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GA. TAX TRIBUNAL

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Yvonne Bouras
Yvonne Bouras
Tax Tribunal Administrator

BEFORE THE GEORGIA TAX TRIBUNAL
STATE OF GEORGIA

H. ALAN ROSENBERG,	:	
	:	
Petitioner,	:	
v.	:	**TAX TRIBUNAL DOCKET**
	:	**NO.: TAX-IIT-1414626**
DOUGLAS J. MACGINNITTIE, Commissioner, Georgia Department of Revenue,	:	
	:	
Respondent.	:	

DECISION

2014 - 15 Ga. Tax Tribunal, November 25, 2014

I. INTRODUCTION

This case presents the important question of whether a Georgia taxpayer who receives pass-through income from an entity that was taxed in Texas under Sections 171.0001-171.909 of the Texas Tax Code (the "Texas Franchise Tax") is entitled to utilize the relief provisions of O.C.G.A. § 48-7-27(d)(1)(C) in computing that taxpayer's taxable Georgia income because the Texas Franchise Tax is a tax "on or measured by income."

As discussed below, the plain language of the statute, the policy underlying its enactment, the applicable rules of statutory construction, and the substantial weight of judicial, administrative and financial authority both in Georgia and other jurisdictions lead ineluctably to the conclusion that the Texas Franchise Tax is indeed a tax "measured on or with respect to income" for purposes of O.C.G.A. § 48-7-27(d)(1)(C). Petitioner H. Alan Rosenberg ("Petitioner" or the "Taxpayer") is therefore entitled to the benefit of these relief provisions.

Accordingly, the Petitioner's Motion for Summary Judgment on this issue in this case is **GRANTED** and Respondent's Motion for Summary Judgment is **DENIED**.

II. FINDINGS OF FACT

The parties have entered into a stipulation of facts pursuant to Ga. Comp. R. & Regs. 616-1-3-.18 as adopted in Standing Order dated June 1, 2013, and the facts are not in dispute.

A. Petitioner's ownership interests in multi-tiered partnerships.

Petitioner, H. Alan Rosenberg, was a resident of the state of Georgia during 2008 and filed a Georgia income tax return for that tax year. During 2008, Petitioner was the owner of membership interests in NDC Leasing, LLC ("NDC Leasing"), a limited liability company organized under Georgia law that is treated as a partnership for federal and Georgia income tax purposes. During 2008, Petitioner was also the owner of membership interests in National Distributing Company, Inc. ("National Distributing"), a corporation organized under Georgia law that is treated as an S Corporation for federal and Georgia income tax purposes.

NDC Leasing and National Distributing, through their direct and indirect ownership of various partnerships, LLCs, and other pass-through entities, are wholesalers and distributors of alcoholic beverages. As a requirement of conducting that business, they (or the entities in which they hold interests) possess licenses to distribute and/or sell alcohol in a number of states, including but not limited to Georgia and Texas.

During 2008, in addition to other sources of income, Petitioner reported pass-through income as a result of his interests in NDC Leasing and National Distributing.

During 2008, NDC Leasing and National Distributing owned interests in NDC Partners, LLC ("NDC Partners"). During 2008, NDC Partners was in turn the owner of membership interests in Republic National Distributing Company, LLC ("RNDC"), which operated in Texas

during 2008. RNDC was the reporting entity on a 2009 Texas Franchise Tax Report that included RNDC and a number of its affiliates. The accounting period for the 2009 Texas Franchise Tax Report filed by RNDC was based on the 2008 calendar year.

In determining its "taxable margin" for purposes of computing the Texas Franchise Tax, RNDC used the "cost of goods sold" deduction provided for in Tex. Tax Code Ann. § 171.101(a)(1)(B)(ii)(a).

B. Petitioner's original Georgia individual income tax return.

On his original 2008 Georgia income tax return, in addition to other sources of income, Petitioner included his distributive shares of the income of NDC Leasing and National Distributing. Therefore, through his indirect interests in RNDC, Petitioner reported an amount to Georgia (greater than one dollar) during 2008 that was subject to Texas Franchise Tax.[1]

With the distributive shares of income from NDC Leasing and National Distributing included in his Georgia income, Petitioner's originally-reported 2008 Georgia taxable net income was $1,317,585, and Petitioner reported total Georgia income tax liability of $78,795 for tax year 2008.

On his original 2008 income tax return, Petitioner did not make any adjustments related to the payment of Texas Franchise Tax by RNDC.

Petitioner did not file a tax return or pay personal income taxes to Texas during 2008 or any other year.

[1] The parties have stipulated that at least one dollar of income from RNDC indirectly flowed through to Petitioner through his direct interests in National Distributing and NDC Leasing. The parties have so far been unable to agree on the exact amount due to the complex nature of the tiered partnership ownership structure and the resulting complex calculations. It is not necessary to resolve the *amount* of the refund that is due in order to resolve *whether* the Taxpayer is entitled to summary judgment on the legal issue in this case, which is the subject of this motion.

C. **Petitioner's request for ruling and the Department of Revenue's response.**

On May 1, 2012, NDC Leasing and National Distributing filed a request with the Georgia Department of Revenue (the "Department") for a letter ruling concerning the application of O.C.G.A. § 48-7-27(d)(1) to the Texas Franchise Tax. In a letter dated July 13, 2012, the Department denied the ruling request, stating in part that because Georgia does not consider the Texas Franchise Tax to be an "income tax," individuals cannot subtract pass-through amounts that were taxed by Texas.

D. **Petitioner's amended 2008 Georgia income tax return (claim for refund).**

In an amended return dated September 12, 2012, Petitioner changed his Georgia taxable net income from $1,317,585 to $857,302 and claimed a total tax refund in the amount of $41,293, plus statutory interest. The adjustments that Petitioner claimed pursuant to O.C.G.A. § 48-7-27(d)(1) yielded a refund claim in the amount of $27,617 for tax year 2008. A portion of the adjustments under O.C.G.A. § 48-7-27(d)(1) derived from the franchise taxes paid by RNDC to Texas. The remainder of those adjustments derived from taxes paid by RNDC to the District of Columbia.

The income tax credits that Petitioner claimed on his amended 2008 Georgia income tax return yielded a refund claim in the amount of $13,676 for tax year 2008. Those income tax credits stemmed from an amended Georgia income tax return filed by National Distributing to claim Georgia jobs tax credits that National Distributing did not claim on its original Georgia income tax return for the 2008 year.[2]

In a letter dated September 12, 2013, the Department denied Petitioner's claim for refund.

[2] The Petitioner has not sought summary judgment with respect to either (i) the District of Columbia adjustment or (ii) the Georgia income tax credits that were claimed. These amounts are still at issue and the parties continue to negotiate as to possible resolution of these issues.

E. Petitioner's case in the Tax Tribunal.

In response to the Department's denial of Petitioner's claim for refund, Petitioner filed his Petition in this matter with the Tribunal on October 17, 2013. Under the Amended Consent Scheduling Order entered in this case, Petitioner filed Petitioner's Motion for Summary Judgment, ("Petitioner's Summary Judgment Motion"), Petitioner's Statement of Theory of Relief and Joint Stipulation of Facts ("Joint Stipulation"), Brief in Support of Motion for Summary Judgment ("Petitioner's Summary Judgment Brief"), and Petitioner's Motion for Oral Argument on June 27, 2104, moving for partial summary judgment on the issue for decision now before us. In response, Respondent filed Respondent's Motion for Summary Judgment ("Respondent's Cross-Motion for Summary Judgment"), Brief in Support of Respondent's Cross-Motion for Summary Judgment ("Respondent's Summary Judgment Brief"), Respondent's Theory of Recovery, and Respondent's Motion for Oral Argument. In response, Petitioner filed his Reply Brief ("Petitioner's Reply Brief") on August 15, 2014.

Oral argument on Petitioner's Motion for Summary Judgment and Respondent's Cross-Motion for Summary Judgment was held on October 3, 2014. In response to requests from the Tribunal, Petitioner submitted supplemental information electronically on October 16, 2014.

III. CONCLUSIONS OF LAW

A. Jurisdiction and venue.

The parties have stipulated that the Tribunal has jurisdiction over this appeal from the Department's denial of a claim for refund of income taxes pursuant to O.C.G.A. §§ 48-2-35(a)(4) and 50-13A-9(a) and that venue is proper before the Tribunal pursuant to O.C.G.A. § 48-2-35(a)(4).

B. Standard of review on summary judgment.

The standards governing summary judgment are well established. To prevail at summary judgment under O.C.G.A. § 9-11-56, the moving party must demonstrate that there is no genuine issue of material fact as to each element of its claim and that the undisputed facts, viewed in the light most favorable to the nonmoving party, warrant judgment as a matter of law. O.C.G.A. § 9-11-56(c); Lau's Corp., Inc. v. Haskins, 261 Ga. 491 (1991). Proceedings before the Tribunal are *de novo* in nature, and the evidence on the issues in a hearing before the Tribunal is not limited to the evidence presented to or considered by the Department prior to the Department's decision. O.C.G.A. § 50-13A-14; see Ga. Comp. R. & Regs. 616-1-3-.11 as adopted in Standing Order dated June 1, 2013.

C. Flow-through entity taxation.

In approaching the issue in this case it is important to understand the context in which the Georgia General Assembly enacted the legislation which is at issue. This case must therefore be understood in the broader context of taxation of flow-through entities in a multi-state context.

The taxation of partnerships, S corporations and other forms of "flow-through" entities on a multistate basis has long been a complex and unsettled area. See, e.g., American Bar Association Subcommittee on State Taxation of S Corporations, Report of the Subcommittee on State Taxation of S Corporations: Model S Corporation Income Tax Act and Commentary, 42 The Tax Lawyer 1001 (1989); Multistate Tax Commission, The Multistate Tax Commission "Working Draft" of a Proposed Model Rule for a Partnership Composite Tax Return Applicable to Multijurisdictional Partnerships, 3 State Tax Notes 810 (1992); Carolyn Joy Lee, Bruce P. Ely and Dennis Rimkunas, State Taxation of Partnerships and LLCs and their Members, Journal of Multistate Taxation and Incentives, Volume 19, Number 10, February 2010. The issues that

arise when multiple states seek to tax the income of business enterprises conducted through flow-through entities are particularly complex.[3]

A flow-through entity is best understood as an entity that is not taxed as a corporation. Under Subchapter C of the Internal Revenue Code, an entity taxed as a corporation (a "C corporation") is taxed on its income as a separate entity, separate and distinct from its owners. It is subject to double taxation first on its earnings at the entity level (currently taxed up to a maximum rate of 39.6 percent for federal income tax purposes plus applicable state income taxes) and then a second time again to the shareholders (currently up to a maximum rate of 39.6 percent for individuals plus applicable state income taxes) when distributed to them. See generally, Corporations, Internal Revenue Service, http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Corporations.

