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SUPREME COURT OF TEXAS
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No. 20-0462

In the Supreme Court of Texas

SIRIUS XM RADIO INC.,
Petitioner,

v.

GLENN HEGAR, COMPTROLLER OF PUBLIC ACCOUNTS OF THE STATE OF TEXAS, AND KEN PAXTON, ATTORNEY GENERAL OF THE STATE OF TEXAS,
Respondents.

ON PETITION FOR REVIEW
FROM THE THIRD COURT OF APPEALS, AUSTIN, TEXAS
NO. 03-18-00573-CV

TAX EXECUTIVES INSTITUTE, INC.'S AMICUS BRIEF

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INTRODUCTION

Amicus curiae Tax Executives Institute, Inc. ("TEI") respectfully submits this brief in support of petitioner, Sirius XM Radio Inc. ("Sirius XM"). This Court's review is necessary to resolve the conflict created by the Texas Court of Appeals' decisions in *Hegar v. Sirius XM Radio, Inc.*, No. 03-18-00573-CV, 2020 WL 2089132 (Tex. App.—Austin May 01, 2020, pet. filed) ("*Sirius XM*") and *Westcott Communications, Inc. v. Strayhorn*, 104 S.W.3d 141 (Tex. App.—Austin 2003, pet. denied) ("*Westcott*").

Sirius XM and *Westcott* use fundamentally different standards to determine how taxpayers providing similar services must apportion their Texas franchise tax bases. The cases reach opposite results and cannot be reconciled, creating uncertainty for Texas taxpayers and the potential for inconsistent taxation.

State tax apportionment rules can profoundly impact the amount of tax multistate taxpayers must pay. Texas taxpayers need a single, clear standard to apportion service providers' franchise tax bases. TEI urges this Court to grant the petition for review pursuant to Texas Rules of Appellate Procedure 56.1(a)(2) and provide this needed guidance.

STATEMENT OF INTEREST

TEI is the largest organization representing taxpayers' interests on issues associated with tax administration. It is a voluntary, nonprofit association of

corporate and other business executives, managers, and administrators responsible for the tax affairs of their employers. TEI was organized in 1944 under the laws of the state of New York and is exempt from taxation under section 501(c)(6) of the Internal Revenue Code. TEI dedicates itself to developing sound tax policy, the uniform and equitable enforcement of tax laws, the minimization of administrative and compliance costs for governments and taxpayers, and the vindication of taxpayers' rights.

TEI's members are employed by a broad cross-section of the business community. The rules governing state taxes generally and, in particular, those governing the allocation and apportionment of income among multiple states, directly affect the multistate companies represented by TEI's membership.

TEI has more than 7,000 members representing more than 3,200 companies globally and throughout the United States. As in-house tax professionals, TEI's members must evaluate tax laws, advise their companies regarding the tax consequences of various transactions and business decisions, and make practical judgments regarding their tax obligations. TEI's members thus have a vital interest in ensuring rules governing the apportionment of income are fair and are applied consistently and without regard to whether a taxpayer conducts operations inside or outside of the state.

Pursuant to Tex. R. App. P. 11(c), TEI advises the Court that it prepared this brief at its own expense.

ARGUMENT

TEI urges this Court to grant discretionary review pursuant to Texas Rules of Appellate Procedure 56.1(a)(2) to resolve the conflict between the Texas Court of Appeals' decisions in *Sirius XM* and *Westcott*. It is imperative for this Court to clarify the standard used to apportion service providers' receipts.

I. Texas's Franchise Tax Must Be Apportioned to Fairly Reflect the Value Service Providers Perform Within the State

The United States Supreme Court has held a tax upon interstate commerce must be fairly apportioned to activities carried on by the taxpayer in the taxing state to satisfy Commerce Clause scrutiny. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). States have latitude in how they apportion their taxes, *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 171 (1983). However, the apportionment method must reasonably reflect the extent of the taxpayer's activities in the state and must not favor in-state taxpayers over out-of-state taxpayers. *Id*. at 169; *see also Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 438 (1980); *Moorman Mfg. Co. v. G. D. Bair*, 437 U.S. 267, 273 (1978).

Sirius XM addresses how Texas calculates its franchise tax for service providers conducting business in Texas and other states. The Texas legislature opted

to apportion its franchise tax using a single factor receipts formula. Hellerstein, Hellerstein & Swain, State Taxation (Thomson Reuters/Tax & Accounting, 3rd ed. 2001, with updates through May 2020) (online version accessed on Checkpoint (www.checkpoint.riag.com) [accessed Jul. 13, 2020]) ("Hellerstein"), at ¶ 9.18[3][d][ii]. That formula divides a taxpayer's tax base using a fraction equal to the "gross receipts from business done in this state" divided by the "gross receipts from its entire business." Tex. Tax Code § 171.106(a).

