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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
Cause No. 03-18-00573-CV

BRIEF OF COUNCIL ON STATE TAXATION AND TEXAS TAXPAYERS AND RESEARCH ASSOCIATION AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

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STATEMENT OF INTEREST

The Council On State Taxation ("COST") is a nonprofit trade association based in Washington, D.C. Its membership is comprised of approximately 550 of the largest multistate corporations engaged in interstate and international business and represents industries doing business in every state across the country.[1] Its objective is to preserve and promote equitable and non-discriminatory state and local taxation of multijurisdictional business entities, many of which do business in Texas. In furtherance of this objective, COST previously has participated as amicus in numerous significant federal and state tax cases since its formation in 1969.

COST provides its unique perspective as a trade association with members that are engaged in business in all 50 states across a wide range of industries and that are required to comply with tax apportionment rules in multiple jurisdictions. COST has a vested interest in this case because fair tax administration depends upon equitable and judicious administration of state tax laws. The Court of Appeals' opinion in this case puts that principle at risk in Texas. Its opinion creates severe incongruities in the sourcing of services rules that do not provide predictability. To that end, this Court should accept review of the Court of Appeals' decision to ensure

[1] No counsel for a party authored this brief in whole or in part, and no counsel or party made a monetary contribution intended to fund the preparation of submission of this brief. No person other than *Amicus Curiae*, their members, or their counsel made a monetary contribution to its preparation or submission. Tex. R. App. P. 11.

uniformity and to provide clear rules as to how to apportion receipts derived from the performance of services. Review of this case is also of national importance for multijurisdictional taxpayers due to Texas' unique statutory language for apportioning service receipts that does not clearly fit squarely with the way in which other states have generally addressed the apportionment of service receipts. As a result, guidance from this Court is imperative.

The Texas Taxpayers and Research Association, TTARA, is a non-profit, non-partisan, Texas-based membership-supported organization of businesses, trade associations, tax practitioners and individuals that endorse and advocate for sound state and local fiscal policy for Texas state and local governments. Our more than 200 member companies come from a broad range of economic sectors and business forms. A large majority of TTARA member companies conduct business both within and outside of Texas and, consequently, have a vital interest in appropriate state and local tax apportionment policies that are clear and consistent so that taxpayers may correctly calculate their tax liability and appropriately plan their finances and business operations.

ARGUMENT

I. Uniformity and Certainty Over How Service Receipts Are Sourced is Needed Because the Court of Appeals Did Not Provide Predictable or Clear Rules.

The Texas franchise tax sourcing rules are intended to provide guidance as to how a taxpayer's gross receipts from "its business done in this state" should be determined. Tex. Tax Code § 171.103(a). When calculating total gross receipts from "business done in this state" a taxable entity must include receipts from "each service performed in this state." *Id.* § 171.103(a)(2) . The Comptroller's regulation on the apportionment of service receipts provides that services are "apportioned to the location where the service is performed." 34 Tex. Admin. Code § 3.591(e)(26). When services are performed both inside and outside of the State, those receipts "are Texas receipts on the basis of the fair value of the services that are rendered in Texas." *Id.*

Here, there is no dispute that Sirius XM's subscription receipts from its original programming delivered via satellite must be apportioned based on the fair value of the services performed by it in Texas. Rather, the parties disagree on whether, and to what extent, Sirius XM performed its services in this State as provided by Tex. Tax Code § 171.103(a)(2).

The Court of Appeals overturned the trial court's decision that concluded Sirius XM properly sourced its subscription receipts based on where it produced its

programming, which were locations primarily outside of Texas. The Court of Appeals' decision, however, cannot be reconciled with its prior 2003 decision in *Westcott Communications, Inc. v. Strayhorn*, 104 S.W.3d 141 (Tex. App.—Austin 2003, pet. denied), which involved a Texas-based taxpayer also in the business of producing and transmitting programming via satellite to its subscribers located throughout the United States.

Although the Court of Appeals attempts to distinguish the facts and circumstances of these taxpayers, its decisions do not provide clear and consistent guidance as to how to determine if a "service [is] performed in the state," pursuant to Tex. Tax Code § 171.103(a)(2). At worst, the Court of Appeals creates a distinction without a difference between these two cases, giving the Comptroller a free pass to drive outcomes in a results-oriented manner. At best, the Court of Appeals narrows the applicability of *Westcott* without a clear rule as to how to determine where a service is performed. In either situation, if the Court of Appeals' opinions remain without any further guidance by this Court, taxpayers will be left without a clear methodology to source services in Texas.

