

AN ALERT FROM THE BDO STATE AND LOCAL TAX PRACTICE

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## SALT



### SUBJECT

## TEXAS ADMINISTRATIVE LAW JUDGE GRANTS TAXPAYER'S USE OF A MARGINS TAX BUSINESS LOSS CARRYFORWARD CREDIT CLAIMED ON A LATE FILED RETURN

### SUMMARY

On July 17, 2015, a Texas Administrative Law Judge ("ALJ") issued a decision in which the ALJ recommended a refund to a taxpayer ("Taxpayer") with respect to a business loss carryforward credit preserved and elected in 2008 and claimed on a 2010 return.<sup>1</sup> The Texas Comptroller of Public Accounts, Taxing Division had denied Taxpayer's use of the credit because the 2010 return was filed late. It appears that the Comptroller may be notifying similarly situated taxpayers that they will also be issued refunds due to the ALJ's decision.

### DETAILS

#### *Background*

For Franchise Tax returns due on or after January 1, 2008, Texas replaced the "old" Taxable Capital/Earned Surplus Tax, with the current Margins Tax. Texas allows a credit against the Margins Tax, which is based on unused business loss carryforwards a taxpayer generated under the Earned Surplus Tax.<sup>2</sup> Under the statute, a taxpayer must provide written notification to the Comptroller of its intent to take the credit on its first return due after January 1, 2008 in order to

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<sup>1</sup> Texas Comptroller of Public Accounts, Hearing No. 110,191 (July 17, 2015).

<sup>2</sup> Tex. Tax Code § 171.111(a).

claim the credit.<sup>3</sup> A taxpayer may thereafter elect to claim the credit on any return due after January 1, 2008 and claim it for up to twenty (20) privilege periods, unless and until the taxpayer revokes the credit or the statute under which the credit is granted expires, whichever first occurs.<sup>4</sup> Tex. Tax Code § 171.111(a) allows a taxpayer to make only one election to claim the credit.<sup>5</sup> A Comptroller regulation, however, requires a taxpayer to make the election on each timely filed return due on or after January 1, 2008.<sup>6</sup>

## **Facts**

Taxpayer, a telecommunications service provider that filed a Texas combined Franchise Tax return, filed a form 05-172 (Franchise Tax Preservation of Temporary Credit) on February 6, 2008 for each of six affiliates to notify the Comptroller of the intent of the affiliates to preserve and take the credit for unused business loss carryforwards. In addition, on May 9, 2008, Taxpayer timely filed an extension of time to file its 2008 return (i.e., its first return due after January 1, 2008), along with the requisite affiliate list, on which it blackened a circle on the form indicating that it would be claiming the credit on its 2008 return. Taxpayer claimed the credit on its timely filed 2008 return and, as a result, the Tax Division issued a check to refund an overpayment of tax it made with its extension request.

Taxpayer timely filed extensions of time to file its 2009 return, which was not at issue in this matter, and its 2010 return, and noted on each election its 2008 preservation and election to claim the credit. With respect to its 2010 return, the Tax Division granted Taxpayer an extension of time to file its return until August 16, 2010. Taxpayer did not request to extend the due date of its 2010 return to November 15, 2010. Thus, Taxpayer's 2010 return, on which it claimed the credit, and which was filed on October 20, 2010, was filed late.

Based upon the language in the regulation, the Tax Division denied Taxpayer's use of the credit claimed on its 2010 return because the return was not timely filed, and issued an assessment for unpaid tax, plus penalties and interest, due to the disallowance of the credit. In addition, the Tax Division issued a letter stating that Taxpayer could not carry over the credit to subsequent taxable years. Taxpayer paid the assessed amount under protest and filed a refund claim claiming that the credit taken on its 2010 return should be allowed.

## **Holding and Reasoning**

The ALJ held that Taxpayer properly preserved the credit in 2008 and recommended that the credit Taxpayer claimed on its 2010 return credit should be granted. The ALJ reasoned that: (i) the unambiguous language of the statute limits a taxpayer to one election; (ii) Taxpayer met the preservation and election requirements under the statute when it filed the forms 05-172 for each of the six affiliates and the 2008 extension; and (iii) there is no provision in the statute that allows revocation of the credit if it is claimed on a late filed return.

