



Credit Where Due? Recent Policy Change May Affect Texas Tax Refund Claims

Companies that have previously had Texas margin tax business loss carryover (“BLC”) credits denied by the Comptroller should examine whether a recent policy change opens the door to recovering those credits for all years for which limitations remains open. A recent Comptroller hearing concluded that the Comptroller’s expansive interpretation of the requirements for claiming BLC credits is not supported by statute, resulting in a refund for previously denied credits.

In 2007, when Texas transitioned from the prior franchise tax based on earned surplus to the current margin-based tax, the legislature enacted a temporary credit on taxable margin. See Texas Tax Code § 171.111 (eff. Jan. 1, 2008). Taxable entities that had unexpired business loss carryforwards (generally net operating losses apportioned to Texas) recognized under the prior franchise tax could elect to apply the loss carryforwards as a credit against the ensuing 20 consecutive years of margin tax reports. To preserve the credit, companies were required to take certain steps in the first margin tax year, and thereafter, companies could elect (for the current year and future years) to claim the credit on any margin tax return.¹

By policy, however, the Comptroller had developed a number of additional limitations on using the credit.

For example, the Comptroller has denied BLC credits due to failure to file a return by the original due date (even though the company had previously timely elected to claim the credit on a prior return). The Comptroller has denied BLC credits due to failure to make a sufficient extension payment to qualify for an extension. The Comptroller has denied BLC credits even when the taxpayer paid the tax in full on the due date for making the payment if the taxpayer happened to use the TEXNET payment system in which the electronic payment did not settle until the following day. The Comptroller has denied BLC credits for failure to re-notify the Comptroller of the company’s intent to claim the credit on the extension request each tax year. Even when a timely extension request was filed, and 100 percent of the tax was timely and fully paid, the Comptroller has denied the credits for failure to pay via electronic funds transfer and in some cases when the taxpayer failed to file a second extension request in August, even if the company timely filed its return by the normal extended due date of November 15.

The Comptroller has denied the use of significant BLC credits due to these varying, confusing, formulaistic limitations. In some cases, the Comptroller not only denied the use of the credit for the year when some alleged requirement was not met but also asserted

that the credit carryforward was lost for all future years. In many cases, these lost credits totaled hundreds of thousands of dollars (each year).

The Comptroller recently reexamined the policy on use of the BLC credit in the context of a hearing and found that the Comptroller's prior expansive interpretation of the requirements for claiming BLC credits is not supported by statute. See Comptroller Hearing No. 110,191, STAR 201506219H (June 2015). The hearing concluded that Texas Tax Code § 171.111 sets forth only two requirements for taking the credit as described above. The additional requirements for claiming the credit each year as articulated in Comptroller Rule 3.594(e)(1)-(2) exceeded the statute. There is no statutory requirement that revokes the credit if it is not taken annually on a timely filed report. Noting that agency interpretations cannot impose restrictions in excess of statutory provisions, the taxpayer was entitled to the refund resulting from the previously denied BLC credit on its return.

Under the revised policy, many BLC credits that were previously denied by the Comptroller should now be allowed. The policy change is not prospective only. All years that are open under the applicable statute of limitations are eligible for review.² Many companies have already recovered refunds attributable to prior years where the BLC credits were originally denied. All companies that have had BLC credits disallowed in prior periods should carefully examine whether it is advisable to file refund claims to recover those lost BLC credits.

Lawyer Contacts

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com/contactus/.

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Endnotes

- 1 Texas Tax Code § 171.111 sets forth two requirements that must be met to claim the credit: (i) on the first report originally due after the effective date for the margin tax, a taxable entity had to notify the Comptroller in writing of its intent to claim the credit; and (ii) the taxable entity had to elect thereafter to claim the credit for the current year and any future year at or before the original due date for any report.
- 2 We note that there have been other, taxpayer-favorable, recent changes to the Comptroller's policy on BLC credits. Texas Tax Code § 171.111(d) provides that a taxable entity loses the right to claim the credit if the entity changes combined groups. The Comptroller previously interpreted that to mean a change in the identity of the common owner of a combined group resulted in every member of the combined group losing its BLC credit. That policy was reconsidered and changed such that except in the case of the creation of a new combined group, only the entity leaving or joining a combined group loses that entity's BLC credit. See Comptroller Taxability Memo STAR No. 201404878L (April 2014). The policy was further clarified by noting that the acquisition of an existing combined group by a newly formed entity will not always result in a change in the combined group for the existing members (however, if an existing entity with a BLC credit acquires a combined group with members who also have a BLC credit, the acquirer may lose its BLC credit, but the other members of the existing combined group should not). See Comptroller Taxability Memo STAR No. 201411985L (November 2014). These favorable changes in Comptroller policy are also not prospective only—these changes could also support refund claims for prior, open years.