By contrast with the C corporation double-tax paradigm, a flow-through entity computes taxable income derived by the enterprise at the entity level, but does not itself pay tax on that income. Rather, it is the entity's owners who pay the tax. As a consequence, such earnings are taxed only once – to the flow-through entity's owners.

The most frequently seen forms of flow-through entities are entities taxed as partnerships, corporations which have elected S corporation status, and single member LLCs which are

[3] Over the last twenty-five years, these issues have assumed ever greater importance for taxpayers and state tax authorities as a result of the proliferation of additional forms of flow-through entities, including Subchapter "S" corporations, limited liability companies ("LLCs"), limited liability partnerships ("LLPs"), limited liability limited partnerships ("LLLPs"), qualified Subchapter S subsidiaries ("QSSSs"), single member limited liability companies that are disregarded for income tax purposes ("SMLLCs") and, most recently, so called "series" limited liability companies. Indeed, since the adoption of the federal "check-the-box regulations" and the rise of the limited liability company as a preferred form of business entity, the number of business enterprises organized as flow-through entities for tax purposes continues to increase while the number of entities taxed as traditional "C" corporations is declining steadily. Looking at the federal statistics in this area is enlightening. See Staff of the Joint Committee on Taxation, Selected Issues Relating to Choice of Business Entity (July 27, 2012), https://www.jct.gov/publications.html?func=startdown&id=4478.

disregarded for federal income tax purposes.[4] Such entities are all generally referred to as "flow-through" entities for federal income tax purposes although each has a distinct tax regime.[5]

D. Flow-through tax treatment for state tax purposes.

The analysis becomes more complex as we move to the taxation of such entities by the several states.

It is quite possible and quite common for two different states to tax the same income. As the Maryland Court of Appeals recently noted in Maryland State Comptroller of the Treasury v. Wynne, et ux., 431 Md. 147, 155 (2013), cert. granted, 134 S. Ct. 2660 (2014),

> A state may tax the income of its residents, regardless of where that income is earned. A state may also tax a nonresident on income earned within the state. Both of these propositions are consistent with the Due Process Cause of the Fourteenth Amendment. Oklahoma Tax Comm's v Chickasaw Nation, 515 U.S. 450, 462-63 & n.11 (1995); New York ex rel. Cohn v. Graves, 300 U.S, 312-13 (1937). However, they raise the possibility of what might be termed "double taxation" when both the state of the taxpayer's residence and the state where the income was generated tax the same income.

To ameliorate this harsh result, many states allow credits or adjustments to the computation of their income to ameliorate the resulting double-tax. As to individuals, for

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[4] Under the check-the-box regulations, a non-corporate entity with at least two members is classified as a partnership unless it elects to be taxed as an association taxable as a corporation. Treas. Reg. §§ 301.7701-2(c)(1), 301.7701-3(a), 301.7701-3(b)(1)(i). An S corporation is a domestic corporation which satisfies the requirements of I.R.C. § 1361 and as to which its shareholders have made the election required by I.R.C. § 1362 on Form 2553. Finally, under the check-the-box regulations, a single member non-corporate business entity (most frequently a limited liability company) is disregarded for tax purposes and treated as an extension of its owner for all income tax purposes unless the entity elects to be classified as an association. Treas. Reg. §§ 301.7701-2(c)(2), 301.7701-3(a), 301.7701-3(b)(1)(ii).

[5] Entities taxed as partnerships are taxed under Subchapter K of the Internal Revenue Code while Subchapter S corporations are cleverly so named because they are taxed under Subchapter S. It is often said that partnerships and S corporations are taxed alike, but, like all generalizations, this one is misleading as there are extremely significant differences in the tax rules that apply to these two types of entities. For income tax purposes, disregarded entities are just that (except for employment tax purposes), but they are generally *not* disregarded for non-income tax purposes, e.g., sales and use taxes.

There are a number of other more exotic forms of flow-through or *quasi* flow-through entities including Regulated Investment Companies ("RICs"), I.R.C. § 852, Real Estate Investment Trusts ("REITs"), I.R.C. §857, Real Estate Mortgage Investment Conduits ("REMICs"), I.R.C. § 860A, Qualified REIT Subsidiaries ("QRSs"), I.R.C. § 856, Qualified Subchapter S Subsidiaries, ("QSSSs"), I.R.C. § 1361(b)(3)(A), and so called "Series LLCs" (Prop. Treas. Reg. §§ 301.6011-6, 301.6071-2, 301.7701-1(a)(5)). Each of these has its own separate tax regime and none is at issue in this case.

instance, Georgia provides a credit for taxes paid in foreign states on the same income. O.C.G.A. § 48-7-28.[6]

So for state income tax purposes, flow-through tax treatment works well when the entity, its owners, and all income earned are located within one taxing jurisdiction. In such circumstances, there is only one sovereign and only one tax imposed. But when a flow-through entity has business activities, income and owners located in multiple states, the complexities of compliance and the potential for owners of the entity to pay tax on the same income in multiple jurisdictions mounts quickly. O.C.G.A § 48-7-30(b); Form IT-711, Instructions to Georgia Partnership Tax Return.

A related, but slightly different issue arises when an entity that is recognized as a flow-through in one state engages in business in a state which does not recognize flow-through treatment. While it is true that as a broad working generalization and subject to various exceptions, most states follow the federal classification of an entity for tax purposes,[7] some states treat flow-through entities as separate taxpayers and impose various entity level taxes on such flow-through entities.[8] These include Texas and Tennessee (neither of which imposes an individual income tax) as well as a number of other jurisdictions. See Ely Chart.

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[6] The degree to which one state is constitutionally required to give credits for taxes on multistate income has long been a subject of scholarly debate. The decision of the Maryland Court of Appeals on this issue in Wynne, has generated great interest and is currently pending before the United States Supreme Court on writ of certiorari. See Comptroller of the Treasury of Maryland v. Wynne, 134 S. Ct. 2600 (2014).

[7] Thus, for example, if an entity organized as a limited liability company in Georgia is taxed as a partnership for federal income tax purposes, Georgia will likewise tax the entity as a partnership for Georgia income tax purposes. O.C.G.A § 14-11-1104.

[8] In the area of state taxation of limited liability companies and limited liability partnerships, for many years, Bruce Ely and his cohorts have performed an invaluable service by annually publishing updated charts summarizing the State Tax Treatment of Limited Liability Companies and Limited Liability Partnerships. These charts summarize federal/state conformity/non-conformity on tax treatment of LLCs and LLPs as well as identifying other state taxes and fees that may apply. See Bruce P. Ely, Christopher R. Grissom, William T. Thistle II, and J. Sims Rhyne, An Update of the State Tax Treatment of LLCs and LLPs, State Tax Notes (February 3, 2014), cited as "Ely Chart" elsewhere in this decision.

E. The adjustment to taxable income provided under O.C.G.A. § 48-7-27(d)(1)(C).

The Georgia General Assembly enacted O.C.G.A. § 48-7-27(d)(1)(C) to address just this latter issue. The language of this adjustment provision, which is at the core of this case, provides:

> A Georgia individual resident who is a partner in a partnership, who is a member of a limited liability company taxed as a partnership, or who is a single member of a limited liability company which is disregarded for federal income tax purposes may make an adjustment to federal adjusted gross income for the entity's *income* taxed in another state which imposes on the entity a tax *on or measured by income*.

O.C.G.A. § 48-7-27(d)(1)(C) (emphasis added).

Under this relief provision, Georgia taxpayers will not be subjected to double taxation with respect to income from flow-through entities where such income is subject to taxation in another state because that state chooses to tax such income directly at the entity, rather than the owner, level. This provision permits the affected Georgia taxpayer to make an "adjustment" to the taxpayer's Federal Adjusted Gross Income in computing the taxpayer's Georgia taxable income for income flowing out to that taxpayer from a flow through entity that has also been subject to tax "on or measured by income" in another state.[9]

Many states, such as Georgia, impose additional requirements to recognize flow-through treatment for S corporations. See O.C.G.A § 48-27(d)(2).

[9] O.C.G.A. § 48-7-27(d)(1)(C) utilizes an "adjustment" mechanism to avoid double taxation at the state level on the same income. This is the same approach adopted by the legislature in O.C.G.A. § 48-7-27(d)(1)(B) with respect to S corporations which are recognized as S corporations for tax purposes in Georgia but not in another state.

This adjustment approach is not the only possible solution to address the issue of taxation of the same income by two states, however. Alternatively, the legislature could have adopted a credit mechanism similar to that contained at O.C.G.A. § 48-7-28, which is how the issue is addressed for individuals. In the analogous area of double taxation of the same income by both the US and a foreign nation, the Internal Revenue Code adopts the "credit" approach to addressing the issue in the Foreign Tax Credit provisions of the Internal Revenue Code, I.R.C. §§ 901-906, http://www.irs.gov/taxtopics/tc856.html.

Each system ("adjustment" vs. "credit") has weaknesses, strengths and computational complexities arising from attempting to harmonize what, are by definition, different tax systems.

Respondent has acknowledged that the provisions of O.C.G.A. § 48-7-27(d)(1)(C) apply to Georgia taxpayers who own interests in entities which conduct business in Tennessee through flow-through entities because Tennessee imposes its excise tax on flow-through entities that provide limited liability, such as LLCs, LLPs, and S corporations, at the rate of 6.5 percent of net income. Tenn. Code Ann. § 67-4-2007(a). The question presented in this case is whether the Texas Franchise Tax is a tax "on or measured by income" that should receive similar treatment.

The parties have stipulated that Petitioner was a resident of the state of Georgia during 2008 and filed a Georgia income tax return for that tax year. On that 2008 return, in addition to other sources of income, Petitioner reported pass-through income as a result of his interests in NDC Leasing and National Distributing. In turn, NDC Leasing and National Distributing (an LLC and an S corporation, respectively) owned indirect membership interests in RNDC, an LLC that operated in Texas during 2008 and paid Texas Franchise Taxes for that year. Therefore, the parties agree in this case that, through his indirect interests in RNDC, Petitioner reported an amount to Georgia (greater than one dollar) during 2008 that was subject to Texas Franchise Tax.