Service providers' gross receipts arise from "business done in this state" if the service is "performed in this state." Tex. Tax Code § 171.103(a)(2). "If services are performed both inside and outside Texas, then such receipts are Texas receipts on the basis of the fair value of the services that are rendered in Texas." 34 Tex. Admin. Code § 3.591(26). This Court has held receipts are sourced to Texas if the "act done or the property producing the income is located in Texas," as it is "the localization of the transaction in Texas and not the place of physical handing over or receiving of money that was significant." *Humble Oil & Refining Co. v. Calvert*, 414 S.W.2d 172, 180 (Tex. 1967).

II. *Sirius XM* and *Westcott* Use Fundamentally Different Approaches to Apportion Service Providers' Receipts

Sirius XM and *Westcott* both address whether a taxpayer's services are "performed" within Texas. The facts underlying the two cases are identical for all practical purposes: both taxpayers produced programming and delivered it to

customers via satellite. However, *Sirius XM* departed from the analysis conducted in the Court of Appeals' decision in *Westcott*, applied a different standard to answer this question, and reached the opposite result.

A. The *Westcott* Decision

Westcott "produced educational, informational, and training programming and delivered the programming to subscribers throughout the nation via satellite broadcast and videotape." *Westcott*, 104 S.W.3d at 144. Westcott's offices, broadcast transmission equipment, and production facilities were located in Texas, and Westcott "produced, filmed, edited, and broadcast its training services" in and from the state. *Id*. at 145. Westcott sold its training content to customers inside and outside of Texas and provided them with satellite dishes and supporting equipment to receive and decode its programming at their locations. *Id*. at 144-45.

In *Westcott*, the Comptroller argued Westcott's receipts should be sourced to Texas because Westcott's primary production facilities were in the state. *Id.* at 145. Westcott disagreed, contending its receipts should be apportioned based upon where its customers received the satellite broadcasts. *Id*.

Citing this Court's decision in *Humble Oil*, the *Westcott* court determined receipts are sourced to Texas if the "act done or the property producing the income [was] located in Texas." *Id*. at 146. Westcott produced its training content at its production facilities in Texas. The *Westcott* court thus sourced Westcott's receipts

to Texas, even though Westcott's customers received the satellite signals, decoded the satellite signals using satellite dishes and supporting equipment provided by Westcott, and viewed Westcott's training content at locations inside and outside of the state. *Id*. at 147.

B. The *Sirius XM* Decision

In *Sirius XM*, the taxpayer provided subscription-based satellite radio service to customers inside and outside of Texas. *Sirius XM*, 2020 WL 2089132 at *3-4. Sirius XM produced 70 percent of its radio content, and its "headquarters, transmission equipment, and production studios [were] located almost exclusively outside of Texas." *Id*. at *4. Sirius XM's customers used their own satellite-enabled radios, which contained chipsets Sirius XM could remotely activate or deactivate, to receive and decrypt the satellite radio signals. *Id*. at *5, 13.

Although the Comptroller argued Westcott's receipts should be apportioned based on the location of Westcott's production facilities, *see Westcott*, 104 S.W.3d at 145, the Comptroller changed its stance in *Sirius XM* and sought instead to use a "receipt-producing, end-product act" standard to apportion Sirius XM's receipts, *Sirius XM*, 2020 WL 163014 at *6.

The Comptroller argued this standard was derived from a 1980 administrative hearing decision, where the Comptroller distinguished between "receipt producing activities" and "support activities." According to the hearing decision:

> [T]he phrase "services performed within Texas" . . . must be construed as "units of service sold, the performance of which occurs within Texas," thereby shifting the focus geographically from every activity performed by a corporation that generates service receipts, to those specific, *end-product acts* for which a customer contracts and pays to receive. If no distinction between *receipt-producing activities* versus non-receipt-producing, albeit essential, support activities were made, no independent meaning could be given to the "receipts from sales of services" factor . . . .

Sirius XM, 2020 WL 163014 at *11(*quoting* Tex. Comp. Pub. Accounts, Comptroller's Decision, CPA Hearing No. 10,028 (Nov. 27, 1980), 1980 WL 5466; emphasis in *Sirius XM* decision). Using this standard, the Comptroller contended Sirius XM's customers purchased the "service of unscrambling the radio signal" and "not the production of satellite programming." *Sirius XM*, 2020 WL 163014 at *5.

Sirius XM relied on the apportionment standard used by the Court of Appeals in *Westcott*. Under *Westcott*, "the relevant activities for purposes of determining where 'the act is done' is not where the audience is located but, instead, where 'the service provider performs its service-related activities ….'" *Id*. at *13-14. Sirius XM thus sought to source its receipts based on where it conducted its production and transmission activities. *Id*.

