Committee.

HB 339 / HB 2613 / SB 11 – This bill makes a statewide "reapportionment" of the court of appeals districts. The introduced version doesn't appear to affect the Third Court of Appeals, which handles all appeals of Texas franchise tax and Texas sales tax protest and refund cases unless those cases are reassigned by the Texas Supreme Court. The Texas Supreme Court routinely transfers cases—including tax cases—to other courts of appeals to level the courts' workloads through "docket equalization transfers." HB 339 has been referred to the House Redistricting Committee. SB 11 was referred to the Senate Jurisprudence Committee which held a public hearing on April 1, 2021.

HB 645 / HRJ 36 – These bills require "the use of honesty state taxation terminology" in legislation, rules, materials, publication, and electronic media. They define a "regulatory tax" broadly, then prohibits the government from referring to any tax as a "fee," "levy," "surcharge," "assessment," "fine," or "penalty." Both bills have been referred to the House Ways & Means Committee.

SB 133 – This bill would facilitate adjusting dollar amounts in Texas tax statutes for inflation by creating biennial reports from the Comptroller to the Legislature detailing how tax collections would change by adjusting statutory figures for inflation. SB 133 has been referred to the Senate Finance Committee.

HB 477 – This bill would legalize gambling in some coastal areas and impose a new "Casino Gaming Tax" equal to 18% of a casino's gross gaming revenue. Revenue would be partially earmarked to cover costs of catastrophic flooding in those coastal areas. HB 477 has been referred to the House State Affairs Committee.

HB 1121 / HB 2070 / SB 736 – These bills would legalize sports betting and tax sports bets at a 6.25% to 10% rate. These bills have been referred to the House State Affairs Committee and the Senate Business & Commerce Committee.

HB 647 / HJR 37 – These bills would allow local governments to legalize or prohibit the operation of "eight-liners" and impose a $350 annual fee on each machine. The tax revenue would be split with 30% allocated to the state general revenue fund and 70% allocated to the municipality (or the county for machines outside city limits). These bills have been referred to the House State Affairs Committee.

SB 159 – This bill would extend the prohibition against using the Texas Open Records Act to obtain lists of taxpayers currently under audit for solicitation to 30 days after the Comptroller makes

the information available to the requestor. Using this information for solicitation is currently only prohibited for 6 days after the Comptroller makes the information available. SB 159 has been referred to the Senate Finance Committee.

HB 1258 – This bill requires financial institutions to regularly share customer data with the Comptroller to identify the accounts of delinquent taxpayers. HB 1258 was referred to the House Pensions, Investments & Financial Services Committee, where a public hearing was held on March 24, 2021 and the bills was reported favorably as substituted.

HB 1377 – This bill would eliminate the severance tax exemption for certain vented or flared gas. HB 1377 was referred to the House Ways & Means Committee.

HB 1494 – This bill would tax flared or vented gas at a severance 25% tax rate, which is over three times the normal rate. HB 1494 was referred to the House Ways & Means Committee.

HB 1389 / SB 1513 – These bills would allow vendors to claim a 2.5% reimbursement for sales tax for customer's purchases made by credit card. HB 1389 was referred to the House Ways & Means Committee. SB 1513 was referred to the Senate Finance Committee.

HB 1445 / SB 775 – These bills would exclude certain medical billing performed prior to the original submission of an insurance claim from taxable insurance services. HB 1445 was referred to the House Ways & Means Committee where a public hearing was held on March 15, 2021 and the bill was reported favorably as substituted. The committee substitute adds dental billing services and billing services performed before the original submission of related claims to the list of excluded services. SB 775 was referred to the Senate Finance Committee.

HB 1454 / SB 498 – These bills would make the interest rate for refunds of tax overpayments the same as the interest rate for tax deficiencies. Texas currently has much higher interest rates for tax deficiencies. The bills provide for phased-in equalization of the interest rates by September 1, 2027. These bills have been referred to the House Ways & Means Committee and the Senate Finance Committee.

HB 1658 – This bill allows the Comptroller to send deficiency determinations and jeopardy determinations by email and deems service to be completed when the email is transmitted. This bill was referred to the House Ways & Means Committee which held a public hearing on March 15, 2021 and reported favorably without amendments.