Because it is undisputed Petitioner received pass-through income from an entity that was taxed in Texas, if the Texas Franchise Tax on those entities is a tax "on or measured by income" the Petitioner in entitled to an adjustment from his federal adjusted gross income under O.C.G.A. § 48-7-27(d)(1)(C). The Petitioner's position is that the Texas Franchise Tax is indeed such a tax.

Respondent's position is that the Texas Franchise Tax is not a "tax on or measured by income." Respondent argues that the Texas Franchise Tax is instead a privilege tax or a gross-receipts tax and operates in a fundamentally different manner than an income tax. Because under

Respondent's analysis, the Texas Franchise Tax is not an income tax or measured by income as determined by long accepted principles, it cannot serve as a basis for an adjustment pursuant to O.C.G.A. § 48-7-27(d)(1).

To resolve this question, it is first necessary to define the meaning of "income" for purposes of the phrase "on or measured by income" contained in O.C.G.A. § 48-7-27(d)(1)(C).

F. Georgia law imposes income tax on an individual's "Georgia taxable net income," which is an individual's "federal adjusted gross income" as adjusted.

In defining an individual's "Georgia taxable net income," O.C.G.A. § 48-7-27(a) provides that it consists of the individual's "federal adjusted gross income, as defined in the United States Internal Revenue Code of 1986," subject to a number of prescribed adjustments. Those adjustments include, *inter alia*, a deduction for either the individual's itemized nonbusiness deductions or a standard deduction; an exclusion for certain amounts of retirement income; and a number of other specified deductions and additions involving specified types of income (e.g., deductions for certain military or disability income). See generally O.C.G.A. § 48-7-27(a)-(b).

The adjustment provision at issue in this case—O.C.G.A. § 48-7-27(d)(1)(C)—cannot be interpreted in isolation, but instead must be considered in connection with all of the related adjustment provisions and related terms of art that appear throughout the Georgia Tax Code (and especially in Code Sections 48-7-21 and 48-7-27). See, e.g., Tew v. State, 320 Ga. App. 127, 130 (2013) ("[A] statute must be construed in relation to other statutes of which it is a part, and all statutes relating to the same subject matter, briefly called statutes in *pari materia* . . . .").

It is crucial that, like O.C.G.A. § 48-7-27(d)(1)(C), other statutory adjustment provisions located throughout O.C.G.A. § 48-7-27 also include numerous explicit references to terms of

art—including "gross income," "taxable income," "net income," and "income taxes."[10] Similarly, the statute which provides for the computation of a corporation's "Georgia taxable net income" also includes a number of adjustment provisions which use terms of art involving the word "income." See generally O.C.G.A. § 48-7-21.[11]

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[10] These provisions include, but are not limited to:

- A provision stating, in describing the amount of retirement income that an individual may exclude, that "[e]arned income in excess of $4,000.00, including but not limited to *net business income* earned by an individual from any trade or business . . . shall not be regarded as retirement income." (O.C.G.A. § 48-7-27(a)(5)(E)) (emphasis added);
- A provision stating: "The commissioner shall by regulation provide that . . . penalty and interest may be waived or reduced for any taxpayer whose estimated tax payments and tax withholdings are less than 70 percent of such taxpayer's Georgia income tax liability if the commissioner determines that such underpayment or deficiency is due to an increase in *net taxable income* attributable directly to amendments to this paragraph . . . ." (O.C.G.A. § 48-7-27(a)(5)(G)) (emphasis added);
- A provision stating that "[s]ocial security benefits and tier 1 railroad retirement benefits, to the extent included in *federal taxable income*," may be subtracted. (O.C.G.A. § 48-7-27(a)(7)) (emphasis added);
- A provision stating that there shall be added to "taxable income" any "[d]ividend or interest income, to the extent that the dividend or interest income is not included in *gross income* for *federal income tax purposes*," on obligations of any state except Georgia or its subdivisions. (O.C.G.A. § 48-7-27(b)(1)(A)) (emphasis added);
- A provision stating that there shall be added to "taxable income" any "[i]nterest or dividends on obligations of the United States" or its subdivisions "which by the laws of the United States are exempt from federal income taxes but not from *state income taxes*." (O.C.G.A. § 48-7-27(b)(1)(B)) (emphasis added); and
- A provision stating that "[t]here shall be added to *taxable income* any *income taxes* imposed by any tax jurisdiction except the State of Georgia to the extent deducted in determining *federal taxable income*." O.C.G.A. § 48-7-27(b)(3) (emphasis added).

[11] These provisions include, but are not limited to:

- A provision stating, "When interest income is derived from obligations of any state or political subdivision except this state and political subdivisions of this state, the interest income shall be added to *taxable income* to the extent that the interest income is not included in *gross income* for federal income tax purposes." (O.C.G.A. § 48-7-21(b)(1)(A)) (emphasis added);
- "There shall be subtracted from *taxable income* interest or dividends on obligations of the United States. . . to the extent such interest or dividends are includable in *gross income* for federal income tax purposes but exempt from state *income taxes* under the laws of the United States." (O.C.G.A. § 48-7-21(b)(1)(B)) (emphasis added);
- "There shall be added to taxable income any taxes on, or measured by, net income or net profits paid or accrued within the taxable year imposed by the authority of the United States or . . . by any state except the State of Georgia . . . to the extent such taxes are deducted in determining federal taxable income." (O.C.G.A. § 48-7-21(b)(2)) (emphasis added); and
- "No portion of any deductions or losses which occurred in a year in which the taxpayer was not subject to taxation in this state including, but not limited to, net operating losses may be deducted in any tax year. When the *federal adjusted gross income* or *net income* of a corporation includes such deductions or losses, an adjustment deleting them shall be made under rules established by the commissioner." O.C.G.A. § 48-7-21(b)(3) (emphasis added).

In contrast to the other adjustment provisions in O.C.G.A. §§ 48-7-21 and 48-7-27 which turn on the application of terms of art including "net income," "taxable income," "federal taxable income," or "income taxes," O.C.G.A. § 48-7-27(d)(1)(C) provides an adjustment to an individual whenever the individual receives pass-through income that has been subject to tax "*on or measured by income*." Therefore, to interpret the "on or measured by income" language that is at the core of this case, it is essential not only to look to the statutory and historical definitions of "income," but also to interpret the phrase in harmony with the related terms of art that appear throughout the Georgia Tax Code.

As the Georgia Court of Appeals explained in the context of interpreting the meaning of the phrase "income tax" in Chilivis v. Int'l Bus. Mach. Corp., 142 Ga. App. 160, 161 (1977), the state's General Assembly "must be assumed to have understood the technical meaning" of those numerous terms of art when it enacted the various adjustment provisions. So one must approach the statute mindful of both this rule and the rule that a statute must be construed "*in pari materia*" to harmonize all of its parts, "whenever possible."

G. The Texas Franchise Tax as a tax "on or measured by income."

1. "Income" for tax purposes means all sources of gain, generally without regard to expenses or other deductions.

Whether the Texas Franchise Tax is a tax "on or measured by income" for purposes of O.C.G.A. § 48-7-27(d)(1)(C) depends on the fundamental question of what "income" means under the statute. Neither the Georgia Tax Code nor the Internal Revenue Code specifically defines the term "income." Courts and scholars have long struggled to define the term. For example, writing in the Connecticut Law Review regarding the proper income tax treatment of gifts, one scholar wrote:

> Determining the constitutional meaning of income is difficult since the [Sixteenth] Amendment nowhere defines the term. The current debate on the proper method of constitutional analysis has not focused on the Sixteenth Amendment, nor has the Supreme Court examined the issue recently. The Court's earlier pronouncements, which began in the 1920's, interpreted the term very strictly, limiting it to its plain or ordinary meaning, whatever that may be.[12]

One of the seminal authorities on this issue is the U.S. Supreme Court's decision in Eisner v. Macomber, 252 U.S. 189 (1920). Seeking to define "income" for purposes of the Sixteenth Amendment, after examining dictionary definitions and the intent of the amendment, the Court concluded: "Income may be defined as the gain derived from capital, from labor, or from both combined . . . ." Id. at 207 (quoting Doyle v. Mitchell Bros., 247 U.S. 179, 185 (1918)). The Court added that the gain must be realized (i.e., "separated" from the capital), and recited the Sixteenth Amendment's language that such realized gain is income, "from whatever source [it is] derived." Id. at 207. Notably, the U.S. Supreme Court in Macomber did *not* define "income" with reference to any expenses or deductions.

While Georgia courts have rarely considered the meaning of the term "income," the Georgia Court of Appeals used a definition nearly identical to the broad definition contained in Macomber in its 1936 decision in Brandon v. State Revenue Comm'n, 186 S.E. 872 (Ga. Ct. App. 1936). There, the court examined the nature of an income tax and defined "income" as follows:

> Whatever may be the strict or technical meaning of income, for tax purposes the term means an actual gain or an actual increase in wealth, and does not include a mere unrealized increase in value. Accordingly, as a subject of taxation, income is the gain derived from capital or labor, or both combined . . . .

Id. at 873; see also City of Fitzgerald v. Newcomer, 162 Ga. App. 646, 648 (1982) (noting as part of interpreting a contract: "It is undoubtedly true that 'profits' and 'income' are sometimes

[12] Marjorie Kornhauser, The Constitutional Meaning of Income and the Income Taxation of Gifts, 25 Conn. L. Rev. 1, 2 (1992).

used as synonymous terms; but, strictly speaking, 'income' means that which comes in or is received from any business, or investment of capital, *without reference to the outgoing expenditures* . . . .") (emphasis added).

More recently, the New Jersey Supreme Court also relied on Macomber to determine whether a federal "windfall profits tax" was a tax measured by income for purposes of that state's adjustment provision. See Amerada Hess Corp. v. Dir., Div. of Taxation, 526 A.2d 1029, 1042-44 (N.J. 1987), aff'd., 490 U.S. 66 (1989). That court concluded that the federal tax was a tax on income:

> Under ordinary dictionary definitions of "income," *i.e.*, *all that comes in without regard to expenditures*, the windfall profit clearly constitutes "income." The windfall profit also meets a more restrictive definition, i.e., gross receipts less costs of goods sold.

Id. at 1042 (emphasis added). Black's Law Dictionary similarly defines the term "income" to mean "the money or other form of payments that one receives, usually periodically, from employment, business, investments, royalties, gifts, and the like"—again making no reference to any expenses or deductions. Black's Law Dictionary (9th ed. 2009).

