GRAPHIC PACKAGING CORPORATION V. HEGAR: TEXAS' SINGLE-FACTOR FRANCHISE TAX APPORTIONMENT REMAINS MANDATORY

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The Texas Supreme Court recently held that taxpayers may not use the Multistate Tax Compact's three-factor formula to apportion their Texas franchise tax base — i.e., their "margin" — in calculating their Texas franchise tax liability. In its decision in *Graphic Packaging Corporation v. Hegar*, No. 15-0669, 2017 WL 6544951 (Tex. Dec. 22, 2017), the court concluded that Graphic Packaging was required to apportion its margin to Texas using the single-factor apportionment formula set forth in Chapter 171 of the Texas Tax Code.

The Compact — which is codified in Chapter 141 of the Texas Tax Code — provides an election to apportion certain income taxes using a three-factor formula based on a taxpayer's sales, property, and payroll. For many taxpayers, including Graphic Packaging, the option to use a three-factor apportionment formula instead of the Texas franchise tax's single-factor formula would have resulted in significant tax savings. The Texas Supreme Court, however, determined that reading the Compact to provide an alternative apportionment election for Texas franchise tax purposes "creates an irreconcilable conflict" with Section 171.106 of the Texas Tax Code, which requires single-factor apportionment without reference to the Compact. Citing statutory construction rules applicable to conflicting statutes, the court then concluded that the Section 171.106 apportionment provision "continues to provide the exclusive formula for apportioning the franchise tax and, by its terms, precludes the taxpayer from using the Compact's three-factor formula." The court of appeals' opinion giving rise to Graphic Packaging's Texas Supreme Court appeal held that the three-factor formula was not available to Graphic Packaging in part because the franchise tax is not an "income tax" within the meaning of the Compact; however, the Texas Supreme Court expressly declined to address whether the Texas franchise tax is an "income tax" as defined in the Compact.

The court determined that the Compact is not a binding reciprocal agreement under which Texas has surrendered its sovereign tax powers. The court concluded that the Compact does not include features that the United States Supreme Court has indicated are generally shared by binding regulatory compacts, "such as: (1) the establishment of a joint regulatory body; (2) state enactments that require reciprocal action to be effective; and (3) the prohibition of unilateral repeal or modification of their terms." The court also concluded that the Compact did not include language pursuant to which Texas would have unmistakably surrendered its sovereign tax power and that determining Texas has nevertheless surrendered such power by virtue of having adopted the Compact could violate the Texas Constitution.

Taxpayers with pending refund claims or audit disputes involving the Compact's election should carefully analyze their own positions and be prepared to decide how to proceed in the coming months. Certain taxpayers that have

taken a franchise tax filing position based on the Compact's election and have not been contacted by the Comptroller's office regarding an audit or investigation may want to consider whether they are eligible to request a voluntary disclosure agreement with the Comptroller. Such agreements may offer benefits, such as interest and penalty waiver and limited lookback periods, for taxpayers wishing to voluntarily disclose past liabilities.

Taxpayers may also want to look into the Comptroller's recently announced tax amnesty program. Although the Comptroller's office has not yet released many details about the program, the agency has confirmed that the program will be available from May 1, 2018, through June 29, 2018.

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