HB 2080 / SB 769 – As filed, these bills required all taxpayers to go through an administrative proceeding prior to filing a tax protest suit. However, in response to input from taxpayers and advocates, a House committee substitute has been offered which preserves the right of a taxpayer to pay the entire amount under protest and file suit in district court. It provides an alternative forum in which a taxpayer may access the courts without paying the entire amount claimed by the state. Taxpayers may instead pay only the amount that is in dispute and go through the Comptroller's administrative proceeding before filing a "suit after redetermination." The measure also prohibits collecting attorney's fees in tax suits. HB 2080 was referred to the House Ways & Means Committee

where a hearing was held on March 24, 2021 and was reported favorably as substituted. SB 769 has been referred to the Senate Finance Committee.

HB 2623 / SB 903 – These bills would allow a taxpayer to file a tax refund suit without a SOAH hearing by filing a lawsuit in district court within 90 days of the Comptroller's denial of the taxpayer's refund claim. The bills also change the res judicata (claim preclusion) provisions in the tax code to eliminate the requirement that the suit relate to the same tax liability period in order for res judicata to bar the re-litigating of the claims. HB 2623 has been referred to the House Ways & Means Committee which scheduled it for public hearing on April 12, 2021. SB 903 was referred to the Senate Finance Committee which a public hearing on April 7, 2021.

SB 310 – This bill would repeal the severance tax exemption for high-cost natural gas. SB 310 has been referred to the Senate Finance Committee.

HB 3305 – This bill requires businesses engaged in e-commerce to disclose the location where goods sold on its website were manufactured or produced. HB 3305 has been referred to the House Business & Industry Committee.

HB 4032 / SB 778 – This bill allows local taxing entities to get copies of audit report and audit working papers from the Comptroller for up to five taxpayers. Local taxing entities are currently allowed to request the tax returns of five taxpayers. SB 778 has been referred to the Senate Finance Committee which held a public hearing on March 30, 2021. SB 778 was left pending in committee.

SB 1651 – This bill eliminates use of the Texas Open Records Act to obtain lists of taxpayers under audit. Current law allows these lists of taxpayers with upcoming or ongoing audits to be obtained and used for solicitation after a six-day waiting period. SB 1651 has been referred to the Senate Business & Commerce Committee.

HB 2857 – This bill requires the Comptroller to wait 20 days after mailing an audit notice to a taxpayer before including that taxpayer's audit on the list of taxpayers under audit available under the Texas Open Records Act. HB 2857 was referred to the House Ways & Means Committee which held a public hearing on April 6, 2021.

HB 3829 – This bill prohibits the Comptroller from filing a tax lien before the taxpayer has exhausted administrative appeals or if the Comptroller has knowledge that the taxpayer is making good faith efforts to pay a tax liability. HB 3829 has been referred to the House Ways & Means Committee.

HB 433 – This bill would create a new tax on the generation of electricity—except by natural gas—imposed on the electric generator at a rate of 1 cent per kilowatt hour. HB 433 has been referred to the House Ways & Means Committee.

HB 4405 – This bill creates a new tax on electric generators and natural gas producers. For electric generators, the tax is equal to the entire net profit received by an electric generator who sells electricity at wholesale for a price exceeding $9,000 per megawatt hour beyond the first four hours of

sale at that price. The gas producers, the tax is equal to the entire net profit received that is attributable to gas sold by the gas producer at the wellhead at a price in excess of $200 per thousand cubic feet. HB 4405 was referred to the House Ways & Means Committee.

HB 4470 / SB 1971 – These bills impose a tax on wind power generators on the entire amount of the federal production tax credit arising from wind generation. These bills have been referred to the House Ways & Means Committee and the Senate Business & Commerce Committee.

SB 1993 – This bill imposes a tax on wind and solar power generators equal to 90% of the tax benefits received under Chapter 312 agreement (tax abatement agreement) or Chapter 313 agreement (property tax value limitation agreement). SB 1993 has been referred to the Senate Business & Commerce Committee.

HB 4467 – This bill creates a tax on digital advertising revenues with progressive rates between 2.5% and 10% depending on the gross revenue from digital advertising. HB 4667 has been referred to the House Ways & Means Committee.

HB 3060 / SB 873 – These bills provide an exception to the confidentiality of tax information for the Comptroller to issue a certificate to the purchaser of a business stating that no tax is due. HB 3060 was referred to the House Ways & Means Committee, which held a public hearing on March 29, 2021 but left the bill pending in committee. SB 873 was referred to the Senate Business & Commerce Committee which held a public hearing on March 16, 2021 and reported favorably without amendments. SB 873 was voted on via voice vote by the entire Senate which passed the bill to engrossment.