Based on the consistent interpretations of the term "income" over the years in Macomber, Brandon, and Amerada Hess, and the similar definition in Black's Law Dictionary, for tax purposes, the term "income" means all amounts that come in, without regard to expenditures.

While the Internal Revenue Code does not itself define the term "income," it equates "income" with "gross income" by defining "gross income" to mean "*all income* from whatever source derived, including (but not limited to) the following items:

(1) compensation for services . . . ;

(2) gross income derived from business;

(3) gains derived from dealings in property;

(4) interest;

(5) rents;

(6) royalties;

(7) dividends;

(8) alimony and separate maintenance payments;

(9) annuities;

(10) income from life insurance . . . contracts;

(11) pensions;

(12) income from discharge of indebtedness;

(13) distributive share of partnership income;

(14) income in respect of a decedent; and

(15) income from an interest in an estate or trust."

26 U.S.C. § 61(a) (emphasis added). Under Georgia law, the Internal Revenue Code's definition of "gross income"—as an aggregate of "all income" with no reference to any deduction for expenditures—is adopted for Georgia tax purposes. See Ga. Comp. R. & Regs. 560-7-6-.02(1) ("Any term used in these Regulations has the same meaning as when used in a comparable context in the laws of the United States or Regulations of the Internal Revenue Service, relating to Federal income taxes, unless a different meaning is clearly required or the term is specifically defined in the Georgia Code or Regulations.").

While "income" is *generally* used interchangeably with "gross income" to refer to all sources of gain or receipts without regard for expenses or other deductions, in specific contexts the term "gross income" has been given a more limited definition which requires a deduction for the "cost of goods sold." Most notably, Treasury Regulation 1.61-3(a) states that for a

manufacturing, merchandising, or mining business,[13] "gross income" means "the total sales, *less the cost of goods sold*, plus any income from investments and from incidental or outside operations or sources." This IRS regulation has been applied on multiple occasions in determining the "gross income" of businesses governed by that provision. See, e.g., Sullenger v. C.I.R., 11 T.C. 1076, 1077 (1948) ("[T]he Commissioner has always recognized, as indeed he must to stay within the Constitution, that the cost of goods sold must be deducted from gross receipts in order to arrive at gross income."); Kazhukauskas v. C.I.R., T.C. Memo. 2012-191, 2012 WL 2848694, at *9 (2012) ("Thus, cost of goods sold is an offset to gross receipts for purposes of computing gross income, and deductions are subtracted from gross income in arriving at taxable income."); Beamer v. Franchise Tax Bd., 563 P.2d 238 (Cal. 1977) (holding that Texas gas and oil production taxes were not taxes on "gross income" because they did not include any deduction for expenses). And the Amerada Hess case specifically noted both an "ordinary dictionary" definition of income and the "more restrictive" definition of income --"i.e., gross receipts less costs of goods sold." Amerada Hess, 526 A.2d at 1042.

So there is extensive support for the proposition that the term "gross income" is synonymous with "income" and includes all sources of income without regard for expenses or other deductions. There is also authority that "gross income" necessarily includes a deduction for the "cost of goods sold." Indeed, the Wisconsin Tax Appeals Commission in Delco Electronics noted the split of authority on just this issue. It did not resolve the question, however, because it was able to reach a decision on the deductibility of the tax in that case (the Michigan Single Business Tax) without reaching a conclusion as to the scope of the phrase "gross income." Delco Elecs. Corp. v. Wis. Dep't of Revenue, No. 95-I-112, 1997 WL 331967,

[13] RNDC operates a merchandising business in which it distributes alcohol.

at *10 (Wis. Tax. App. Comm'n, June 16, 1997) ("We do not believe it is necessary here to define the outer limits of 'gross income,' because the issue can be resolved on other grounds.").

As in Delco Electronics, it is not necessary to determine the precise meaning of "income" in order to reach a resolution in this case. It will be seen that even under the narrower definition of "income" (providing for the cost of goods sold deduction) the Texas Franchise Tax is a tax "on or measured by income." That is to say, the Texas Franchise Tax is "on or measured by income" under either the broad definitions of "income" and "gross income" discussed above or the more restrictive definition of "gross income" found in the Treasury Regulation and other authorities.

2. The Texas Franchise Tax is based on the same items of "income" used in computing the Federal income tax base.

During 2008, Texas imposed its entity-level franchise tax on the "taxable margin" of each "taxable entity" doing business in Texas. Tex. Tax Code Ann. §§ 171.001(a), 171.002(a)-(b). The term "taxable entity" was defined to include, *inter alia*, "a partnership, limited liability partnership, corporation, banking corporation, savings and loan association, [and a] limited liability company . . . ." Tex. Tax Code Ann. § 171.0002(a). The Texas Comptroller has explicitly ruled that S corporations and LLCs are subject to the Texas Franchise Tax, and the parties have stipulated in this case that RNDC—an LLC that was doing business in Texas in 2008—reported and paid Texas Franchise Tax for that year. See Texas Policy Letter Ruling No. 200609761L (Sept. 6, 2006).

Because the Texas Franchise Tax is imposed on a taxable entity's "taxable margin," the Taxpayer must show that the "taxable margin" base is one that is "on or measured by income" for purposes of O.C.G.A. § 48-7-27(d)(1)(C). As will be seen, it is—because a business's "total

revenue" and "taxable margin" for Texas Franchise Tax purposes are comprised of the same items that are used in determining "gross income" for federal and Georgia income tax purposes.

The starting point for determining the amount of the taxable margin is to compute the taxpayer's "total revenue from its entire business." Tex. Tax Code Ann. § 171.101(a). For taxable entities treated as partnerships for federal income tax purposes (such as NDC Leasing), Tex. Tax Code Ann. § 171.1011(c)(2) and the Instructions to the Texas Franchise Tax Report state that "total revenue" is computed by

a. Adding:

i. The amount reported as income on line 1c of IRS Form 1065 (for gross receipts or sales less "returns and allowances");

ii. The amount reported as income on line 6a of Schedule K of Form 1065 (dividend income);

iii. The amount reported as income on line 5 of Schedule K of Form 1065 (interest income);

iv. The amounts reported as income from line 3a of Schedule K of Form 1065 and line 17 of Form 8825 (rental income);

v. The amount reported as income on line 7 of Schedule K of Form 1065 (royalty income);

vi. The amounts reported as income on line 6 of Form 1065 and lines 8, 9a, and 10 of Schedule K of Form 1065 (net gains or losses attributable to capital assets or other sales of business property);

vii. The amounts reported as income on lines 4 and 7 of Form 1065, line 11 of Schedule K of Form 1065 (to the extent not already included), and the amount

from line 11, plus line 2 or line 45 of Form 1040, Schedule F (other income or loss); and

viii. Any "total revenue" reported by a lower-tier entity as includable in the taxable entity's total revenue under the tiered partnership election under Tex. Tax Code Ann. § 171.1015(b); and then

b. Subtracting from that total:

i. The amount reported on line 12 of Form 1065 (bad debt expensed for federal income tax purposes);

ii. Foreign royalties and foreign dividends, to the extent included in gross revenue;

iii. Net distributive income from a taxable entity treated as a partnership or as an S corporation for federal income tax purposes (to avoid double Texas taxation of the revenue of those entities);

iv. Allowable deductions from IRS Form 1120, Schedule C, to the extent related to dividend income included in total revenue;

v. Items of income attributable to an entity that is disregarded for federal income tax purposes (again, to avoid double Texas taxation of the revenue of those entities);

vi. Dividends and interest from federal obligations; and

vii. "Other deductions" to the extent that they were included in the taxpayer's

gross revenue. See Exhibit A, at 10-13 (Instructions to 2009 Texas Franchise Tax Report); see also Tex. Tax Code Ann. § 171.1011(c)(2).[14]

For all types of entities, Section 171.101(a)(1) of the Texas Tax Code then defines the "taxable margin" for taxable entities as the lesser of (A) 70 percent of the taxable entity's "total revenue"; or (B) "total revenue" less cost of goods sold; or (C) "total revenue" less compensation.[15]

The starting point for computing the Texas Franchise Tax is thus the sum of essentially every relevant item of business "income" that is included in the definition of "gross income" for federal income tax purposes. A comparison of (i) the line items of "income" included in the computation of "total revenue" for Texas Franchise Tax purposes with (ii) the line items shown on the tax forms for computing the federal gross income of a partnership or an S corporation reveals that the Texas "total revenue" and federal gross income bases are essentially identical. Compare Tex. Tax Code Ann. §§ 171.1011(c)(1) with 171.1011(c)(2). When one reviews the relevant federal tax returns filed by NDC Leasing, National Distributing, NDC Partners, and RNDC, and RNDC's Amended Texas Franchise Tax Report it can be seen that the "total revenue" for each partnership or S corporation under the Texas Franchise Tax is computed by adding the line items of "income" that were included on the relevant partnership or S corporation return that was filed for federal income tax purposes.

3. Whichever alternative definition of "income" is used, the Texas Franchise Tax is a tax "on or measured by income."

[14] The computation of "total revenue" for corporations treated as S corporations for federal income tax purposes (such as National Distributing) similarly tracks the line items from the entity's federal return (Form 1120S). See Instructions to 2009 Texas Franchise Tax Report; see also Tex. Tax Code Ann. § 171.1011(c)(1).

[15] RNDC determined its taxable margin using the "cost of goods sold" deduction provided for in Tex. Tax Code Ann. § 171.101(a)(1)(B)(ii)(a). Both "cost of goods sold" and "compensation" are computed under the Texas Tax Code in a manner that is substantially similar to the federal deduction afforded to such items. See Tex. Tax Code Ann. §§ 171.1012, 171.1013.

So the Texas Franchise Tax is a tax based on or measured by "income" or "gross income" whether one uses (i) the broad and ordinary definition of "income" or (ii) one of the technical definitions of "gross income" in conducting the analysis.

First, the concept of "total revenue" that serves as the initial basis for computing the Texas Franchise Tax base is based on or measured by "income" or "gross income," as those terms are broadly defined, because "total revenue" is computed by adding up all of the specified line items of "income" used in computing a pass-through entity's federal income tax base. By using all of the specific and relevant line items from a pass-through entity's federal income tax return to compute "total revenue," it is tautological to conclude that "total revenue" under the Texas Franchise Tax is on or measured by "income."

