

Sales Tax 2016 Year-in-Review TX, OK, LA, NM

November 16, 2016



Texas: Processing/Manufacturing Exemptions



- Southwest Royalties, 2016 WL 3382151 (Tex. 2016)
 - ❑ Was Southwest Royalties' purchases of casing and tubing entitled to the Texas sales tax exemption for being used in processing or manufacturing of tangible personal property?
 - ❑ Southwest Royalties is an oil and gas exploration and production company. They filed claims for refund of sales tax it paid for casing, tubing, and related equipment it used to extract oil and gas from the underground as exempt manufacturing equipment pursuant to **Tex. Tax Code § 151.318**.
 - ❑ The casing was used to line the well borehole to prevent environmental harm. The tubing was used to pump water into the bottom of the well in order to drive oil to the surface.

Texas: Processing/Manufacturing Exemptions



➤ Tex. Tax Code § 151.318(a) exempts:

- ❑ (2) **tangible personal property directly used or consumed in or during the actual manufacturing, processing, or fabrication of tangible personal property** for ultimate sale if the use or consumption of the property is necessary or essential to the manufacturing, processing, or fabrication operation and directly makes or causes a chemical or physical change to
 - (A) The product being manufactured, processed or fabricated for ultimate sale; or
 - (B) Any intermediate or preliminary product that will become an ingredient or component part of the product being manufactured, processed, or fabricate for ultimate sale.
- ❑ (5) **tangible personal property** used or consumed in the actual manufacturing, processing, or fabrication of tangible personal property for ultimate sale if the use or consumption of the property is **necessary and essential to a pollution control process**;
- ❑ (10) **tangible personal property** used or consumed in the actual manufacturing, processing, or fabrication of tangible personal property for ultimate sale if the use or consumption of the property is necessary and essential to comply with federal, state, or local laws or rules that establish requirements **related to public health**.

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Texas: Processing/Manufacturing Exemptions



➤ Southwest Royalties, 2016 WL 3382151 (Tex. 2016)

- ❑ Southwest Royalties does not qualify for the exemption because its equipment is not directly used in the processing of oil and gas.
- ❑ Court focused on theoretical possibility that oil and gas could be pumped without equipment claimed for exemption if the perfect conditions existed underground.
- ❑ Court did not care that the casing and tubing are required, not only to create and maintain pressure, but also to comply with environmental regulations
- ❑ Court ruled against claim that equipment qualifies under § 151.318(a)(2).
- ❑ Court did not consider claims under § 151.318(a)(5) or (10), leaving the issues unresolved.

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Texas: Services Taxable



➤ Checkfree Services Corporation

- ❑ Checkfree contracted with several banks to provide bill pay services through these banks' on-line banking services to the banks' customers.
- ❑ Comptroller assessed through audit sales tax on its sales of these services determining Checkfree engaged in providing taxable **data processing services**.
- ❑ Checkfree paid the \$3 million assessment following the audit and subsequently challenged the auditor's determination through administrative proceedings, but was unsuccessful.
- ❑ Checkfree filed suit against the Comptroller, seeking a refund of the \$3 million it paid.

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Texas: Services Taxable



- Tex. Tax Code § 151.0101(a)(12) enumerates as a taxable service "data processing" services .
- Tex. Tax Code § 151.0035 defines "data processing service" to include
 - ❑ Word processing, data entry, data retrieval, data search, information compilation, payroll and business accounting data production, the performance of a totalisator service with the use of computational equipment required by the Texas Racing Act, and *other computerized data and information storage or manipulation*. Also includes the use of a computer or computer time for data processing whether the processing is performed by the provider of the computer or computer time or by the purchaser or other beneficiary of the service.
- Tex. Tax Code § 151.351 provides a 20% exemption for data processing & information services.

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Texas: Services Taxable



- 34 Tex. Admin. Code § 3.330(a)(1) provides:
 - ❑ Data processing services—the processing of information for the purpose of compiling and producing records of transactions, maintaining information, and entering and retrieving information. It specifically includes word processing, payroll and business accounting, and computerized data and information storage or manipulation.
 - ❑ The charge for data processing services is taxable regardless of the ownership of the computer.
 - ❑ Examples of data processing services include entering inventory control data for a company, maintaining records of employee work time, filing payroll tax returns, preparing W-2 forms, and computing and preparing payroll checks.
- Tex. Tax Code § 151.351 provides a 20% exemption for data processing & information services.

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Texas: Services Taxable



- CheckFree Services Corporation
 - ❑ Trial Court signed a judgement in favor of CheckFree ordering Comptroller to refund CheckFree the \$3 million in sales and use tax paid plus credit interest.
 - ❑ Comptroller timely noticed its appeal of the trial court's judgement.
 - ❑ Comptroller had only one sole issue: whether the trial court erred in determining that the services CheckFree provided were not taxable data processing services.