The *Sirius XM* court ultimately adopted the Comptroller's "receipt-producing, end-product act" standard. The court concluded that, under this standard, Sirius XM's customers paid for "the *receipt* of Sirius XM programming" and the receipt-producing, end-product act that allowed Sirius XM's customers to receive such

programming "occurred when Sirius XM decrypted the program by activating or deactivating the customer's chipset in their satellite-enabled radio …." *Id.* at *13 (emphasis added). The court thus sourced Sirius XM's receipts based upon the location of its customers rather than the location of Sirius XM's production and transmission facilities, as it had done in *Westcott*. *Id.*

C. *Sirius XM* and *Westcott* Cannot Be Reconciled

The *Sirius XM* court suggested that *Westcott* adopted and applied the "receipt-producing, end-product act" standard, and that this standard reflected the Comptroller's longstanding administrative interpretation of Texas law. *Id.* at *12-13. Neither assertion is correct.

The Court of Appeals is correct that *Westcott* cited Texas Comptroller's Decision No. 10,028, the administrative hearing decision first discussing the "receipt-producing, end-product act" standard. *Westcott*, 104 S.W.3d at 146. However, *Westcott* cited this administrative decision only for the proposition, first articulated by this Court in its decision in *Humble Oil* that "where 'the act is done' determines the geographical character of receipts derived from the performance of a service." *Id.* *Westcott* did not mention any "receipt-producing, end-product act" standard, nor did it address what "end-product acts" Westcott's customers sought to purchase, nor did it distinguish between Westcott's receipt-producing and non-

receipt-producing activities. Rather, *Westcott* solely focused on where Westcott performed its activities. *Westcott*, 104 S.W.3d at 145-47.

Moreover, the Comptroller did not adopt the "receipt-producing, end-product act" standard as its administrative interpretation following Texas Comptroller's Decision No. 10,028 and, in fact, expressly rejected this standard when it issued Westcott's administrative hearing decision. *See, e.g.*, Tex. Comp. Pub. Accounts, Comptroller's Decision, CPA Hearing No. 35,481, (Jul. 29, 1998), 1998 WL 877860 (training services delivered via satellite); Tex. Comp. Pub. Accounts, Comptroller's Decision, CPA Hearing No. 10,386 (July 27, 1981), 1981 WL 12549 (apartment management services); Tex. Comp. Pub. Accounts, Comptroller's Decision, CPA Hearing No. 11,786 (Dec. 10, 1982), 1982 WL 12820 (loan servicing); Tex. Comp. Pub. Accounts, Comptroller's Decision, CPA Hearing No. 46,585 (Sept. 21, 2006), 2006 WL 3761630 (alarm monitoring services); Tex. Comp. Pub. Accounts, Letter Ruling 200305904L (2003) (broadcasting live and on-demand events, website development, and web hosting); Tex. Comp. Pub. Accounts, Letter Ruling 200807139L (2008) (internet-based securities brokerage and financial services). Like *Westcott*, each of these decisions focused on two factors: the service the taxpayer's customers sought to acquire, and where the taxpayer performed that service. The *Sirius XM* decision represents a fundamental change in how the Comptroller sought to apportion services providers' receipts.

The results of the *Westcott* and *Sirius XM* decisions further confirm *Westcott* did not apply the "receipt-producing, end-product act" standard. Westcott and Sirius XM both produced original content, were paid by their customers to provide such content via satellite, and decrypted the signals for such services at their customers' location. *Id*. at *15. The only distinguishing fact raised by the court was that Westcott produced its content for specific types of customers (*e.g.*, schools, law enforcement personnel, and nurses), whereas Sirius XM produced its content for the general public. *Id*. at *16. The *Sirius XM* court did not address, nor is it apparent, why this might cause the "receipt-producing, end-product act" standard to reach opposite results. Moreover, Texas's statutes governing the apportionment do not distinguish between services on this basis.

Had the *Westcott* court used the *Sirius XM* court's rationale, Westcott's customers also would have been deemed to purchase the "receipt" of Westcott's training services. Just as Sirius XM's customers had to use their satellite-enabled radios to decode Sirius XM's radio signal, Westcott's customers had to use their satellite dishes and supporting equipment to decode Westcott's training services. *Sirius XM*'s purports to uphold rather than overrule *Westcott*; however, *Sirius XM*'s adoption of the "receipt-producing, end-product act" standard thus represents a fundamental change in how Texas apportions service providers' receipts, and the two cases cannot be reconciled.

III. Texas Taxpayers Require This Court's Guidance Regarding the Appropriate Standard for Apportioning Service Providers' Receipts

State tax apportionment rules can profoundly affect the amount of tax multistate taxpayers must pay. This is particularly true in states, such as Texas, where the Legislature has opted to apportion the franchise tax using a single receipts apportionment formula.