A. The Court of Appeals' Decisions in *Sirius XM* and *Westcott* Conflict with One Another.

Sirius XM and *Westcott* contradict each other because the taxpayers in these two cases have nearly identical businesses and they provided the same type of service to their respective subscribers. States also generally use one of two different

approaches to sourcing receipts from the performance of a service. The Court of Appeals, however, improperly adopts both approaches. This is not rational because the outcomes of these two approaches are distinct and mutually exclusive.

i. The Court of Appeals Treats Taxpayers Providing the Same Type of Service Differently.

In *Westcott*, the Court of Appeals ruled in favor of the Comptroller and required Westcott Communications, a Texas-based satellite programming company, to source 100 percent of its receipts to Texas because it produced, filmed, edited, and broadcasted its services in Texas. Conversely, in *Sirius XM*, the Court of Appeals again ruled in the Comptroller's favor, requiring Sirius XM, an out-of-state satellite programming company, to source its service receipts based on its customers' locations rather than the locations where it produced, recorded, edited, and transmitted its service.

The Court of Appeals explains these two seemingly contradictory results by distinguishing the facts between the taxpayers in these two cases. But these taxpayers' business models were virtually identical. Both Sirius XM and Westcott Communications created, produced, and recorded original programming transmitted to its subscribers via satellite. Both taxpayers produced the programming at their own respective studios and encrypted the programming. Revenue was generated through their subscription fees and their subscribers were located across the nation.

In both cases, subscribers needed equipment to decrypt the satellite signal and receive the programming.

Despite these overwhelming similarities, the Court of Appeals in *Sirius XM* hinges its decision on the nature of the programming transmitted—Westcott Communication's programming was for educational and training purposes while Sirius XM's programming was primarily for entertainment. There is, however, no difference as to the nature of the service being provided—original programming content transmitted by satellite.

Moreover, the Court of Appeals' analysis marginalizes its decision in *Westcott*. *Westcott* considered the taxpayer's argument that it provided a mere broadcast signal to its customers, similar to a cable television provider. The Court of Appeals rejected the argument, determining that Westcott Communications' "services go well beyond providing a broadcast signal to its customers." *Westcott*, 104 S.W.3d at 147. It is evident that Sirius XM's service, like Westcott Communications', goes well beyond providing broadcast signals—producing original and unique content exclusively available to its subscribers.

Nonetheless, the Court of Appeals treats these similarly situated taxpayers completely differently, resulting in a standard that would appear to be based on what generates the most tax revenue for the State.

ii. There Are Two Distinct Approaches to Sourcing Services and the Court of Appeals Cannot Adopt Both Approaches.

The issue of how to source services for income and franchise tax apportionment purposes is not new or unique to Texas. The sourcing of the sales of items other than tangible property, including services and intangibles, has been subject to wide debate among the states for the last 60 years. The initial rule adopted by most states is referred to as the "costs of performance" ("COP") rule, which sources services primarily based on the activities and location of the service provider, not the consumer. Generally, under this rule, if the service provider performs its "income-producing activity" in more than one state, then for income and franchise tax purposes, the service is sourced to the state where "a greater proportion of the income-producing activity is performed … based on costs of performance."[2]

In recent decades, there have been legislative shifts in many states to a "market-based sourcing" approach, which sources services primarily to the location

[2] The COP rule was set forth in Article IV, Section 17 of the initial Multistate Tax Compact (Compact). This Compact was drafted as a model law in 1966 by a widely representative group of state officials, including tax administrators, attorneys general, state legislators and a Special Committee of the Council of State Governments. The Compact became effective, under its terms, on August 4, 1967. Article IV of the Compact was composed of the Uniform Division of Income for Tax Purposes Act (UDITPA). Most states adopted the COP rule initially. Section 17 originally provided that "[s]ales, other than sales of tangible personal property, are in this State if: (a) the income-producing activity is performed in this State; or (b) the income-producing activity is performed both in and outside this State and a greater proportion of the income-producing activity is performed in this State than in any other State, based on costs of performance."

of the consumer, rather than the service provider. Under this approach, if the service is provided in more than one state, then the service is sourced to a state "if and to the extent the service is delivered to a location in this state."[3]

The important point here is not the changes in state apportionment formulas relating to the sourcing of multistate services, or the reasons behind the shift. Rather, it is the fact that there are two very different approaches to the sourcing of these types of receipts. Under the COP method, services are sourced primarily based on the activities and location of the **service provider.** The "market-based sourcing" approach does just the opposite, sourcing services primarily based on the location of the **customer**. While states have shifted on the approach, most have made the shift legislatively and there has been a consensus that the two rules have very different outcomes and policy rationales.

