The Current State of the States | February 2014

230 West Street
Suite 700
Columbus, OH 43215
tel 614.221.1120
fax 614.227.6999
www.gbq.com

GBQ Partners

SALT WATCH

Listen
Plan
Execute

Texas District Court Rejects a Taxpayer's Election to Use Multistate Tax Compact Evenly – Weighted Three-Factor Apportionment

On January 15, 2014, in Graphic Packaging Corp. v. Combs, Cause No. D-1-GN-12-003038, the District Court of Travis County, Texas, 353rd Judicial District (the "District Court"), issued an order granting the Comptroller's motion for summary judgment, and issued an order denying Graphic Packaging Corporation's ("Graphic's") motion for summary judgment. The issue raised in the case was whether Graphic was entitled to elect to use the Multistate Tax Compact (the "Compact") as the basis for an evenly-weighted three-factor apportionment formula to apportion its Revised Franchise Tax (commonly referred to as the "Margins Tax") base in lieu of the standard single-receipts factor.

Graphic's Facts

Graphic timely filed amended 2008 and 2009 Margins Tax returns seeking refunds of tax reported and paid with its originally-filed returns. In addition, Graphic filed an original 2010 Margins Tax return seeking a refund of estimated tax paid. On each return, Graphic calculated the Margins Tax using an evenly-weighted property, payroll, and sales apportionment formula. The Comptroller denied Graphic's refund claims for 2008 and 2009. The Comptroller issued an assessment for additional Margins Tax, plus interest and penalties related to Graphic's 2010 return.

On June 3, 2011, Graphic timely filed a Request for Refund Hearing with respect to its 2008 and 2009 returns and a Request for Redetermination with respect to its 2010 return. The requests were ultimately consolidated. On August 10, 2012, the Comptroller issued a final decision upholding her denial of the 2008, 2009, and 2010 refund claims, as well as the assessment for the 2010 report year.

Graphic then timely filed a Motion for Rehearing on August 31, 2012, which the Comptroller denied on September 17, 2012. Graphic paid the tax and timely filed suit for refund with the District Court on September 27, 2012. Graphic and the Comptroller each subsequently filed motions for summary judgment.

Graphic's Arguments

In its motion for summary judgment, Graphic first argued that the Margins Tax meets the Compact's definition of an "income tax" because the deductions from total revenue are not specifically and directly related to particular transactions and that the Margins Tax "Revised Franchise Tax" label cannot be used to determine whether it qualifies as an income tax.

Graphic then went on to argue that the Texas Legislature was aware of the Compact when it enacted the Margins Tax because it referred to the Compact in Texas Tax Code §171.1014(a) and specifically repealed a statutory provision in the predecessor to the Margins Tax that prohibited application of the Compact. Accordingly, the Texas Legislature must have contemplated that the Compact would apply for purposes of the Margins Tax.

Texas District Court Rejects a Taxpayer's Election to Use Multistate Tax Compact Evenly – Weighted Three-Factor Apportionment

Lastly, Graphic argued that the United States Supreme Court recognized the Compact as valid and enforceable and that, generally, a multistate compact functions as a statute as well as a contract among the participating states. Basic contract law, the Contracts Clause of the United States Constitution, and the Texas Constitution prohibit unilateral modification of a multistate compact.

Comptroller's Arguments

In its motion for summary judgment, the Comptroller first argued that the prefatory "[e]xcept as provided by this section" language in Texas Tax Code § 171.106(a) dictates that the single-receipts formula is the exclusive means by which the Margins Tax may be apportioned and that nothing in the Texas Tax Code affirmatively activates the Compact for purposes of the Margins Tax.

The Comptroller then went on to argue that the Compact is not binding upon the member states because it does not meet all of the indicia of a "regulatory interstate compact" – namely, no joint organization was created to regulate the subject matter of the Compact, no reciprocal action is required in order for the Compact to be effective, and the Compact does not prohibit unilateral modification or repeal.

Rather, the Compact is advisory in nature. Thus, the Compact does not prohibit Texas from mandating use of single-receipts factor apportionment.

Lastly, the Comptroller argued that, even if the Compact is binding, the Margins Tax does not fit squarely within the Compact's definition of an "income tax" because that definition contemplates a net income tax and the Margins Tax is a hybrid franchise-gross receipts tax, the Texas Legislature specifically stated that the Margins Tax is not an income tax, and the Texas Supreme Court held that the Margins Tax is not an income tax.

Furthermore, nothing in the Compact prohibits Texas from mandating use of an alternative apportionment formula and the requirement to use single-receipts factor apportionment does not unconstitutionally impair Compact obligations.

Insights

The District Court did not provide a written decision with regard to its disposition of the Comptroller's and Graphic's respective motions as the Compact apportionment formula election was but one of several issues being litigated by the taxpayer. Therefore, the basis for the court's decisions is unknown at this time.

The Comptroller has consistently denied all Compact apportionment factor election claims. Thus, taxpayers filing returns using the Compact's apportionment factor election should expect the Comptroller to adjust their original returns and reject refund claims. The Compact apportionment factor election issue addressed in Graphic Packaging Corp. has recently been litigated in lower courts in

GBQ Partners

SALT WATCH

Texas District Court Rejects a Taxpayer's Election to Use Multistate Tax Compact Evenly – Weighted Three-Factor Apportionment

California and Michigan [1]. The California and Michigan matters are currently before the California Supreme Court and the Michigan Supreme Court, respectively [2].

For more information, please contact:

Sara L. Goldhardt, CPA
Senior Manager, State and Local Tax Services
614.947.5243
sgoldhardt@gbq.com

This article originally appeared in BDO USA, LLP's "BDO Knows: SALT" newsletter (February 2014).

[1] See Gillette Co. v. Franchise Tax Board, Docket No. A130803 (Cal. Ct. App. Oct. 2, 2012); and International Business Machines Corp. v. Department of Treasury, Docket No. 306618 (Mich. Ct. App. Nov. 20, 2012).
[2] See Gillette Co. v. Franchise Tax Board, California Supreme Court, Case No. S206587; and International Business Machines Corp. v. Department of Treasury, Michigan Supreme Court, Case No. 146440.