Alternatively, the Texas Franchise Tax is also based on or measured by "income" when focusing on the "taxable margin." The first option for computing the "taxable margin" is simply to take 70 percent of the "total revenue" base that is comprised of items from the entity's federal income tax base. See Tex. Tax Code Ann. § 171.101(a)(1). Using this method, a taxpayer's "taxable margin" would still be on or measured by "income," because it is comprised exclusively of the items used to compute the taxpayer's "income" on a federal return, before deductions. Alternatively, taxpayers may elect to compute their "taxable margin" by deducting the "cost of goods sold" from their "total revenue." See Tex. Tax Code Ann. § 171.101(a)(1). This second option is how RNDC—a merchandiser— in fact computed its taxable margin for purposes of reporting its Texas Franchise Tax. So this method of computation of the Texas Franchise Tax is *also* one that is on or measured by "income" because RNDC's tax base began with the taxpayer's "total revenue" -- which, as described above, is based on 'income" or "gross income" -- and then was further computed using a deduction for "cost of goods sold." This method of calculation is

in accord with the more restrictive definition of "gross income" that applies for federal income tax purposes to a merchandising business (such as RNDC). See Treas. Reg. § 1.61-3(a).

The Texas Franchise Tax is thus on or measured by "income," whether the focus is on the "total revenue" base or the "taxable margin" base. Because Petitioner received pass-through income that was subject to Texas Franchise Tax, it then follows that Petitioner is entitled to an adjustment for the "portion of the income on which such tax was actually paid." See O.C.G.A. § 48-7-27(d)(1)(D) (noting that in "multi-tiered situations, the adjustment for such individual shall be determined by allocating such income between the shareholders, partners, or members at each tier based upon their profit/loss percentage").

H. The conclusion that Petitioner qualifies for the benefits of O.C.G.A. § 48-7-27(d)(1)(c) is consistent with the policy underlying this statute.

The conclusion that the Texas Franchise Tax is a tax "on or measured by income" finds strong support in the policy underlying O.C.G.A. § 48-7-27(d)(1), which—according to the Georgia Court of Appeals in a case involving the taxation of an S corporation's pass-through income—is to allow shareholders or members of a pass-through entity "to avoid the double taxation that would otherwise occur if the shareholder paid taxes on any portion of his passed-through income on which the corporation had already paid income taxes . . . at the corporate level." Graham v. Hanna, 297 Ga. App. 542, 545-46 (2009). This policy underlying the adjustment provisions in O.C.G.A. § 48-7-27(d)(1) strongly supports Petitioner's contention that he is entitled to the Section 48-7-27(d)(1)(C) adjustment for the portion of his distributive shares of income on which RNDC already paid Texas Franchise Tax.

I. The adjustment under O.C.G.A. § 48-7-27(d)(1)(C) for taxes "on or measured by income" is not limited to taxes that are "on or measured by *net* income."

Respondent counters that the Texas Franchise Tax does not qualify for purposes of

O.C.G.A. § 48-7-27(d)(1)(C) because it is not a "net income" tax. The Department denied Petitioner's request for a letter ruling with respect to O.C.G.A. § 48-7-27(d)(1)(C) on the basis that the term "income" in that provision ought to be construed as "net income." This was the basis for denying Petitioner's refund claim and continues to be the basis urged before this Tribunal. But to so construe the statutory language imposes a restriction that is simply not contained in the statute.

1. In contrast to "income" and "gross income," for tax purposes, "net income" is always defined to include the deduction of expenses.

Unlike the terms "income" and "gross income"—which are not directly defined in the Georgia Tax Code—an individual's "net income" is specifically defined by reference to the individual's "federal adjusted gross income" less certain deductions and subject to certain addition adjustments. See O.C.G.A. § 48-7-27; see also Ga. Dep't of Revenue v. Ga. Chemistry Council, Inc., 270 Ga. App. 615, 617 (2004) (recognizing that an individual taxpayer's "net income" is the individual's "federal adjusted gross income, less deductions") (citing O.C.G.A. § 48-7-27(a)). The Georgia statutory definition of "net income" comports with a standard dictionary definition, as Black's defines "net income" as "the profit of a business arrived at by deducting operating expenses and taxes from gross receipts." Black's Law Dictionary (9th ed. 2009). Thus, whereas "income" and "gross income" are often used interchangeably, "net income" has a specified technical meaning that is different from "income" or "gross income." Yet despite the differences among those terms, the Department denied Petitioner's request for a letter ruling with respect to O.C.G.A. § 48-7-27(d)(1)(C) on the basis that the term "income" in that provision ought to be construed as "net income."

In addition to violating various rules of statutory construction (discussed below), the Department's position on this issue contradicts the Georgia Court of Appeals' direction in I.B.M.

that terms of art used in the tax code must be given their proper technical construction. In that case, the Department argued that a taxpayer should have added back to its taxable income all "franchise, excise, and privilege taxes paid in other states which were measured by income" under a statute which required the add-back of all "income taxes" imposed by other states. I.B.M., 142 Ga. App. at 160 (interpreting the predecessor version of current O.C.G.A. § 48-7-27(b)(3)). But the Court of Appeals rejected the Department's contention that "income tax" means "any tax, the amount of which is determined by income," instead holding that "income tax" is a "term of art" which refers to "taxes on income *and does not include taxes on subjects other than income, although measured by income.*" Id. (emphasis added). Therefore, based on the Court of Appeals' decision in I.B.M., "income tax" is a term of art which applies only to taxes "on income"—a set of taxes that is narrower than the set of taxes that are "measured by income," and which includes many taxes labeled as "franchise, excise, and privilege taxes" by other states. See id.; see also Amerada Hess, 526 A.2d at 1044 ("State taxes that are denominated franchise or excise taxes are often measured by income."). The Texas Franchise Tax is just such a tax -- a tax that is labeled a "franchise tax" but which is "on or measured by income".

2. Interpreting O.C.G.A. § 48-7-27(d)(1)(C) to add the term "net" income is inconsistent with well-settled rules of statutory construction.

The Department denied the Petitioner's ruling request reasoning that the adjustment in O.C.G.A. § 48-7-27(d)(1)(C) was intended to apply only to taxes on or measured by *net* income. Such an interpretation contravenes at least four well settled rules of statutory construction.

First, interpreting O.C.G.A. § 48-7-27(d)(1)(C) to apply only to pass-through income that was taxed in another state which imposes a tax "on or measured by *net* income" violates the rule of construction that statutes are to be interpreted "according to the natural and most obvious

import of the language, without resorting to subtle and forced constructions." Graham v. Hanna, 297 Ga. App. 542, 545 (2009). To interpret "income" to mean "net income"—despite the Georgia Tax Code's frequent use of both of these terms of art—would be to impose a "forced construction" on the plain language of the statute, in conflict with the "natural and most obvious" definition of "income."

Second, to interpret the statute as applying only to a tax "on or measured by *net* income" violates the rule that "a statute must be construed in relation to other statutes of which it is a part, and all statutes relating to the same subject-matter, briefly called statutes in *pari materia*, [must be] construed together, and harmonized whenever possible." Tew v. State, 320 Ga. App. 127, 130 (2013). To interpret the adjustment for "taxes on or measured *by income*" in O.C.G.A. § 48-7-27(d)(1)(C) to apply only to taxes "on or measured by net income" fails to harmonize the different terms of art used in the specific income tax adjustment provisions provided by the General Assembly, including but not limited to Code Sections 48-7-21, 48-7-23, 48-7-24, 48-7-27, and 48-7-28. Stated a bit differently, to read the word "net" into O.C.G.A. § 48-7-27(d)(1)(C) is to ignore the General Assembly's provision for numerous adjustments in Sections 48-7-21 and 48-7-27 which turn on the nature of the tax to which the taxpayer has been subjected.

Third, to accept Respondent's position on this issue would violate the rule that requires statutes to be interpreted to "avoid a construction that makes some language mere surplusage." Singletary v. State, 310 Ga. App. 570, 572 (2011). That conclusion is unavoidable, because an interpretation concluding that the adjustment for "taxes on or measured *by income*" in O.C.G.A. § 48-7-27(d)(1)(C) applies only to taxes "on or measured by *net income*" renders the use of the term "net" in Code Sections 48-7-21(b)(2), 48-7-28, and other sections of the Code "mere

surplusage," because two different terms of art would be interpreted as having the same meaning. Contrast O.C.G.A. § 48-7-21(b)(2)) with O.C.G.A. § 48-7-27(d)(1)(C) (emphasis added); see also O.C.G.A. § 48-7-28 ("A resident individual who has an established business in another state . . . may deduct from the tax due upon the entire *net income* of the resident individual the tax paid upon the *net income* of the business . . . in another state when the business . . . is in a state that levies a tax upon *net income*.") (emphasis added).

Finally, interpreting O.C.G.A. § 48-7-27(d)(1)(C) so that it only applies with respect to pass-through income taxed in another state which imposes on the entity a tax "on or measured by *net* income" violates the rule which requires a presumption that all statutes are "enacted with full knowledge of existing law." Singletary, 310 Ga. App. at 572. To interpret Section 48-7-27(d)(1)(C) to apply only to taxes on or measured by "net income" fails to acknowledge or give effect to the numerous specific statutory adjustment provisions applicable to taxes on "net income"—such as Sections 48-7-21(b)(2) and 48-7-28—that existed prior to the codification of Section 48-7-27(d)(1)(C). See 2006 Ga. Laws Act 619, H.B. 1160 (Ga. Reg. Sess. 2006) (codifying Sections 48-7-27(d)(1)(C)-(D)).

3. Respondent's arguments that it is unreasonable not to construe O.C.G.A. § 48-7-27(d)(1)(C) to limit it to taxes imposed on net income are not persuasive.

(a) Use of the term "adjusted gross income" elsewhere in the statute does not establish that O.C.G.A. § 48-7-27(d)(1)(C) is meant to apply to "net income" when applied to an entity.

It is well settled that a statute should not be construed in a manner that leads to "an unreasonable result unintended by the legislature." Haugen v. Henry Cnty., 277 Ga. 743, 745 (2004). Respondent argues it would be "unreasonable" to construe "on or measured by income" as it is written, because the phrase "is preceded twice by references to the taxpayer's 'federal adjusted gross income' . . . ." The Respondent asserts that the phrase "on or measured by

income" must therefore have been intended to be modified by "federal adjusted gross income," which uses a "net income base."