SB 902 – This bill creates a statute of limitations prohibiting the Comptroller from enforcing a tax liability on the purchaser of a business more than three years after the purchase. SB 902 was referred to the Senate Finance Committee was scheduled for a public hearing on March 30, 2021 but no action was taken in committee.

Links:

Separate lists of all bills filed to date in each chamber are available here:

- House bills: https://capitol.texas.gov/Reports/Report.aspx?LegSess=87R&ID=housefiled
- Senate bills: https://capitol.texas.gov/Reports/Report.aspx?LegSess=87R&ID=senatefiled

II. Jurisdiction

Recent Wins and Losses for Taxpayers on Jurisdiction

Judicial Review of Penalties & Interest Waiver. A Texas court ruled that the courts have jurisdiction to review the Comptroller's discretionary authority to waive all or part of the tax, penalty, or interest found due.[53]

J.D. Fields & Company is a pipe and piling distributer headquartered in Houston. The Comptroller initially audited J.D. Fields for sales tax compliance for reporting periods between April 2005 and May 2008. At the conclusion of that audit, the Comptroller found that J.D. Fields was incorrectly collecting local sales tax based on the location where pipes were delivered rather than where the sale took place.[54] At the conclusion of that audit, according to J.D. Fields, the auditor told the taxpayer that it was not necessary to begin collecting tax based on the location of the sale. When J.D. Fields' CFO asked the auditor if the company could wait until January 1, 2009 to begin collecting tax correctly, the auditor allegedly said "I think that will be fine."[55]

In 2012, the Comptroller audited J.D. Fields again, and assessed tax for June 2008 through December 2008 (among other periods) based on J.D. Fields' improper local tax collection. J.D. Fields requested relief from the assessment on the ground that it relied on the auditor's statement to the CFO that J.D. Field could correct the practice beginning January 1, 2009. The Comptroller's rules provide that "The [C]omptroller will give relief to a taxpayer who follows erroneous advice given to a taxpayer by an agency employee."[56] The Comptroller argued that his discretion in providing relief was absolute, based entirely on equitable discretionary considerations, and that a taxpayer could not even raise the issue in a suit challenging a tax assessment.[57] The court rejected this argument, stating:

> That the Comptroller's rules require it to take certain equitable considerations into account when deciding claims for relief does not affect the Comptroller's obligation to follow those rules when deciding claims.[58]

The court followed with "[w]e do not agree that the Comptroller's discretion is absolute."[59] The court noted that the statute allowing the Comptroller to waive penalties and interest provided "a specific and objective standard to govern the Comptroller's exercise of judgment" because the statute provides for waiver if a taxpayer "exercised reasonable diligence to comply with" the tax laws.[60]

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53 *Hegar v. J.D. Fields & Company, Inc.*, No. 03-19-00351-CV (Tex. App.—Austin Apr. 15, 2020, pet. filed).

54 Slip op. at 1–2.

55 Slip op. at 2.

56 Comptroller Rule 3.10(c). See also Comptroller Rule 3.5(b)(3)(K) (identifying "reliance on advice provided by the [C]omptroller's office" as a factor for penalty and interest waiver).

57 *Hegar v. J.D. Fields & Company, Inc.*, No. 03-19-00351-CV, slip op. at 2–3 (Tex. App.—Austin Apr. 15, 2020, pet. filed) (pending before the Texas Supreme Court, No. 20-0510).

58 Slip op. at 5.

59 Slip op. at 6.

60 Tex. Tax Code § 111.103(a).

The Comptroller has appealed the decision to the Texas Supreme Court.

Quoting Refund Statute and Providing Supporting Schedules Sufficient to Maintain Jurisdiction. After a two-justice majority of the Third Court of Appeals sided with the Comptroller and dismissed El Paso Electric Company's sales tax refund suit, a majority of the full Third Court reversed and found the taxpayer adequately raised its legal arguments at the administrative level.

El Paso Electric Company is a fully integrated public utility in the business of manufacturing, generating, transmitting and distributing electricity in west Texas and southern New Mexico.[61] El Paso Electric filed an administrative sales tax refund claim for a variety of different types of equipment under a variety of sales tax exemptions. Of the $5.1 million total refund El Paso sought, the Comptroller agreed to refund over $2.5 million.