Westcott and *Sirius XM* together, however, essentially apply both the COP and market-based approaches, respectively, without any legislative change to the underlying sourcing statute. This incompatibility highlights the need for this Court to accept the instant case. The validation of two very different sourcing approaches

[3] In 2014, Article IV, Section 17 of the Compact was changed to a "market-based sourcing" approach by the Multistate Tax Commission. For further discussion, see Report of the Hearing Officer Multistate Tax Compact Article IV [UDITPA] Proposed Amendments by Richard Pomp, July 2013. Revised Section 17 provides that "[r]eceipts, other than receipts described in Section 16, are in this State if the taxpayer's market for the sales is in this state. The taxpayer's market for sales is in this state…(3) in the case of sale of a service, if and to the extent the service is delivered to a location in this state…"

under the same statutory language is not the basis for sound judicial precedent. If not addressed by this Court, the contradictory rulings will undermine taxpayer confidence in the rule of law and the fairness of the application of the Texas franchise tax.

B. If *Sirius XM* Narrows the Applicability of *Westcott*, then the Court of Appeals Creates Additional Uncertainty That Needs to Be Addressed.

Alternatively, if the application of *Westcott* has been narrowed by this case, there is still ambiguity that further exacerbates the lack of predictability. In overturning the trial court's decision in *Sirius XM*, the Court of Appeals agrees with the Comptroller's interpretation that where the "service [is] performed" means where the "receipt-producing, end-product act" is done, as first pronounced in a 1980 Comptroller Decision, Texas Comptroller Public Accounts Hearing No. 10,028. Under this standard, the Court of Appeals found that Sirius XM should source its services based on the local decryption of the satellite that occurred on each subscriber's radio. The Court of Appeals then presumes that if the subscriber had a Texas address, then that subscriber's subscription fees should be sourced to Texas.

With this determination, however, the Court of Appeals has left the "receipt-producing, end-product act" standard unclear. In *Westcott*, there is no mention of the "receipt-producing, end-product act" standard, other than reference to the court's adoption of the "where the act is done" standard from *Humble Oil & Refining Co. v.*

Calvert, 414 S.W.2d 172 (Tex. 1967). 104 S.W.3d at 146. If the "receipt-producing, end-product act" standard was applied equally in *Westcott* and *Sirius XM*, then the Court of Appeals fails to explain what makes an act a "receipt-producing, end-product act" in either case.

The two decisions simply cannot be reconciled, no matter how hard the Court of Appeals tried to do so. At a minimum, these decisions create ambiguity as to the role and application of the "receipt-producing, end-product act" standard.[4] The only certain thing is that this uncertainty will allow the Comptroller to determine what the relevant act is for any taxpayer. This leaves service providers on unequal footing as they are left without a clear methodology to determine if a "service [is] performed in the state." Tex. Tax Code § 171.103(a)(2).

II. Clarification of the Sourcing Rule for Services Is Important to Multijurisdictional Businesses with Operations in Texas.

Westcott and *Sirius XM* both involve satellite programming providers. But the Texas sourcing rule for services applies to, and is of great importance to, all businesses providing services, at least to the extent they provide services in Texas and at least one other state. One of the most significant changes in the economy over the last 50 years has been the enormous growth of the service sector. The provision

[4] The "receipt-producing, end-product act" standard also does not fit squarely within the historical statutory language found in either the costs of performance or market-based sourcing approach taken by other states to source receipts from the performance of a service.

of services now makes up more of the overall economy than sales of tangible personal property.

The Federation of Tax Administrators (FTA), an organization representing all of the state tax collection agencies, conducted a survey in 2017 of all the primary service industries and designated 198 different service offerings in the United States economy.[5] While some of these service categories such as dry cleaning, barber shops and beauty parlors, and bail bond fees are typically local activities that do not raise multi-state sourcing issues, many if not most of the other service categories are (or can be) provided on a multi-state basis. These include services relating to telecommunications, data processing, legal and accounting, engineering, electricity, real estate, transportation, advertising, streaming, cloud computing, and finance.

This large and divergent cross-section of service businesses is impacted by state income and franchise tax rules as to how services that are provided in multiple states should be sourced. Thus, the ambiguity that currently exists in Texas given the *Wescott* and *Sirius XM* decisions will create difficulties relating to tax compliance and financial reporting obligations of tax liabilities for tens of thousands of businesses operating in Texas.

[5] Federation of Tax Administrators, *FTA Survey of Services Taxation – Update (July-August 2017)*, https://www.taxadmin.org/assets/docs/ByTheNumbers/0817_services.pdf.

CONCLUSION

For the foregoing reasons, COST urges this Court to accept review of this case. The Court needs to clarify the rule for sourcing the sales of services so that tens of thousands of multijurisdictional service providers have a clear and consistent rule to follow in complying with the Texas franchise tax.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing brief was served on all counsel of record through the Court's electronic filing system on July 15, 2020.

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CERTIFICATION OF COMPLIANCE

I certify that the foregoing brief was prepared using Microsoft Word 2016, and that, according to its word-count function, the sections of the foregoing brief covered by TRAP 9.4(i)(1) contain 2689 words in a 14-point font size and footnotes in a 12-point font size.

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