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SALT ALERT: **Texas Court of Appeals Declares Franchise Tax Throwback Provision Unconstitutional**

State Tax Alert

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In Home Interiors & Gifts v. Strayhorn, the Texas Court of Appeals overturned a District Court decision and declared the state's requirement to add back (commonly referred to as "throwback") out-of-state sales of tangible personal property where an in-state company had no nexus was unconstitutional.

Background

The Texas franchise tax is imposed on all corporations for the privilege of doing business in the state. The franchise tax is assessed on the greater of 4.5 percent of a corporation's net taxable income or 0.25 percent on net taxable capital. Under the net taxable income calculation, which uses a single sales factor, out-of-state sales of tangible personal property are thrown back to Texas if the corporation does not have nexus in states other than Texas. This provision was included in order for Texas to impose tax on out-of-state sales that are protected from taxation in other states due to Public Law 86-272, a federal law that bars states from taxing out-of-state corporations whose only in-state activities are limited to the solicitation of orders.

Decision

The Texas Court of Appeals overturned the lower District Court decision and reasoned that the throwback provision unconstitutionally burdens interstate commerce because it is unfairly apportioned and discriminates between companies that make all of their sales of tangible personal property within Texas versus companies that make sales within and without Texas and have no nexus outside of Texas. Specifically, the Court held that the internal consistency test in *Complete Auto Transit* was not met.

Action Required

As a result of this decision, companies in Texas that have throwback sales in the previous four years may be entitled to a refund of franchise tax. Protective refund claims should be considered in case the state does not appeal or loses its appeal to the Texas Supreme Court. Since a decision will probably take months or even years, action is now required to keep refund claims open until a final verdict is rendered. We recommend the following action steps:

- Review all of your clients that sell tangible personal property within and without Texas for all open years (four years).
- Make a quick calculation to determine the potential refund.
- File protective refund claims in order to preserve your client's right to a refund of franchise tax.

FOR MORE INFORMATION
PLEASE CONTACT:

Mike Goral or
Mike Becker,
BDO Dallas at 214-969-7007
or a member of the
**BDO Seidman Multistate Tax
Group** for further details.

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