

Income/Franchise:

Texas: Appellate Court Says Company Qualified for Reduced Rate and Cost of Goods Sold Deduction

Case No. 14-19-00358-CV, Tex. Ct. App. (8/31/21). Contrary to assertions made by the Texas Comptroller of Public Accounts, a Texas Court of Appeals (Court) affirmed that a company engaged in the retail and wholesale distribution of printing and publishing systems, including selling various types of business equipment through the use of certain finance lease contracts (*i.e.*, “sales-type leases”) i) qualified for the reduced Texas franchise tax rate (0.5%) applicable to entities primarily engaged in retail or wholesale trade for the 2008 and 2009 report years at issue; and ii) may include costs related to the sales-type leases in its Texas franchise tax cost of goods sold (COGS) deduction. In doing so, the Court examined the substance of the sales-type leases rather than their form and agreed with the trial court that they constituted “wholesale trade” under Texas Tax Code section 171.0001(18), thus allowing the company to meet the requisite threshold for being “primarily engaged” in wholesale trade under Texas Tax Code section 171.002(c) for the periods at issue. The Court explained that, based on the underlying facts, the trial court did not err in concluding that it was proper to classify the revenue from the company’s sales-type leases under Financial Accounting Standard No. 13 (“FAS 13”) as revenue from sales falling within the scope of wholesale trade. Regarding the COGS deduction, the Court agreed with the trial court that the property leased under the company’s sales-type leases may be considered “sold” under the ordinary meaning of sold as used in Texas Tax Code section 171.1012(a)(1) utilizing similar “substance over form” analysis, thus allowing the company to include the costs related to the sales-type leases in its COGS deduction. Under the facts, the lease terms of the company’s sales-type leases generally were for the entirety of the economic life of the leased equipment. In reaching its conclusions, the Court also reasoned that the ordinary meaning of “selling,” “sold,” or “sale” does not require the transfer or passage of title, but it does require the transfer of the item being sold. Please contact us with any questions.

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