

Texas Court disallows use of MTC evenly-weighted, three-factor formula

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Overview

Affirming an earlier decision rendered by the District Court of Travis County, Texas, 353rd Judicial District (District Court), the Texas Court of Appeals, Third District (Court of Appeals) recently held that Graphic Packaging Corporation (Graphic) was not entitled to use the Multistate Tax Compact's (Compact) evenly-weighted, three-factor apportionment formula to compute Texas franchise tax (commonly referred to as the "Texas Margin Tax").¹ Instead, the Court of Appeals ruled that "Graphic was required to use the single factor formula in [Texas Tax Code] section 171.106(a)"² Graphic has 15 days after the date of this Court of Appeals decision to file with that court either a motion for rehearing or a motion for reconsideration *en banc*.³ Graphic may also file, within 45 days after this Court of Appeals decision, a petition for review with the Texas Supreme Court.⁴ As of the date of this Tax Alert, no such motion or petition has been filed.⁵

In this Tax Alert we summarize the proceedings and the Court of Appeals' decision.

Background

On January 15, 2014, the District Court issued an Order granting a Motion for Partial Summary Judgment brought by the Texas Comptroller (Comptroller), thus disallowing Graphic's use of the Compact's evenly-weighted, three-factor apportionment formula (Compact Formula) to compute Texas Margin Tax.⁶ The District Court also denied Graphic's Motion for Summary Judgment,⁷ wherein Graphic sought confirmation of its right to apportion its margin to Texas using the Compact Formula as adopted into law in Texas Tax Code (TTC) Chapter 141.

In its Motion for Partial Summary Judgment, the Comptroller argued that TTC § 171.106 (single sales factor) supersedes the Compact Formula, and that TTC § 171.106 established the specific apportionment formula to be used in calculating tax due. Further, the Comptroller argued:

- That the Compact is not a regulatory interstate compact, but rather an advisory compact, which does not bind its member states.
- That even if the Compact were binding, the Texas Margin Tax does not fit squarely under the Compact's definition of an income tax and, accordingly, it cannot be an "income tax" for purposes of applying the provisions of the Compact.

In the Order granting the Motion for Partial Summary Judgment in favor of the Comptroller, the District Court did not provide any analysis or rationale for its decision. Graphic appealed the matter to the Court of Appeals.

Graphic's argument before the Court of Appeals

Graphic's position on appeal was that it properly elected to use the Compact Formula to apportion its margin to Texas because:

- (i) Sec. 171.106(a) did not impliedly repeal chapter 141's election and formula; (ii) if Sec. 171.106(a) did impliedly repeal chapter 141's election and formula, the repeal was invalid because the . . . Compact is an interstate agreement that is binding on the party states unless and until they withdraw; and (iii) if chapter

¹ *Graphic Packaging Corporation v. Hegar, Comptroller of Public Accounts of the State of Texas*, No. 03-14-00197-CV (Tex. Ct. App. 3rd Dist., Jul. 28, 2015), slip op. at 16. A copy of the decision is available [here](#).

² *Id.*

³ Tx. Rules of Appellate Procedure, Rules 49.1 and 49.7.

⁴ *Id.*, at Rules 53.1 and 53.7(a)(1).

⁵ See, Tex. Ct. App. 3rd Dist., case information for *Graphic Packaging Corporation*, No. 03-14-00197-CV, available [here](#).

⁶ *Graphic Packaging Corporation v. Susan Combs, Comptroller*, Dist. Ct. of Travis County, Texas (353rd Dist.) Cause no. D-1-GN-12-003038, Order on Plaintiff's Motion for Summary Judgment and Defendants' Motion for Partial Summary Judgment (Jan. 15, 2014).

⁷ *Id.*

141's election and formula were not repealed, the "Texas [Margin Tax] is an 'income tax' as defined to be within the scope of the ... Compact's applicability."⁸

Appellate court's ruling

The Court of Appeals ruling centered on whether the Texas Margin Tax falls within the meaning of an "income tax" under chapter 141. Chapter 141 defines "income tax" as "a tax imposed on or measured by net income[,] including any tax imposed on or measured by an amount arrived at by deducting expenses from gross income, one or more forms of which expenses are not specifically and directly related to particular transactions."⁹ The Court of Appeals found that the alternative tax bases for determining Texas Margin Tax liability under chapter 171 (i.e., total revenue and 70 percent of total revenue) do not fall within the plain meaning of "net income."¹⁰ Thus, when applying the plain meaning of the term "income tax" in the context of the overall structures of chapters 141 and 171, the Court of Appeals concluded that the Texas Margin Tax is not "a tax imposed on or measured by net income."¹¹ The court ruled that because the Texas Margin Tax does not fall within the meaning of an "income tax" under chapter 141, "the three-factor [Compact Formula] was not an alternative apportionment formula for Graphic, and Graphic was required to use the single-factor formula in section 171.106(a) to apportion its margin" for Texas Margin Tax purposes.¹² On this basis, the Court of Appeals affirmed the lower court's decision, thus disallowing Graphic's use of the Compact Formula.¹³

Considerations

As noted previously, Graphic has 15 days to file a motion for rehearing or a motion for reconsideration *en banc* with the Court of Appeals, and 45 days to file a petition for review with the Texas Supreme Court.¹⁴ Although the case is not final, taxpayers that have made, or are considering making, an election to use the Compact Formula may wish to discuss with their tax advisers the potential effect of this Court of Appeals decision.

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⁸ *Graphic Packaging Corporation*, No. 03-14-00197-CV, slip op. at 5.

⁹ Tx. Tax Code ANN. § 141.001, art. II.4.

¹⁰ *Graphic Packaging Corporation*, No. 03-14-00197-CV, slip op. at 16.

¹¹ *Id.*

¹² *Id.*

¹³ *Id.*

¹⁴ Tx. Rules of Appellate Procedure, Rules 49.1, 49.7, 53.1 and 53.7(a)(1).