This argument overlooks the fact that "adjusted gross income" is a defined term that is defined specifically in reference to the computation of an *individual's* taxable income and therefore would not have been used to describe the measure of an *entity's* income. See O.C.G.A. § 48-7-27(a) ("Georgia taxable net income of an *individual* shall be the taxpayer's federal adjusted gross income, as defined in the [IRC] of 1986," subject to specified adjustments) (emphasis added); I.R.C. § 62(a) ("For purposes of this subtitle . . . the term 'adjusted gross income' means, *in the case of an individual*, gross income minus the following deductions . . .") (emphasis added). Since "adjusted gross income" only applies to the income of an individual, it would be incorrect to construe "adjusted gross income" as used in Section 48-7-27(d)(1)(C) as modifying the phrase "on or measured by income" when used in reference to the income of a pass-through entity. Therefore, it is more reasonable to construe "on or measured by income" according to its ordinary meaning and not seek to impose a "forced construction" on the statute. See, e.g., I.B.M., 142 Ga. App. at 160 (stating that the legislature is assumed to have understood the technical meaning of its chosen language and holding that "the statute shall be construed in accordance with the accepted legal definition" of that language).

(b) Use of the term "income tax" in O.C.G.A. § 48-7-27(b)(3) does not require that O.C.G.A. § 48-7-27(d)(1)(C) also be construed to be limited to "income taxes."

Respondent argues that it is necessary to add the concept of "net" income to O.C.G.A. § 48-7-27(d)(1)(C) in order to "harmonize" this provision with the other provisions of O.C.G.A. § 48-7-27, particularly subsection (b)(3). But this argument begs the question of why the legislature would have used the phrase "on or measured by income" if it intended for the

adjustment to apply only to "income taxes"—a different term of art used elsewhere in the Code. We must assume that the General Assembly intended something different from "on or measured by net income" by not using that phrase. Dep't of Human Res. v. Clay, 247 Ga. App. 392, 396 (2000), disapproved on other grounds, Ga. Dep't of Transp. v. Heller, 285 Ga. 262 (2009) ("[A]ny decision to depart from the federal language must have been made for a reason. The question thus becomes, 'Why did the legislature elect to make the state statute different from the federal statute?' The answer cannot be . . . [b]ecause it wanted the meaning to be identical.").

(c) It is reasonable to apply O.C.G.A. § 48-7-27(d)(1)(C)'s adjustment provision as written, even if some of the taxes "measured by income" under that provision are not "income taxes" pursuant to the add-back adjustment in O.C.G.A. § 48-7-27(b)(3).

Respondent also argues that the phrase "on or measured by income" in O.C.G.A. § 48-7-27(d)(1)(C) must be interpreted to apply only to taxes "on or measured by *net* income," because to hold otherwise might result in a "double benefit" to taxpayers who are permitted the (d)(1)(C) adjustment but who are not required to make the Section 48-7-27(b)(3) add-back. Respondent argues the add-back provision in subsection (b)(3) of Section 48-7-27 is the "mirror image" of subsection (d)(1). According to the Department, the two must therefore be interpreted in identical fashion.

Respondent's argument ignores the fact that in 2006 the General Assembly enacted subsection (d)(1) to provide "additional adjustments" for taxpayers who would otherwise be subject to double taxation. See 2006 Ga. Laws Act 619, H.B. 1160; see also Graham v. Hanna, 297 Ga. App. at 546. It must be presumed that the legislature's choice of language that is *different* from the language in the then existing add-back provision was intended to have different consequences. See, e.g., Dep't of Human Res. v. Clay, 247 Ga. App. at 396 ("[A]ny decision to depart from [prior] language must have been made for a reason.") If the legislature

had intended for the (d)(1)(C) adjustment to apply only when the add-back applies, it could have said so with a cross reference, or it would *at least* have used the same language in both provisions.

Second, Respondent argues that the legislature could not have intended that a taxpayer be entitled to the (d)(1)(C) adjustment because the Texas Franchise Tax is "measured by income" while also permitting the Texas Franchise Tax to be subject to the "add-back" provision in O.C.G.A. § 48-7-27(b)(3)). The difficulty with this argument is this Tribunal has not been asked to decide, and specifically is not deciding, whether the Texas Franchise Tax is an "income tax" for purposes of the O.C.G.A. § 48-7-27(b)(3) add-back. That is an entirely different issue for another day. So any argument based on this point is purely conjectural.

Third, even assuming for purposes of argument that the Texas Franchise Tax is indeed an add-back for purposes of O.C.G.A. § 48-7-27(b)(3), the resulting "double benefit" with which Respondent is concerned is slight when compared with the potential "double taxation" that the statute was designed to resolve. That difference is the natural consequence of the different language in those provisions: Section 48-7-27(b)(3) requires the addition of "any income taxes" imposed by other taxing jurisdictions (to the extent deducted from federal taxable income), while Section 48-7-27(d)(1)(C) permits the subtraction of the portion of any "income" taxed in another state, so long as that tax was "on or measured by income." Thus, while the add-back statute requires the addition of the income tax liability in the other jurisdiction, O.C.G.A. § 48-7-27(d)(1)(C) permits a subtraction adjustment for the entire income base that was subject to tax in the other state—an adjustment that is typically substantially larger than the mere add-back of taxes paid.[16] For example, as applied to this Taxpayer, the Georgia tax impact of the add-back (if

[16] Note the same would be true even when a *net* income base is at issue.

applicable) would be approximately $640, while the amount of the Taxpayer's claim for refund that is attributable to the Texas Franchise Tax is in excess of $20,000.[17]

Therefore, even assuming it is required, there is nothing "unreasonable" about the potential that a taxpayer may receive the (d)(1)(C) adjustment but will not be required to make the (much smaller) add-back adjustment for the same taxes. This distortion must be contrasted with the results that occur if the statute is to be interpreted so as to interpret O.C.G.A. § 48-7-27(d)(1)(C) in a manner that undercuts the legislature's intent, just so that it is co-extensive with a *different statutory provision* that uses *different language*, would certainly be the type of "unreasonable result unintended by the legislature" that the rules of statutory construction forbid.

(d) The differences between the Georgia and Texas tax bases do not make the application of O.C.G.A. § 48-7-27(d)(1)(C) to the Texas Franchise Tax unreasonable.

Respondent's argument that the difference between the Georgia and Texas tax bases requires the conclusion that the Texas Franchise Tax is not "on or measured with respect to income" simply does not withstand analysis. All states that impose a tax based on or measured by income (or on net income for that matter) impose a tax on a base that ultimately differs—sometimes substantially—from the "federal taxable income" base because of each state's specific addition and subtraction adjustments. It is not only taxes which are measured by "income" that might generate the need to perform certain modifications in order to compute the adjustment under O.C.G.A. § 48-7-27(d)(1)(C) properly. Substantial differences might also arise in the computation of a tax based on *net income* such that similar modifications are necessary to

[17] The Taxpayer computed the approximate Georgia tax impact of the add-back provision with respect to the Texas Franchise Tax by taking the following steps: (1) determining the Texas Franchise Tax paid by RNDC for the 2008 tax year—$904,285.00; (2) multiplying that amount by the Taxpayer's distributive share percentage of RNDC's income for that year (1.179960646%) to determine the amount that would be required to be added to the Taxpayer's adjusted gross income; and (3) multiplying the amount of the add-back by the Georgia tax rate of 6 percent.

compute the Georgia adjustment.[18] Under this argument, no tax would qualify under O.C.G.A. § 48-7-27(d)(1)(C) unless the tax bases were substantially identical.

Instead of focusing on the differences between two states' tax bases as evidence of why O.C.G.A § 48-7-27(d)(1)(C) should be interpreted more narrowly than the plain language indicates, the rules of statutory construction and common sense suggest a much simpler conclusion: that the legislature passed the law with the intention of preventing double taxation, and that it drafted the statute to apply to a broad set of taxes in order to maximize the adjustment provision's impact. By focusing on the statute's remedial intent, it is much more reasonable to conclude that the statute should be applied as written. The Department can, if it chooses to do so, exercise its regulatory authority to provide guidance regarding such base modifications, so that taxpayers only receive an adjustment "for the portion of the income on which such tax was actually paid" by the pass-through entity. See O.C.G.A. § 48-7-27(d)(1)(D). The Department has the authority and ability to promulgate regulations and/or provide other guidance to explain how taxpayers should compute such adjustments. See, e.g., O.C.G.A. § 48-2-12. So the adjustment to all taxes "on or measured by income" does not yield any "unreasonable results"

[18] For example, a partnership that is subject to tax in Tennessee and which receives dividends from an 80-percent-owned corporation can take a dividends-received deduction for Tennessee excise tax purposes; however, that dividend income is included in the partnership's (and, ultimately, partner's) federal taxable income, and would therefore show up in the partner's tax base for purposes of computing the Georgia adjustment under Section 48-7-27(d)(1)(C). To compute the "portion of income on which such [Tennessee] tax was actually paid," the partner would have to—among other modifications—eliminate the dividend from the Tennessee tax base. Under the Department's view, does that substantial modification affect whether the Tennessee tax was "measured by income" for purposes of the adjustment? It should not. Such modifications are an inevitable consequence of the legislature's decision to provide an adjustment for taxes "measured by income." There are numerous other examples of adjustments that can cause significant differences between federal taxable income and a state tax base—including a state *net income* tax base—such as bonus depreciation (see, e.g., Tenn. Code Ann. § 67-4-2006(b)(1)) and related-party intangible expense add-backs (see, e.g., Ala. Code § 40-18-35(b)(1)).

under O.C.G.A. § 48-7-27(d)(1)(C). And note again that Respondent is well equipped with the tools available to address such issues if they do in fact arise.[19]

The application of the O.C.G.A. § 48-7-27(d)(1)(C) adjustment to all taxes "on or measured by income" does not lead to any unreasonable results. Rather, those differences are the natural consequence of the legislature's decision to extend the remedial adjustment to all taxes on or measured by "income," rather than limiting it only to those taxes on or measured by "net income." It is much more reasonable to conclude that such differences (to the extent they are perceived as problematic) should be resolved by applying the straightforward and ordinary meaning of the statute and permitting taxpayers to take the adjustments, but then requiring all necessary modification adjustments to the tax base (pursuant to O.C.G.A. § 48-7-27(d)(1)(D)), rather than to undermine the legislative intent by interpreting the remedial statute more narrowly than the legislature provided. See Ins. Dep't of Ga. v. St. Paul Fire & Cas. Ins. Co., 253 Ga. App. 551, 554 (2002) ("[U]ncertainties or ambiguities in remedial statutes should be resolved in favor of a liberal interpretation . . . .").