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Texas: Services Taxable



CheckFree Services Corporation

- ❑ Comptroller would have court ignore trial court's factual findings and conclude that, because the users of the bill pay service input data into CheckFree's system, which CheckFree relied on to ultimately pay their bills, CheckFree was selling taxable data processing services to the banks.
- ❑ Court determined it must defer to the trial court's unchallenged fact findings regarding the nature of the activities in this case

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Texas: Services Taxable



CheckFree Services Corporation

- Court ruled that trial court's findings establish that CheckFree provides a professional services – facilitated by the use of computers and an electronic commerce system – that requires the oversight and management of thousands of certified specialists to achieve the goal of paying the bills of the banks' customers.

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Texas: Sale for Resale



Fitness International v. Hegar, June 2016

- Third Court of Appeals denied part of Fitness International's refund claim for alleged overpayment of sales taxes for certain items it purchased for use by its health club members.
- Under Texas law, taxpayers who purchase items under the "Sale for Resale" exemption are entitled to a refund of taxes paid in error on purchases that qualify.
- Did Fitness purchase the items at issue (1) for the purpose of "reselling" or "transferring" them to its members or (2) as an integral part of taxable service?

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Texas: Sale for Resale



Fitness International v. Hegar, June 2016

- Court examined the statutory text establishing the exemption that Fitness claimed and determined that there is no reasonable conclusion that "Fitness purchased the exercise equipment and other items at issue for the purpose of (1) reselling them, (2) transferring (i.e., legally conveying) them, (3) transferring legal possession of them, or (4) offering them for lease or rental."
- The Texas Court of Appeals disagreed with the taxpayer in this case and ruled in favor of the Comptroller.

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Texas: Temporary Employment Services



- Allstate Insurance Co. V. Hegar, 03-13-00341-CV (Tex. App. Dist. 3 02/18/2016)
- Third Court of Appeals did not agree with the Comptroller's reading of the sales tax exclusion.
- Comptroller argued that temporary employment services do not include services provided:
 - Under long-term umbrella or needs contracts;
 - To an employer who understaffs its workforce; or
 - Under contracts in which the temporary employees are independent contractors.

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Texas: Temporary Employment Services



- Exclusion is in Tex. Tax Code § 151.057 and applies if:
 - The service supplements a customer's existing work force on a temporary basis;
 - The service provider is a temporary employment service as defined in Labor Code Sec. 93.001;
 - The service is one that is usually performed by the customer's employees;
 - The temporary employee is under the direct or general supervision of the customer; and
 - The customer provides all supplies and equipment necessary.

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Texas: Temporary Employment Services



- Allstate entered into an “umbrella agreement” with Pilot Catastrophe Services, Inc. (“Pilot”) to provide Allstate the services of adjusters upon request.
- Allstate was not obligated to pay Pilot unless Allstate needed and Pilot provided adjusters.
- Allstate employed adjusters, who were assigned to local offices based on the number of policies in a region and on actuarial information. When there was a catastrophe that resulted in large claims, Allstate assigned the claims to its “National Catastrophe Team.”
- When the event required additional adjusters, Allstate called Pilot to provide adjusters until Allstate had worked through the claims.

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Texas: Frac Trailer Leases Not Subject to Tax



- Leases of frac trailers in Texas are not subject to tax if trailers are designed to carry separate property
- Decision found that a frac trailer is not specialized equipment subject to sales and use tax and determined that the frac trailers were “motor vehicles.”
- Texas imposes sales tax on leases of specialized equipment.
- No tax is due on leases—agreements for more than 180 days—of motor vehicles, including trailers.
- No tax is due on charges for labor to repair, maintain, or restore motor vehicles (including trailers), but tax is due on charges to maintain, restore, or repair specialized equipment.

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Texas: Frac Trailer Leases Not Subject to Tax



- ALJ determined that the frac trailers were not specialized equipment but were trailers because the frac trailers were designed to also carry separate property in addition to performing hydraulic fracturing.
 - ❑ Trailers included fuel tanks and racks to carry high-pressure iron and discharge hoses.
- Comptroller cited 2006 Texas administrative hearings decisions 41,202 and 42,326, arguing that the frac trailers were not motor vehicles because their “primary” function was not to transport separate property on the highway.
- ALJ rejected Comptroller’s argument and reminded staff that neither the law nor the Comptroller’s regulation regarding specialized equipment (34 TAC 3.88) included this requirement.

