Texas combined group controlling interest satisfied by set of common owners

Overview

The Texas Comptroller of Public Accounts (Comptroller) recently issued an order (Comptroller's order) upholding an Administrative Law Judge decision (ALJ decision), which held that the Comptroller Staff (Staff) erred in: (1) rejecting the amended combined Texas franchise tax reports for Company A and Company B (collectively referred to as the taxpayers), and (2) denying the corresponding refund claims.[1,2]

Company A and Company B originally each filed separate Texas franchise tax reports for the report years at issue. Subsequently, Company A and Company B filed amended Texas franchise tax reports, as members of the same affiliated group engaged in a unitary business, on a single combined group basis and claimed a refund on their combined Texas franchise tax report.[3] Staff then denied the refund claim arguing that Company A and Company B were not members of the same affiliated group and, thus, were ineligible to file as members of the same combined group because no single shareholder held a controlling interest for both entities.[4] Ultimately, the ALJ decision and the Comptroller's order sided with the taxpayers and concluded that the requisite controlling interest may be held by the same set of common owners.[5] In this Tax Alert, we summarize this "controlling interest" issue and the related analysis in the ALJ decision, as well as offer some taxpayer considerations.

Background

For Texas franchise tax report years 2008, 2009, 2010, and 2011 (hereinafter referred to as the refund years), more than 50 percent of both the voting power and the beneficial ownership interest in Company A and Company B were owned by the same set of individuals.[6] During the refund years, Company A and Company B originally filed separate Texas franchise tax reports, each on a combined group basis, whereby they served as the lead reporting entity for their respective Texas franchise tax combined reports. Subsequently, Company A and Company B filed amended Texas franchise tax reports for each of the refund years as a single combined group with Company A as the lead reporting entity. By eliminating intercompany transactions on this amended Texas franchise tax report, Company A claimed a refund for each of the refund years.[7]

Staff denied the taxpayers' refund claims, arguing Company A and Company B did not meet the definition of an "affiliated group" and thus were not entitled to file on a combined group basis.[8] Company A and Company B then each timely filed a request for a refund hearing appealing the denial of the refund claims.[9] Staff then referred the two cases to the Texas Office of Administrative Hearings, where the administrative law judge joined the cases.[10]

Analysis of ALJ decision and comptroller's order

At the administrative law judge hearing, the dispute centered on whether Texas Tax Code Annotated (TTC) § 171.0001(1) requires that a single owner hold the requisite controlling interest (as argued by Staff), or whether the requisite controlling interest may be held by a set of common owners who collectively own the requisite controlling interest in each entity (as argued by the taxpayers).[11] For purposes of the refund years, Staff argued that no single shareholder in either Company A or Company B controlled over fifty percent of the total combined voting power of all classes of stock in both corporations, or owned directly or indirectly more than fifty percent of the beneficial

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[1] Accession No. 201506494H, Texas Comptroller of Public Accounts (June 23, 2015) (referencing SOAH Docket Nos. 304-14-1811.13; 304-14-1811.13; 304-14-1812.13; and 304-14-1813.14), available here. (hereinafter referenced as Comptroller's Order.)
[2] A Comptroller Order may not be relied upon as precedent by other taxpayers. However, the reasoning, analysis, and conclusions set forth in an Order may potentially suggest how the Comptroller would interpret the applicable law when presented with facts that closely resemble those addressed in the Order.
[3] Comptroller's Order, at *6.
[4] *Id*.
[5] *Id*. at *6.
[6] *Id*. at *7.
[7] *Id*.
[8] *Id*. at *8.
[9] *Id*.
[10] *Id*. at *6.
[11] *Id*. at *8.

ownership interest in the voting stock of both corporations. However, Staff conceded that over fifty percent of the ownership in both Company A and Company B was owned by the same set of individuals.[12]

Under TTC § 171.1014(a), "taxable entities that are part of an affiliated group engaged in a unitary business shall file a combined group report in lieu of individual reports based on the combined group's business." TTC § 171.0001(1) defines an affiliated group as "a group of one or more entities in which a controlling interest is owned by a common owner or owners, either corporate or noncorporate, or by one or more of the member entities." A controlling interest in a corporation consists of "either more than fifty percent, owned directly or indirectly, of the total combined voting power of all classes of stock of the corporation, or more than fifty percent, owned directly or indirectly, of the total beneficial ownership interest in the voting stock of the corporation."[13]

As recognized by the judge in the ALJ decision, the plain language of TTC § 171.0001 states that an affiliated group exists where the requisite "controlling interest" is owned by either a common owner (singular) or by common owners (plural).[14] Notwithstanding this language, Staff interpreted the provision as restricting ownership of the controlling interest to a single, common owner.[15] In response, the taxpayers argued that "as a matter of common usage, the word 'owners' refers to more than one owner, a meaning that is underscored by the use of the disjunctive phrase, 'or owners', immediately after the singular, 'owner'."[16]

According to the judge in the ALJ decision, the Texas legislature, by including the term "owners" in TTC § 171.0001, clearly contemplated that the controlling interest in taxable entities could be held by the same two or more persons.[17] Thus, Company A and Company B constituted an "affiliated group" during the refund years. Because Company A and Company B were part of an affiliated group engaged in a unitary business,[18] the administrative law judge held the taxpayers were entitled to file a single combined Texas franchise tax report for the refund years.[19] The Comptroller thereafter generally adopted the administrative law judge's proposal for decision without any additional analysis.[20]

Considerations

Taxable entities that have filed or intend to file separate Texas franchise tax returns because a single owner did or does not hold the requisite controlling interest for a group of entities engaged in a unitary business may wish to consider whether it would prove beneficial to file a single Texas franchise tax combined report for such a group for any open years and/or going forward if a set of common owners collectively owned or owns the requisite controlling interest in the entities at issue.[21]

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[12] *Id*.
[13] TTC § 171.0001(8).
[14] Comptroller's Order at *9.
[15] *Id*.
[16] *Id*. at *10.
[17] *Id*.
[18] Staff did not dispute that Company A and Company B were engaged in a unitary business. *See id*.
[19] *Id*.
[20] *Id*. at *3. The Comptroller's Order made one change to the ALJ's proposal for decision where a conclusion of law incorrectly referenced the Comptroller versus the Comptroller's Staff. *See id*. at *11.
[21] *See* Footnote 2.

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