J. Other states that have considered the issue have concluded that the Texas franchise tax is either a tax "on or measured by income" or an "income tax."

1. A number of states have concluded that the Texas Franchise Tax is a tax "on or measured by income" or an "income tax."

[19] Indeed, a major reason the Department's administrative position in this case is not entitled to any deference is that the Department has done nothing to explicate the application or operation of this statute which, while simple on its face, quickly becomes extremely complex in application once one begins to attempt to mesh the calculations of very different state tax systems to calculate the adjustment. Yet it appears the Department has only addressed the application of O.C.G.A. § 48-7-27(d)(1)(C) twice—as to taxes imposed by Tennessee and Texas—and each time only in conclusory answers to "frequently asked questions" posted on the Department's website. There are other jurisdictions that have entity level taxes on flow-through entities, at least one of which is an issue in this case. See Ely Chart. And, as noted, the calculations under this statute are susceptible to being computed in a number of alternative ways. And yet there appears to be no published guidance from the Department on any of these issues. So Respondent's argument that the Department's position on the issue in this case should be given deference rings hollow.

When we look to other states, we see that a number of state taxing authorities have determined that the Texas Franchise Tax is a tax "on or measured by income" or even gone further and concluded it is an "income tax." Indeed, there do not appear to be any authorities that have considered the precise issue in this case that have determined that the Texas Franchise Tax is *not* a tax "on or measured by income."

First, in a letter of findings, the Indiana Department of State Revenue (the "Indiana Department") determined that the Texas Franchise Tax qualifies as a tax "based on or measured by income." Ind. Dep't of State Rev. Letter of Findings No. 02-20120562 (Apr. 24, 2013). To determine Indiana adjusted gross income, Indiana requires taxpayers to add to federal adjusted gross income "an amount equal to any deduction or deductions allowed by [the Internal Revenue Code] for taxes *based on or measured by income* and levied at the state level by any state of the United States." Ind. Code § 6-3-1-3.5(b) (emphasis added). The Indiana Department determined that taxpayers are required to add back taxes paid pursuant to the Texas Franchise Tax because the tax "starts with and is based on the entity's income as reported on the federal income tax." Ind. Dep't of State Rev. Letter of Findings No. 02-20120562. Accordingly, the Indiana Department concluded: "[i]t is apparent from the face of the law that the [Texas Franchise Tax is] 'based on or measured by income.'" Id.

Second, the Missouri Department of Revenue (the "Missouri Department") issued a letter ruling determining that the Texas Franchise Tax is an "income tax" under Missouri law. Mo. Private Letter Rul. No. LR 5309 (Dec. 12, 2008). To reach its conclusion, the Missouri Department extended to the Texas Franchise Tax the reasoning of Herschend v. Director of Revenue, 896 S.W.2d 458 (Mo. 1995). Herschend established that, in order to qualify as an "income tax" under Missouri law (and thus provide a credit against Missouri income tax),

another state's tax must satisfy two criteria. The tax must be (i) "based on federal taxable income" and (ii) must "pay compensation for benefits, such as roads, police, and fire protection," rather than tax the privilege of doing business in the state. Mo. Private Letter Rul. No. LR 5309. According to the Missouri Department, the Texas Franchise Tax is "based solely on various types of income reported on the federal income tax return" and "is a compensatory tax that operates as an income tax." Id. (internal quotation marks omitted). Therefore, according to the Missouri Department, the tax meets both criteria of Herschend and qualifies as an income tax.

Third, the Kansas Department of Revenue concluded that "the revised Texas franchise tax is based on income and is therefore in the nature of an income tax," at least as long as the cost of goods sold or compensation deduction methodologies are used. Kan. Op. Letter No. O-20009-005; Kan. Op. Letter No. O-2008-004 (Sept. 2, 2008). The Kansas Department of Revenue made its determination despite the fact that Texas itself describes the Texas Franchise Tax as a privilege tax, rather than an income tax. See also Ind. Dep't of State Rev. Letter of Findings No. 02-20120562 ("The Texas tax is designated as a 'margin tax' or 'franchise tax' but merely labeling the tax as such does not change the nature of the tax.").

Finally, the California Franchise Tax Board has determined that the Texas Franchise Tax, when computed using the cost-of-goods method, "qualifies as an income tax." Cal. FTB Technical Advice Memo. No. 2011-03 (Apr. 13, 2011).[20] When determining if taxes paid to another state by a pass-through entity create a credit against California income taxes, California law distinguishes between gross income taxes (which are eligible for the credit) and gross receipts taxes (which are not). Using the cost-of-goods method to calculate the base of the Texas

[20] The California Franchise Tax Board recently withdrew the guidance provided in Technical Advice Memorandum No. 2011-03, stating that it will be issuing "additional guidance." See Cal. FTB Technical Advice Memo. No. 2014-01 (Jan. 28, 2014). There is no indication that the FTB intends to change its view regarding the Texas Franchise Tax. Given that Memorandum No. 2011-03 also addressed the old "Michigan Business Tax," it would appear likely that the withdrawal is to provide updated guidance regarding the new Michigan tax regime.

Franchise Tax excludes all "return on capital"; therefore, the Franchise Tax Board determined that a taxpayer electing the cost-of-goods deduction under the Texas Franchise Tax is entitled to the credit because the tax for such taxpayers is "on or measured by income." Id.[21]

K. Those authorities that have concluded that the Texas Franchise Tax is not a tax on "net income" are not persuasive.

Though no state has determined that the current version of the Texas Franchise Tax is not a tax "on or measured by income," some state departments of revenue have determined that individuals cannot take a credit or adjustment with respect to the Texas Franchise Tax. In every such case, however, state law required the departments to examine *specifically* whether the Texas Franchise Tax is a tax on *net* income. See Mass. DOR Directive No. 08-7 (Dec. 18, 2008) ("The [Texas franchise tax is] based on or derived directly from gross receipts and [is] not imposed on *net income*.") (emphasis added); Va. Pub. Doc. Rul. No. 08-169 (Sept. 11, 2008) ("[I]t is my conclusion that the Texas Business Margin Tax is not a tax based on, measured by, or computed with reference to *net income*.") (emphasis added); Minn. Rev. Notice No. 08-08 (July 21, 2008) ("It is the department's position that the Texas business margin tax is not a tax based on *net income*.") (emphasis added). In each case the department of revenue found that, because the Texas Franchise Tax does not allow for sufficient deductions for business expenses, it is not a tax on net income.

Because O.C.G.A § 48-7-27(d)(1)(C) does not limit its inquiry to taxes "on or measured by *net* income" the reasoning of these decisions is not persuasive. Every state authority that has

[21] At least two states have gone even further than these four states, concluding that the Texas Franchise Tax is not only on or measured by "income," but that it is actually measured by "net income." See S.C. Rev. Rul. No. 09-10 (July 17, 2009) (listing the Texas franchise tax as nondeductible from South Carolina taxable income because it is a tax "measured by net income"); Wisc. Dept. Rev. Tax Bulletin No. 156 (Apr. 1, 2008) ("[T]he Texas margin tax qualif[ies] for the credit for net income tax paid to another state . . . .").

considered whether the Texas Franchise Tax is a tax "on or measured by income" (but not specifically a *net* income tax) has answered that question affirmatively.

L. The Financial Accounting Standards Board has also concluded that the Texas Franchise Tax is a tax "on or measured by income."

State departments of revenue are not the only authorities that have decided that the Texas Franchise Tax as one "on or measured by income." The Financial Accounting Standards Board ("FASB") has similarly concluded that the Texas Franchise Tax should be treated as an income tax for purposes of FASB Interpretation Number 48.[22] FASB, Minutes of the August 2, 2006 Meeting on Potential FSP: Texas Franchise Tax. ("The staff received technical inquiries from constituents requesting the staff's opinion on whether the Texas Franchise Tax was an income tax that should be accounted for under Statement 109. After discussing the issue with constituents, *the staff concluded that the Texas Franchise Tax is an income tax because the tax is based on a measure of income.*") (emphasis added). This determination under FASB Interpretation Number 48 is important, because with respect to every "income tax" to which the standard applies, it governs the recognition of deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns.

Not surprisingly, each of the nation's four major accounting firms has also issued guidance advising its clients that the Texas Franchise Tax is a tax that is "on or measured by income" and is therefore subject to FIN 48.[23]

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[22] FASB Interpretation Number 48, commonly known as "FIN 48," is entitled "Accounting for Uncertainty in Income Taxes" and interprets FASB Statement 109 (ASC 740), "Accounting for Income Taxes." See FASB, FASB Interpretation Number 48, No. 281-B (2006).

[23] See:

- Guide to Accounting for Income Taxes, PricewaterhouseCoopers LLP, § 1.2.2.4 (2013), http://www.pwc.com/us/en/cfodirect/publications/accounting-guides/guide-to-accounting-for-income-taxes-2013-edition.jhtml ("As discussed in Section TX 1.2.1, we believe that a tax based on income has a

M. The authorities cited by Respondent to support the conclusion that the Texas Franchise Tax is not "on or measured by income" are not persuasive.

To support his position that the Texas Franchise Tax is not a tax "on or measured by income," but is instead a privilege tax or a gross-receipts tax that operates in a fundamentally different manner than an income tax, Respondent relies principally on In re Nestle USA, Inc., Relator, 387 S.W.3d 610 (Tex. 2012) and Ardire v. Tracy, 674 N.E.2d 1155, 1156 (Ohio 1997). On close examination it can be seen that these cases are inapposite.

