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8 of 18 DOCUMENTS

**NAME:** IN RE: \* \* \*

**NUMBER:** HEARING NO. 41,192

**COURT:** COMPTROLLER OF PUBLIC ACCOUNTS OF THE STATE OF TEXAS

**CITE:** 2003 Tex. Tax LEXIS 83

**DATE:** May 22, 2003

**PANEL:** [\*1]

ELIZABETH WILSON DAVIS, Administrative Law Judge

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

\* \* \*, Representing Claimant

**OPINIONBY:** DAVIS

TAXPAYER NO: \* \* \*

AUDIT OFFICE: \* \* \*

AUDIT PERIOD: 1992 THROUGH 1995

FRANCHISE TAX/RFD

**COMPTROLLER'S DECISION**

**PRELIMINARY DISCUSSION:**

At Claimant'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 Claimant and the issues involved in the case. Unless otherwise indicated, all Section references are to Title 2, Texas Tax Code Ann. (Vernon 2002). References to Rules are to sections of Title 34, Texas Administrative Code.

On March 14, 2003, the Claimant filed Exceptions to the February 27, 2003 Proposed Comptroller's Decision. The Administrative Hearings Section ("AHS") filed its Response to these Exceptions on March 28, 2003. The ALJ and the Comptroller have considered the Claimant's Exceptions and the AHS's Response, and this Comptroller's Decision represents the ruling thereon.

**CONTENTION OF CLAIMANT:**

Claimant contends that its business [\*2] loss carry-forward was improperly applied.

**FINDINGS OF FACT:**

Each party submitted Proposed Finding of Facts. The following Findings of Fact represent the ALJ's ruling on those Proposed Findings of Fact:

1. This is a refund hearing on the former administrative redetermination that was the subject of Comptroller Hearing No. 37,092. On January 5, 2001, the Comptroller by Order of the ALJ denied Claimant's second motion for rehearing and made final the Comptroller's Decision Upon Rehearing, signed on November 6, 2000. Claimant timely filed a refund claim on July 5, 2001.

2. The Findings Of Fact in Comptroller's Decision Upon Rehearing in Hearing No. 37,092 were as follows:

(1) Petitioner was audited for franchise tax compliance for the audit period consisting of the report years 1992 through 1995. As a result of the audit, the Comptroller issued a Texas Notification of Audit Results dated March 17, 1997, in the amount of . . . , including tax, penalty, and interest calculated through the date of the Notification.

(2) On August 8, 1997, an Amended Texas Notification of Audit Results was issued. The Notification covered the same audit period as the Notification of March [\*3] 17, 1997. The amendment consisted of deleting earned surplus throwback sales for which the [AHS] determined there is nexus. The Notification resulted in a credit in the amount of . . . .

(3) On September 18, 1997, n1 Petitioner filed a petition for redetermination of the Texas Franchise Tax audit in response to the amended audit. Petitioner contended that (a) penalty should be waived for the 1993 report period, and (b) additional sales thrown back to Texas gross receipts should be deleted. In subsequent pleadings Petitioner added Contention Number Two regarding Comptroller's Rule 3.55 [3.555] (g)(2).

(4) The business loss in the amount of \$ \* \* \* (reported on Schedule A, Line 23 of Petitioner's Franchise Tax Return) was applied (see Schedule A, Line 25) to the extent of Petitioner's apportioned earned surplus (\$ \* \* \*) in report year 1994 and the remainder (\$ \* \* \*) to report year 1995.

3. Other than the agreed stipulations, the ALJ denied Claimant's additional claimed credits in Contentions One and Two in Hearing No. 37,092. In Contention Two, the taxpayer contended that Rule 3.555 (g)(2) conflicts with Section 171.110(e) to unfairly deny Claimant the benefit of its losses [\*4] incurred within the five-year period provided for by the statute.

4. *Schedule AR* and *Schedule A* of the amended audit report and the original audit report, respectively, show that the Comptroller applied Claimant's business loss carry-forward for the report years 1994 and 1995 to the extent of Claimant's taxable earned surplus.

5. Schedule AR of the amended audit report shows Claimant's Apportioned Earned Surplus for the report years 1994 and 1995 to be \$ \* \* \* (1994), and \$ \* \* \* (1995), respectively.

6. Schedule AR of the 2nd Amended Audit Report shows Claimant's Apportioned Earned Surplus for the report years 1994 and 1995 to be \$ \* \* \* and \$ \* \* \*, respectively.

7. The Comptroller applied Claimant's business loss carry-forward for the report year 1994 up to and to the extent of its Apportioned Earned Surplus of \$ \* \* \* (Claimant's apportioned earned surplus -- *Schedule AR of 2nd Amended Audit Report*), and then carried over the remainder of the business loss carry-forward of \$ \* \* \* (*Schedule AR of 2nd Amended Audit Report*) to the following report year 1995.

8. Claimant's audited taxable capital for report year 1994 was \$ \* \* \*, and for report year 1995 [\*5] was \$ \* \* \*.

n1 **The correct filing date, as pointed out in Claimant's Exceptions, was September 8, 1997.**

#### **CONCLUSIONS OF LAW AND DISCUSSION:**

Claimant's contention should be denied.

Claimant contends that its business loss carry-forward was improperly applied. Claimant seeks to have the business loss carry-forward applied to report year 1994 limited to \$ \* \* \* and the remainder of the business loss carry-forward in the amount of \$ \* \* \* carried forward and applied to report year 1995, in addition to the \$ \* \* \* currently applied.