For context, many other states apportion their taxes using an equally-weighted, three-factor formula considering the relative presence of a taxpayer's property, payroll, and sales in the state. *Container*, 463 U.S. at 183. A three-factor formula examines the geographic location of the taxpayers' assets, employees, and customers within the state and thus takes a comprehensive view of a taxpayer's operations. Other states opt to double-weight the sales factor within the three-factor apportionment formula, and some states, such as Texas, apportion their tax bases solely using a single sales or receipts factor.

While the language used to describe these concepts varies from state to state, states take one of two approaches to apportion the service provider's sales or receipts: (1) an origin/income-producing activity/costs of performance approach focusing on the location of the service provider's activities inside and outside the state, or (2) a market-state approach focusing on the location of the service

provider's customers. *See, e.g.*, Hellerstein, State Taxation at ¶9.13[3].[1] *Westcott*, and the Comptroller decisions focusing on the service provider's activities, use an origin-based approach. In contrast, the "receipt-producing, end-product act" standard parses the taxpayer's operations. In *Sirius XM*, where the taxpayer's operations were primarily located outside of Texas, the Comptroller opted to apply this test in a manner focusing on the portion of the service most closely associated with the customer's location. This resulted in a market-state approach in the *Sirius XM* case.

Many states have amended their apportionment statutes over the past decade to switch from an origin-based approach to a market-state approach. *See, e.g.*, Hellerstein, State Taxation at ¶9.18[3][c]. The Texas legislature, however, has not amended the Texas Tax Code to effectuate this significant policy change, and continues to apportion the Texas franchise tax based on where the taxpayer performs its services. And, while states are free to adopt either an origin method or a market-based method, a state cannot require both.[2]

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[1] Different rules apply to source sales of tangible personal property. Texas, like all states, sources sales of tangible personal property to Texas if the property is delivered or shipped to a buyer in the state. *See* Tex. Tax Code § 171.103(a)(1); *Lockheed Martin Corp. v. Hegar*, No. 18-0566, 2020 WL 2089741, *9 (Tex. May 01, 2020).

[2] A tax that applied an origin-based method and market-state method would violate the U.S. Supreme Court's internal consistency test. The internal consistency test "helps courts identify tax schemes that discriminate against interstate commerce" by

Whether a state uses an origin-based or market-state approach is particularly significant for service providers concentrating their operations in a few states. For example, Westcott's offices, broadcast transmission equipment, and production facilities operations were in Texas, but its customers were located primarily outside of Texas. *Westcott*, 104 S.W.3d at 145. An origin-based approach would source all of Westcott's receipts to Texas, whereas a market-state approach would source most of Westcott's receipts outside Texas. Sirius XM's headquarters, transmission equipment, and production studios were located almost exclusively outside of Texas, but its customers were located throughout the country. *Sirius XM*, 2020 WL 2089132 at *4. An origin-based approach would source most of Sirius XM's receipts outside Texas, while a market-state approach sources receipts in a manner that reflects the U.S. population (*i.e.*, 8 percent to Texas). *Id*. at *6. Thus, the standard used dramatically affects the amount of a service provider's Texas franchise tax liability.

"look[ing] to the structure of the tax at issue to see whether its identical application by every State in the Union would place interstate commerce at a disadvantage as compared with commerce intrastate." *Comptroller of Treasury of Md. v. Wynne*, 135 S. Ct. 1787, 1803 (2015). A dual origin-based and market-state sourcing methodology for services has the prohibited "potential to result in the discriminatory double taxation of income earned out of State" and would create "a powerful incentive to engage in intrastate rather than interstate economic activity." *Id*.

Texas taxpayers need a single, clear standard to apportion service providers' franchise tax bases. *Sirius XM* purports to be consistent with, and did not overrule, *Westcott*. Right now, service providers are presented with two fundamentally different approaches to apportion their receipts. This situation creates uncertainty and will cause similarly situated taxpayers to be taxed inconsistently. It also enables the Comptroller to advocate for the standard generating the highest Texas franchise tax liability for each taxpayer, as the Comptroller did when litigating *Westcott* and *Sirius XM*, rather than using the same standard. Texas's apportionment formula cannot be driven by tax-motivated gamesmanship. This Court should grant Sirius XM's petition for review and provide this needed guidance.

CONCLUSION

For the foregoing reasons, TEI urges this Court to grant Sirius XM's petition for review.

Respectfully submitted,

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CERTIFICATE OF WORD COMPLIANCE

I certify that this amicus brief complies with the type-volume limitation of Texas Rule of Appellate Procedure 9.4(i)(2) because it contains 3019 words, excluding the parts of the brief exempted by Texas Rule of Appellate Procedure 9.4(i)(1).

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