1. In re Nestle USA, Inc., Relator.

In Nestle, the petitioner challenged the constitutionality of the Texas Franchise Tax on the grounds that it bore no reasonable relationship to its object, which is the privilege of doing business in Texas, and therefore violates the Texas Constitution's mandate that "[t]axation shall be equal and uniform" (Tex. Const. art. VIII, § 1(a)), the Fourteenth Amendment's Equal

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tax base that consists of income less deductible expenses. Because the margin tax has a base that possesses this characteristic, along with other characteristics of a tax based on income, the margin tax should be accounted for under ASC 740."); see also id., § 1.2.1 ("In general, practice has been that a 'tax based on income' would even apply to tax regimes in which revenues or receipts are reduced by only one category of expense.");

- A Roadmap to Accounting for Income Taxes, Deloitte & Touche LLP, § 2.05 (2011), http://www.deloitte.com/view/en_US/us/Services/audit-enterprise-risk-services/Financial-Statement-Internal-Control-Audit/Accounting-Standards-Communications/e9e4e4b44f5be210VgnVCM3000001c56f00aRCRD.htm ("[T]he scope of ASC 740 is limited to 'taxes based on income,' where income is determined after revenues and gains are reduced by some amount of expenses and losses."); see also id., §§ 2.13-2.15 (explaining that the Texas franchise tax "is determined by applying a tax rate to a base that takes both revenues and expenses into account; therefore, the new tax is considered an 'income tax.' . . . Therefore, the [Texas] margin tax has characteristics of an income tax and should be accounted for as such in accordance with ASC 740.");
- Financial Reporting Developments: Income Taxes, Ernst & Young LLP, § 5.6.4. (Sept. 2013), http://www.ey.com/Publication/vwLUAssetsAL/Financial ReportingDevelopments_BB1150_IncomeTaxes_19September2013/$FILE/FinancialReportingDevelopments_BB1150_IncomeTaxes_19September2013.pdf ("We believe the Revised Tax, while based on an entity's margins (as discussed above), is nonetheless, a tax based substantially on income, and as such is subject to the provisions of ASC 740."); and
- Accounting for Income Taxes, KPMG LLP, § 9.122 (June 2012) ("Because the tax base on which the Texas margin tax is computed is derived from an income-based measure, the margin tax is considered to be an income tax for financial reporting purposes and, therefore, the provisions of ASC Topic 740 regarding the recognition of deferred taxes apply to the Texas margin tax.").

Protection and Due Process guarantees (U.S. Const. amend. XIV & 1) and the U.S. Constitution's Commerce Clause (U.S. Const. art. I, § 8). After a lengthy discussion of the Texas Franchise Tax (cited by both Respondent and Petitioner as supporting their respective positions), the Texas Supreme Court upheld the constitutionality of the statute as a privilege tax.

From the Texas Supreme Court's statement that the Texas Franchise Tax is a privilege tax, Respondent then jumps to the conclusion that because the Texas Franchise Tax is a privilege tax, it is not an income tax, and, therefore, because it is not an income tax, it cannot be a tax "on or measured by income." Respondent urges that because the Texas Franchise Tax is a "privilege" tax, the Texas tax "is not an income tax, but rather a gross receipts or a privilege tax."

There are multiple difficulties with Respondent's logic.

First, it is well-established that how a tax is labeled is not dispositive of a tax's measure. See, e.g., Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977) (rejecting formalistic rules which would determine the constitutionality of a tax based on its nomenclature, and instead looking to the tax's substance); Amerada Hess Corp. v. Dir., Div. of Taxation, 526 A.2d 1029, 1044 (N.J. 1987), aff'd., 490 U.S. 66 (1989) ("State taxes that are denominated franchise or excise taxes are often measured by income."); MacFarlane v. Utah State Tax Comm'n, 134 P.3d 1116, 1119-20 (Utah 2006) ("The Tax Commission's focus on the labels of the taxes as franchise, excise, or income taxes . . . is misplaced."); Beamer v. Franchise Tax Bd., 563 P.2d 238, 242 (Cal. 1977) ("In ascertaining whether the Texas taxes are on or measured by income . . . our task is to determine their true nature and not to be guided by labels.").[24] Indeed, even the Tennessee Excise Tax, Tenn. Code Ann. Section 67-4-2007, *et seq.* which Respondent agrees

[24] The most famous statement regarding the irrelevance of the "label" in defining the measure of a tax was recited by the U.S. Supreme Court in Trinova: "A tax on sleeping measured by the number of pairs of shoes you have in your closet is a tax on shoes." Trinova Corp. v. Mich. Dep't of Treas., 498 U.S. 358, 374 (1991) (citing Jenkins, State Taxation of Interstate Commerce, 27 U. Tenn. L. Rev. 239, 242 (1960)). Thus, a tax may be "measured by income," regardless of the label used to describe it.

qualifies for the adjustment under O.C.G.A. § 48-7-27(d)(7)(C) is formally categorized as an excise, rather than income, tax.

Second, and more importantly, Respondent makes his logical jump without analyzing the relevant terms and without discussing any of the features that would distinguish a "gross receipts tax" or a "privilege tax" from a tax "measured by income," and without discussing or attempting to identify what a privilege tax is "measured by." Indeed, as Petitioner correctly notes, there is much in the Texas Supreme Court's opinion which is supportive of Petitioner's contentions in this case.[25]

And finally, as noted above, the issue in this case is *not* whether the Texas Franchise Tax is an "income tax." The issue is whether the Texas Franchise Tax is a tax "on or measured by income." There is no dispute that the Texas Franchise Tax is an atypical tax. But even if Respondent is correct, and even if the Texas Franchise Tax is not an income tax, the Texas Supreme Court's discussion in Nestle simply does not address the issue in this case. [26]

2. Ardire v. Tracy.

The other case on which Respondent relies heavily is Ardire v. Tracy, 674 N.E.2d 1155, 1156 (Ohio 1997). In that case the Supreme Court of Ohio held that the Michigan Single

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[25] Among other things, the Texas Supreme Court noted that "total revenue" for purposes of computing the Texas Franchise Tax "*is income reported to the federal IRS with various deductions, limitations, and exceptions.*" Nestle, 387 S.W.3d at 615-16 (emphasis added); see also Nestle, 387 S.W.3d at 614 ("In 1991, the Legislature shifted the primary basis of the franchise tax profoundly, from capital to 'net taxable earned surplus'—*i.e.*, income."); id. at 615-16 ("The current franchise tax is the product of further legislative restructuring in 2006 . . . . The tax is still based primarily on revenue . . . . [and] [t]otal revenue is income reported to the federal IRS . . . ."); id. at 621 ("Over the years, the Legislature increased the number of exemptions, added adjustments and deductions, *and shifted the basis of the tax from capital to income.*") (emphasis added).

[26] While the Supreme Court of Texas in Nestle noted that the Texas Franchise Tax uses an income base, in a separate case, it avoided the specific question of whether the Texas Franchise Tax is an "income tax." See In re Allcat Claims Serv., LP, 356 S.W.3d 455 (Tex. 2011). The court noted, however, the legislature's express declaration that the Texas Franchise Tax "is not an income tax." See id. at 463. That issue is important because, as explained in Allcat, under the Texas Constitution, an individual income tax, unlike a privilege tax, requires approval by the voters in a statewide referendum.

Business Tax ("Michigan Single Business Tax") was not "on or measured by income" for purposes of the Ohio credit for taxes "on or measured by income."

There are several reasons why Ardire is not persuasive, however. First and foremost, the Ardire case dealt with the now repealed Michigan Single Business Tax. The Michigan Single Business Tax was a unique tax with many peculiarities. It had unusual overtones of, and was actually described as, a value added tax. It was roundly criticized in many circles as creating a hostile business environment. See, e.g., James R. Hines Jr., Michigan's Flirtation with the Single Business Tax, University of Michigan Ross School of Business (December 2002), http://www.bus.umich.edu/otpr/WP2003-1paper.pdf; see also What is the Single Business Tax?, Michigan Department of the Treasury, http://www.michigan.gov/taxes/0,1607,7-238-43533-154440--,00.html (last visited Nov. 13, 2014). Respondent has not shown whether or how the Michigan Single Business Tax is at all like the Texas Franchise Tax, however, so it is difficult to evaluate whether a holding involving the Michigan Single Business tax has any relevance to this case.[27]

Moreover, the analysis in Ardire appears to be flawed by the court's conflation of the phrase "on or measured by income" with the phrase "on or measured by net income." In particular, the Ohio court concluded that the Michigan Single Business Tax was not "measured by income" by relying *exclusively* on the Michigan court's analysis in Gillette Co. v. Dep't of Treasury, 497 N.W.2d 595 (Mich. Ct. App. 1993), without recognizing that the Michigan court *had only considered whether the SBT was on or measured by* "net" *income.* See Ardire, 674 N.E.2d at 1158-59 (reciting Gillette's conclusion that the SBT was not "measured by net

[27] At oral argument, Petitioner and Respondent both agreed that the Michigan Single Business Tax was such an unusual tax that it would be an example of a tax that would not trigger the application of the adjustment provision of O.C.G.A. § 48-7-27(d)(1)(C).

income" and then concluding for Ohio purposes: "Therefore, the Michigan appellate courts have clearly determined that the SBT is neither a tax on income nor a tax measured by income.").

Indeed, a careful reading of Ardire suggests that the Ohio court either did not appreciate the distinction or did not care to draw it given the highly unusual nature of the Michigan Tax. See Ardire, 674 N.E.2d at 1158-59 (reaching its holding in reliance on Gillette's holding with respect to "net income" and then string-citing a "number of authorities throughout this country [which] agree with the view that Michigan's SBT is neither a tax *on income* nor a tax *measured by income*," but proceeding instead to cite, in part, authorities that turned on whether the Michigan Single Business Tax was "on or measured by *net* income").

IV. SUMMARY

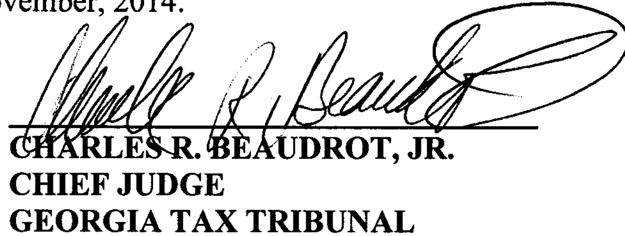
There may well be state taxes that sufficiently diverge from an income base such that they would not be eligible for adjustment under O.C.G.A. § 48-7-27(d)(1)(C). See, e.g., First Chicago NBD Corp. v. Dep't of State Revenue, 708 N.E.2d 631, 635 (Ind. Tax Ct. 1999) (stating that "[n]ot every tax that is measured by income subtracts costs of production . . . [but] no tax that is measured by income *adds* costs of production.") (emphasis in original). Indeed, the parties both agree that such would have been the case with the now repealed Michigan Single Business Tax. But while the drawing of the line may be difficult in some instances in the future, it is unnecessary to explore those boundaries here because the answer is clear.

V. CONCLUSION

Accordingly, for the reasons discussed above, this Tribunal finds that the Texas Franchise Tax is a tax that is "on or measured by income" for purposes of O.C.G.A. § 48-7-27(d)(1)(C).

Therefore, Petitioner's Motion for Summary Judgment must be **GRANTED** and Respondent's Cross-Motion for Summary Judgment **DENIED**.

SO ORDERED, this 25th day of November, 2014.



CHARLES R. BEAUDROT, JR.
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