The Comptroller would not agree to refund sales tax El Paso allegedly paid in error on the purchase of meters and disconnect collars that El Paso believed were exempt because they were "telemetry units related to step-down transformers," a specific type of exempt manufacturing equipment.[62] After the Comptroller denied El Paso's administrative refund claim, El Paso filed a district court lawsuit.[63] The Comptroller moved to dismiss the district court suit, arguing that the statement of grounds filed in El Paso's earlier administrative refund claim failed to adequately put the Comptroller "on notice" of El Paso's claim for telemetry units related to step-down transformers.[64]

El Paso's original administrative filing identified the refund claim by citing and quoting in full the subsection of the manufacturing exemption statute that contains a long list of exempt support equipment:[65]

> (4) actuators, steam production equipment and its fuel, in-process flow through tanks, cooling towers, generators, heat exchangers, transformers and the switches, breakers, capacitor banks, regulators, relays, reclosers, fuses, interruptors, reactors, arrestors, resistors, insulators, instrument transformers, and telemetry units that are related to the transformers, electronic control room equipment, computerized control units, pumps, compressors, and hydraulic units, that are used to power, supply, support, or control equipment that qualifies for exemption under Subdivision (2) or (5) or to generate electricity, chilled water, or steam for ultimate sale; transformers located at an electric generating facility that increase the voltage of electricity generated for ultimate sale, the electrical cable that carries the electricity from the electric generating equipment to the step-up transformers, and the switches, breakers, capacitor banks, regulators, relays, reclosers, fuses, interruptors, reactors, arrestors, resistors, insulators, instrument transformers, and telemetry units that are related to the step-up transformers; and transformers that decrease the voltage of electricity generated for ultimate sale and the switches, breakers, capacitor banks, regulators, relays, reclosers, fuses, interruptors, reactors, arrestors, resistors, insulators, instrument transformers, and telemetry units that are related to the step-down transformers.

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61 *Hegar v. El Paso Electric Company*, No. 03-18-00790-CV (Tex. App.—Austin Aug. 13, 2020, no pet. h.) (majority opinion).

62 Tex. Tax Code § 151.318(a)(4).

63 *Hegar v. El Paso Electric Company*, slip op. at 2.

64 Slip op. at 7; see also Tex. Tax Code § 111.104 (requiring refund claim to (1) "be written"; (2) "state fully and in detail each reason or ground on which the claim is founded"; and (3) be filed before the expiration of the statute of limitations).

65 Slip op. at 9.

El Paso also cited and quoted in full other subsections of the manufacturing exemption statute and various other provisions of the tax code. Two justices on the initial panel that heard the appeal held that "one its own, quoting every word of all of those subsections did not suffice to put the Comptroller on notice of the legal basis of a refund claim for telemetry units related to step-down transformers."[66]

The third member of the three-justice panel issued a dissenting opinion.[67] She would have found that schedules El Paso submitted with its original statement of grounds sufficed to identify the equipment and put the Comptroller on notice of the exemption for telemetry units related to step-down transformers. These schedules "identif[ied] specific transactions involving "meters" by line items that included detailed information about the particular transaction including dates, invoice numbers, and amounts and specifically refer[red] to manufacturing exemption . . ."[68] Amicus briefs and letters were filed by several groups, including the Texas Taxpayers and Research Association, the Texas Association of Manufacturers, and Martens, Todd & Leonard. These amicus briefs and letters asked the Third Court to re-hear the case en banc (i.e., with all justices in lieu of a three-justice panel) or to adopt the dissenting opinion in favor of the taxpayer.

On March 5, 2021, four of the six justices sitting on the Third Court of Appeals reversed the three-justice panel and rendered an en banc opinion in favor of the taxpayer. The Court concluded that El Paso Electric had adequately invoked the court's jurisdiction over its refund claim for telemetry units by quoting the entire manufacturing exemption statutory subsection at issue and by listing the meters (which constituted exempt telemetry units) in its schedules of transactions submitted with its administrative filings. Two justices joined in a dissenting opinion, arguing that merely quoting the statute and listing the transactions on supporting schedules was insufficient to adequately put the Comptroller on notice of the nature of the taxpayer's claim.

On March 22, 2021, the Comptroller filed a Motion for En Banc Reconsideration, arguing that the Court's opinion will enable taxpayers to escape meaningful agency review of their refund claims and imploring the court to replace the en banc opinion with a new opinion in the Comptroller's favor. On April 2, 2021, the Third Court requested a response from the taxpayer.

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66 Slip op. at 11.

67 *Hegar v. El Paso Electric Company*, No. 03-18-00790-CV (Tex. App.—Austin Mar. 5, 2021, no pet. h.) (Kelly, J., dissenting)) (pending subsequent Motion for En Banc Reconsideration before the Third Court of Appeals).

68 Slip op. at 4–5 (Goodwin, J., dissenting).