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elias lorenzana

Send to: LORENZANA, ELIAS
TEXAS WORKERS COMPENSATION COMMISSION
7551 METRO CENTER DR. STE 100
AUSTIN, TX 78744

14 of 18 DOCUMENTS

NAME: IN RE: * * *

NUMBER: HEARING NO. 41,114

COURT: COMPTROLLER OF PUBLIC ACCOUNTS OF THE STATE OF TEXAS

CITE: 2002 *Tex. Tax LEXIS 54*

DATE: June 28, 2002

PANEL: [*1]

ANNE K. PEREZ, Administrative Law Judge

COUNSEL: ELIAS V. LORENZANA, JR., Representing Administrative Hearings Section

* * *, Representing Petitioner

OPINIONBY: PEREZ

TAXPAYER NO.: * * *

AUDIT OFFICE: * * *

AUDIT PERIOD: 1995 THROUGH 1998

FRANCHISE TAX/RDT

COMPTROLLER'S DECISION

PRELIMINARY DISCUSSION:

At Petitioner's request, the Administrative Law Judge ("ALJ") based this Comptroller's Decision on a review of the parties' written submissions.

The ALJ took official notice of all records of the Comptroller's office that pertain to the Petitioner and the issues involved in the case. Unless otherwise indicated, all Section references are to Title 2, Texas Tax Code Ann. (Vernon 1992). References to Rules are to sections of Title 34, Texas Administrative Code.

PETITIONER'S CONTENTION:

Petitioner contends that the Comptroller should accept its amended 1997 Texas franchise tax report.

FINDINGS OF FACT:

1. * * * ("Petitioner") is a multimedia entertainment retail seller of books, music, software, videos, DVDs, and periodicals. Petitioner maintains its headquarters in * * *, Texas, and operates approximately 140 stores in sixteen states.

2. The Comptroller audited Petitioner [*2] for franchise tax compliance for report years 1995 through 1998. Pursuant to that audit, on February 18, 1999, the Comptroller issued to Petitioner a Texas Notification of Audit Results showing a tax refund/credit due. Petitioner timely requested a redetermination of that audit, resulting in this proceeding.

3. Petitioner filed amended franchise tax returns for the report years 1997, 1998, and 1999. The Comptroller accepted as filed both the 1998 and 1999 amended reports, but declined to accept the 1997 amended report.

4. Petitioner's amended 1997 franchise tax report seeks to correct accounting errors that understated the cost of goods sold. Although the amended report was filed in November 2000, before the expiration of the four-year state statute of limitations for requesting a refund, the Comptroller rejected the report because it was based upon pro forma numbers from an accounting period that ended January 31, 1996.

5. Petitioner's original 1996 federal income tax return Form 1120 was filed in October 1996.

6. Petitioner did not file an amended 1996 federal income tax return Form 1120X by October 15, 1999, when the relevant federal statute of limitations expired. n1 Petitioner's [*3] amended return Form 1120X was not filed with the Internal Revenue Service (IRS) until January 18, 2002. n2

n1 26 U.S.C. § 6511.

n2 A copy of the amended return was included in Petitioner's Reply to the Position Letter, dated January 21, 2002.

CONCLUSIONS OF LAW AND DISCUSSION:

Petitioner's contention should be denied.

Petitioner argues that its amended franchise tax report for 1997 was timely because it was filed within the four-year state statute of limitations for requesting a refund. Petitioner explains that its original 1997 franchise tax report overstated earned surplus due to federal taxable income being overstated. When Petitioner discovered and corrected accounting errors for fiscal year 1996, the corrections resulted in a significant decrease in Petitioner's net income reported for accounting purposes, which also decreased its federal taxable income for 1996. Petitioner's amended 1997 franchise tax report therefore shows a reduction in earned surplus figures. Furthermore, Petitioner argues that it restated its relevant audited financial statements as mandated by the Securities and Exchange Commission (SEC), which is a "competent authority" within Rule 3.544(d). [*4]

The Administrative Hearings Section ("AHS") asserts that the Comptroller properly rejected Petitioner's amended 1997 franchise tax report. The AHS argues that any amendments to a Texas franchise tax report must be based on a final adjustment to the taxpayer's relevant federal income tax return. Here, Petitioner's 1997 amended franchise tax report is based upon pro forma numbers because Petitioner did not file an amended 1996 federal income tax return Form 1120X before the federal statute of limitations expired.