The ALJ further reasoned that its interpretation of Tex. Tax Code § 171.111(a) is consistent with the Comptroller's interpretation of the "old" version of Tex. Tax Code § 171.111(a), which granted a similar credit in relation to a 1991 change in the law resulting in the adoption of the Earned Surplus Tax. The language in the old version of Tex. Tax Code § 171.111(a) is nearly identical to the language in the current version, and, with respect to the old version, the Comptroller issued a Earned Surplus Tax regulation and a Taxability Memorandum in which taxpayers are specifically instructed that the election is a one-time election and not an annual election.<sup>7</sup>

<sup>3</sup> Tex. Tax Code § 171.111(a) ("On the first report originally due under this chapter on or after January 1, 2008, a taxable entity must notify the comptroller in writing of its intent to take a credit in an amount allowed by this section on the tax due on taxable margin.")

<sup>4</sup> Tex. Tax Code § 171.111(a) ("The taxable entity may thereafter elect to claim the credit for the current year and future year at or before the original due date of any report due after January 1, 2008, until the taxable entity revokes the election or this section expires, whichever is earlier. A taxable entity may claim the credit for not more than 20 consecutive privilege periods beginning with the first report originally due under this chapter on or after January 1, 2008.")

<sup>5</sup> Tex. Tax Code § 171.111(a) ("A taxable entity may make only one election under this section and the election may not be conveyed, assigned, or transferred to another entity.")

<sup>6</sup> 34 Tex. Admin. Code § 3.594(e) ("The election to claim the credit shall be made on each report originally due on or after January 1, 2008 and before September 1, 2027. A taxable entity elects the credit by: properly taking the credit on a report filed on or before the original due date; or electing the credit on a timely filed extension request and properly taking the credit on the report filed on or before the extended due date of the report.")

<sup>7</sup> 34 Tex. Admin. Code § 3.559(d)(1); Taxability Memorandum, STAR Accession No. 9109L113A09 (September 25, 1991).

The ALJ rejected the Tax Division's argument that the language in Tex. Tax Code § 171.111(c), which merely allows the Comptroller to request that a taxpayer submit with its return information related to the amount of the credit, also allows the Comptroller to impose a requirement that a taxpayer make an annual election to take the credit.<sup>8</sup> The ALJ reasoned that a plain reading of Tex. Tax Code § 171.111(c) merely authorizes the Comptroller to request information related to the amount of the credit and to construe Tex. Tax Code § 171.111(c) to allow the Comptroller to impose an annual election requirement would put it in "irreconcilable conflict" with a plain reading of Tex. Tax Code § 171.111(a).

### *Similarly Situated Taxpayers*

Based upon correspondence BDO had received in relation to a client, it appears that the Comptroller may be notifying similarly situated taxpayers that it has reversed its policy that each taxable year's return must be timely filed in order to claim the credit for that year and that it will automatically issue refunds with respect to taxable periods open under the four-year statute of limitations.

## BDO INSIGHTS

- ▶ While it appears that the Comptroller may be reviewing its records for similarly situated taxpayers and automatically issuing refunds, rather than wait for correspondence from the Comptroller and risk the lapse of the statute of limitations with respect to a taxable year, taxpayers should consider conducting their own review and taking the appropriate action.
- ▶ The decision may also serve as a reminder to taxpayers that a regulation may not impose requirements or limitations without statutory or other authorization.

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<sup>8</sup> Tex. Tax Code § 171.111(c) ("The comptroller may request that the taxable entity submit, with each annual report in which the taxable entity is eligible to take a credit, information relating to the amount determined under Subsection (b)(1). The taxable entity shall submit in the form and content the comptroller requires any information relating to the amount determined under Subsection (b)(1) or any other matter relevant to the computation of the credit for which the taxable entity is eligible.").

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