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Oklahoma: Sales Tax Rate Increase



- Oklahoma Rejects Ballot Initiative to Raise Sales Tax
 - ❑ On November 8th, Voters rejected State Question No. 779 by almost a 20 point margin.
 - ❑ Measure would have increased the state sales and use tax rate from 4.5% to 5.5%, with the additional revenue dedicated to increase spending on education.
 - ❑ Interestingly, state Senator Kyle Loveless included in an editorial opposing the measure concerns about how local government might be constrained (with the change, local and state combined sales tax rates would near or exceed 10% in certain jurisdictions).
 - ❑ 69.5% of the revenues were to be allocated to common education and among these revenues 86 1/3% were to go to raising teacher salaries.

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Oklahoma: Reduced Period for Filing Sales & Use Tax Refund Claims



- On June 6, 2016, Governor Mary Felling signed HB 3205 which in part reduced the period for filing a sales and use tax refund claim from three years to two years.
- Any taxpayer that has erroneously paid Oklahoma sales or use tax may file a claim for refund within two years of the date of the payment of the tax.
- The Oklahoma Tax Commission (OTC) may accept amended sales or use tax report or return as a verified claim for refund if either establishes a liability less than what was provided on the original report or return.
- Effective date of this reduced statute of limitations period is August 25, 2016.

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Louisiana: Manufacturing Exemption



Bridges v. Nelson Industrial Steam Co., 190 So.3d 276 (La. 5/3/16) (the "*NISCO decision*")

- Issue: Whether the purchase of limestone to comply with environmental regulations is exempt from sales tax on the basis that it is used for the manufacture of ask.
- Facts: NISCO is an electric power generating facility in Louisiana. In order to comply with environmental regulations, Nelson is required to add limestone to the petcoke fuel that runs the generators.
- The cost of the limestone was \$46 million.

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Louisiana: Manufacturing Exemption



The NISCO decision

- The petcoke and limestone react with one another and create ash, which NISCO sells for \$6.8 million per year.
- The Louisiana Department of Revenue argued that the main purpose of the limestone was for complying with environmental protection laws, not generating ash.
- Otherwise, NISCO could be operating at a \$39 million loss.
- Louisiana law exempts from its sales tax “sales of materials for further processing into articles of tangible personal property.”

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Louisiana: Manufacturing Exemption



The NISCO decision

- Holding: NISCO does not need to pay sales tax on the purchase of limestone because it is used for processing ash.
- The Supreme Court reasoned that there was nothing in the exemption that required the end product to be the enterprise’s primary product. The Supreme Court did not care that NISCO was selling the ash at a loss.
- One dissenting justice wrote the this opinion opened a door to “creative sales” in order for businesses to start claiming the processing exemption for every purchase of raw material that is not otherwise exempt.

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New Mexico: Gross Receipts Tax Deduction Disallowed



Hearing No. 16-42, August 17, 2016

- Taxpayer, Weil Construction, Inc., is engaged in the construction business in New Mexico.
- Taxpayer filed an application for refund of gross receipts tax for the periods of October 1, 2012 through December 31, 2013.
- Taxpayer was involved in a construction project for Sante Fe County, building a new fire station for the city of Edgewood.
- Taxpayer issued Type 6 nontaxable transaction certificates (NTTCs) to its vendors for items that were included in the construction project.

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New Mexico: Gross Receipts Tax Deduction Disallowed



Hearing No. 16-42, August 17, 2016

- Taxpayer sought refund on gross receipts tax paid on items of tangible personal property incorporated into the fire station that could be classified as depreciable property.
- Taxpayer determined some of the items it incorporated into the fire station could be deemed depreciable property under Section 168 of the Internal Revenue Code and in an effort to reduce the county's expenses related to this project filed claims.

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New Mexico: Gross Receipts Tax Deduction Disallowed



Hearing No. 16-42, August 17, 2016

- The Department granted a partial refund, but the majority of the refund request remains outstanding.
- The portion of the refund that was granted was for items easily removed from the fire station and not permanently affixed, such as window treatments, appliances and fire extinguishers.
- Remaining items including cabinets, countertops, flooring, piping and ventilation were denied because they are permanent structural components of the building or permanently affixed.

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New Mexico: Gross Receipts Tax Deduction Disallowed



Hearing No. 16-42, August 17, 2016

- Taxpayer argued that the depreciable property is tangible personal property sold to a government agency and should be deductible.
- Department argued mainly that the receipts from performing a construction project for a governmental agency ***are receipts derived from performing a service*** and are not deductible. NMAC Regulation 3.2.212.10.
- Receipts from the sale of construction materials to government agencies are not deductible, and construction materials include any items incorporated into a construction project.

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