

Income/Franchise:

Texas: Taxpayer Must Exclude Gross Receipts from Hedging Transactions from Apportionment Factor

Accession No. 202202020H, Texas Comptroller of Public Accounts (2/25/22). The Texas Comptroller of Public Accounts (Comptroller) held that a company failed to demonstrate, by a preponderance of the evidence, that the gross proceeds from certain hedging transactions were received from securities treated as “inventory” for federal income tax purposes and thus was only permitted to include the net proceeds, rather than gross proceeds, from such hedging transactions in calculating its Texas franchise tax apportionment factor. Under the facts, for each Texas franchise tax report year at issue, the taxpayer elected “mark-to-market” treatment under Internal Revenue Code (IRC) section 475(f) for the securities at issue; the taxpayer reported the gains from hedging transactions as capital gains and losses as costs of goods sold on its corresponding federal income tax returns. Examining these facts, the Comptroller reasoned that the exception for securities held as inventory found in Texas Tax Code § 171.106(f) applies only to those securities and loans for which a taxable entity is required or elects treatment under IRC section 475(a)(1) (*i.e.*, securities in the inventory of a securities dealer), or generally accounts for such security as inventory under IRC section 471. The Comptroller noted that, under federal law, traders who elect mark-to-market treatment are required to recognize gains or losses on any security held in connection with its business at the close of any taxable year as if such security were sold for its fair market value. Because such traders do not have “inventory” for federal purposes, the Comptroller reasoned that this treatment is identical to the treatment of securities held by a dealer that are *not* held as inventory. In this respect, the Comptroller concluded that the Texas franchise tax exception for securities held as inventory generally does *not* apply to securities or loans for which an election is made under IRC section 475(f). Please contact us with any questions.

[URL: https://star.comptroller.texas.gov/view/202202020H](https://star.comptroller.texas.gov/view/202202020H)

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