The parties agree that Petitioner's amended 1997 franchise tax report was filed within the four-year statute of limitations set forth in the General Provisions of the Tax Code. n3 However, the AHS insists that Petitioner's amended report cannot be accepted because the earned surplus figures are based on federal taxable income figures that have not been *reported* to the IRS. Put differently, the IRS will not accept Petitioner's amended 1996 federal income tax return Form 1120X because it was filed outside of the three-year federal statute of limitations established by § 6511 of the United States Tax Code. Petitioner responds that Section 171.110, which sets forth the calculation [*5] for earned surplus, does not require IRS verification.

n3 See generally, Sections 111.104, 111.107, 111.201, and 111.203 through 111.207.

Section 171.212(a)(1) of the Texas Tax Code provides that a corporation must file an amended franchise tax report "if the corporation's net taxable earned surplus n4 is changed as the result of an audit or other adjustment by the [IRS] or another competent authority." Section 171.212(b) provides that the amended report must be filed within 120 days after the Revenue Agent's Report (RAR) or other adjustment is final. Under Section 171.212(b), an RAR or other adjustment is final "on the date on which all administrative appeals with the Internal Revenue Service or other competent authority have been exhausted or waived."

n4 In turn, the Tax Code provides that the earned surplus calculation begins with the determination of "reportable federal taxable income." Section 171.110(a)(1).

Rule 3.544(d) also addresses the filing of amended franchise tax reports when a corporation's earned surplus is changed as a result of a final audit/adjustment by the IRS or other competent authority. The Rule provides, in relevant part, as follows:

§ 3.544. Reports [*6] and Payments

* * *

(d) Amended reports . . .

(1) A corporation may file an amended report for the purpose of correcting a mathematical or other error in a report or for the purpose of supporting a claim for refund.

(2) A corporation which has been audited by the Internal Revenue Service must file an amended franchise tax report within 120 days after the Revenue Agent's Report (RAR) is final, if the RAR results in changes to earned surplus amounts reported for franchise tax purposes. An RAR is final when all administrative appeals with the Internal Revenue Service have been exhausted or waived. An administrative appeal with the Internal Revenue Service does not include an action or proceeding in the United States Tax Court or any other federal court.

(3) A corporation whose net taxable earned surplus is changed as a result of an audit or other adjustment by a competent authority other than the Internal Revenue Service must file an amended franchise tax report within 120 days after the adjustment is final. An adjustment is final when all administrative or other appeals have been exhausted or waived. For the purposes of this section, a competent authority includes, but is not limited [*7] to, the United States Tax Court, United States District Courts, United States Courts of Appeals, and United States Supreme Court.

(4) A corporation must file an amended franchise tax report within 120 days after the corporation files an amended federal income tax return that changes the corporation's net taxable earned surplus. A corporation is considered to have filed an amended federal income tax return if the corporation is a member of an affiliated group during a period in which an amended consolidated federal income tax return is filed.

* * *

Section 171.212 requires a taxpayer to amend its franchise tax report when its earned surplus component has changed as a result of an IRS audit, or an adjustment by the IRS (e.g., an amended federal tax return) or "other competent authority." The Comptroller has interpreted the phrase "other competent authority" to include the United States Tax Court, United States District Courts, United States Courts of Appeals, and the United States Supreme Court. Rule 3.544(d)(3). While this list is not intended to be exhaustive, it is clear that "other competent authority" has been interpreted to include only bodies with adjudicative authority to [*8] rule upon federal income tax matters.

Moreover, it makes good policy sense to allow the amendment of franchise tax reports only when such amendments are consistent with federal taxable income figures that have actually been *reported to* and *accepted by* the IRS. This requirement allows smoother administration of the franchise tax because federal taxable income figures are easily verifiable. It also discourages underreporting because the requirement is part of a larger system of checks and balances.

In summary, because Petitioner's amended 1996 federal income tax return Form 1120X was filed after the federal statute of limitations expired, the IRS does not recognize Petitioner's amended federal taxable income figures. Petitioner's net taxable earned surplus has therefore not changed "as the result of an audit by the [IRS] or another competent authority" for purposes of Section 171.212(a)(1). Petitioner should not be allowed to amend its 1997 franchise tax report.

RECOMMENDATION:

Based upon the findings of fact, conclusions of law, and discussion contained herein, the ALJ recommends that the audit results remain unchanged.

SIGNED June 28, 2002.

ORDER OF THE COMPTROLLER [*9]

The above decision of the Administrative Law Judge is approved and adopted in all respects. This decision becomes final twenty-three (23) days from the date of this Order.

If a rehearing is desired, a Motion for Rehearing must be filed with the Administrative Law Judge no later than twenty-three (23) days after the date of this Order, and must state the grounds upon which the motion is based.

RENDERED and ISSUED June 28, 2002.

CAROLE KEETON RYLANDER, Comptroller of Public Accounts of the State of Texas

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