Claimant argues that the Comptroller's interpretation of § 171.110(e) in Rule 3.555(g) is unreasonable and inconsistent with the statute because applying the business loss carry-forward in subsequent years when the surtax is already zero generates negative surtax. It argues that the Comptroller's interpretation cannot create a negative tax.

The AHS takes the position that Rule 3.555(g) is a reasonable interpretation and application of the statute. The AHS's arguments are summarized in the statement taken from its pleadings:

Rule 3.555 represents the Comptroller's interpretation and implementation of Section 171.110(e). The rule does not [\*6] conflict with the statute as Petitioner would argue, but rather it is a reasonable interpretation given the nature of the Texas franchise tax. Without citing authority, Petitioner argues that the Comptroller's application of the business loss and interpretation of the Section 171.110(e) is outside her scope of authority. In Petitioner's opinion, such application would be to maximize the taxpayer's benefit, even if not applying the losses to the extent of apportioned taxable earned surplus in a succeeding taxable year. Petitioner argues that under the statute". . . *the business loss be applied successively, but does not state that the net taxable earned surplus must be zeroed out each year before any amount can be carried over to the following year.* . . .

Section 171.110(e) provides that the business loss shall be carried forward to the year succeeding the loss year as a deduction to net taxable earned surplus, then successively to the succeeding four taxable years after the loss year or until the loss is exhausted, whichever occurs first, but for not more than five taxable years after the loss. [Emphasis added.] The Comptroller's interpretation of this statutory provision under [\*7] Rule 3.555(g) is that a business loss which is carried forward to a report year must be deducted from apportioned plus allocated taxable earned surplus after any allowable deductions for enterprise zone projects or solar energy devices (net taxable earned surplus), and that a business loss which is carried forward to a successive year must be applied to the extent of apportioned plus allocated taxable earned surplus (net taxable earned surplus) in that succeeding year. The plain meaning of the statute requires that the business loss "shall" be carried forward as a deduction to net taxable earned surplus for each successive year until the loss is exhausted. It is only reasonable to apply the loss to the extent of the apportioned taxable earned surplus after exhausting each successive year's taxable earned surplus until the loss is fully applied and exhausted. This regulatory provision in Rule 3.555(g) is a reasonable interpretation and application of the statute, and the Comptroller applied Petitioner's business loss carried forward as dictated by the statute and by the regulatory provisions. As was stated in the prior decision, "*It is difficult to envision how the rule deviates [\*8] from the purpose of the statute.*" The issue has already been decided.

Claimant's contention was previously considered and denied in the Comptroller's Decision Upon Rehearing in Hearing No. 37,092. Set out below is the ALJ's discussion on this issue:

Petitioner seeks to invalidate a Comptroller's rule. It is a well-settled principle in administrative law that deference is due to the Comptroller's regulatory interpretation. Such deference is discarded if the rule is unreasonable or inconsistent with the statute. I agree with the Administrative Hearings Section that Petitioner fails to present a convincing factual or legal case in support of such drastic action.

The applicable statutory provision is Section 171.110(e) that reads in relevant part as follows:

(e) For purposes of this section, a business loss is any negative amount after apportionment and allocation. The business loss shall be carried forward to the year succeeding the loss year as a deduction to net taxable earned surplus, then successively to the succeeding four taxable years after the loss year or until the loss is exhausted, whichever occurs first, but for not more than five taxable years after the loss year. [\*9] Notwithstanding the preceding sentence, a business loss from a tax year that ends before January 1, 1991, may not be used to reduce net taxable earned surplus. n2

Comptroller's Rule 3.55 [3.555] represents the Comptroller's interpretation and implementation of Section 171.110(e). Comptroller's Rule 3.55 [3.555] includes the following language that Petitioner argues is inconsistent with Section 171.110(e):

Subsection (g)(2) with respect to franchise tax reports originally due after January 1, 1992:

(2) A business loss which is carried forward to a successive year must be applied to the extent of apportioned taxable earned surplus in that succeeding year.

The disputed regulatory provision represents a reasonable interpretation and implementation of the statute. The rule governs how the carryover authorized by the statute shall be used year by year. It is difficult to envision how the rule deviates from the purpose of the statute.

n2 A fourth sentence was added to subsection (e) effective September 1, 2001, but is not applicable under the facts in this hearing.

...

The ALJ concludes that Comptroller's holding in Hearing No. 37,092 is correct and must be followed in [\*10] this refund hearing for the same audit period. As clearly provided in § 171.110(e), the "business loss shall be carried forward to the year succeeding the loss as a deduction to net taxable earned surplus, then successively to the succeeding four taxable years after the loss or until the loss is exhausted, whichever occurs first. . . ." Claimant's contention is not supported by the language of the statute or by the language of Rule 3.555(g)(2).

Thus, the ALJ concludes that Claimant's business loss carry-forward was correctly applied under the provisions of § 171.110(e) and Rule 3.555(g)(2).

**RECOMMENDATION:**

Based upon the findings of fact, conclusions of law, and discussion contained herein, the ALJ recommends that Claimant's refund claim be denied.

SIGNED May 22, 2003.

**ORDER OF THE COMPTROLLER**

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 [\*11] motion is based.

RENDERED and ISSUED May 22, 2003.

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

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