Texas Supreme Court rejects challenge to state business tax

Decision eliminates any question of constitutionality of the tax.

By Kate Alexander
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The Texas Supreme Court on Friday rejected a constitutional challenge to the state’s main business tax for the second time in a year.

The 6-2 decision “removes any doubt as to the tax’s constitutionality on its face,” said John Kennedy of the Texas Taxpayers and Research Association, a business-backed organization.

Other than that, Kennedy said, “it plows no new ground.”

Food and beverage giant Nestle USA Inc. had claimed the tax, known as the margins or franchise tax, was not applied uniformly to different kinds of businesses. Nestle’s vast operation, which includes out-of-state manufacturing, paid a higher tax rate than in-state manufacturers.

The court maintained that the tax, which is imposed in exchange for the right to do business in Texas, had been applied fairly because Nestle’s business in Texas benefits from the out-of-state manufacturing.

“What Nestle criticizes as a departure from uniformity is actually an attempt to treat like taxpayers alike,” Justice Nathan Hecht wrote in the majority opinion.

Justices Don Willett and Debra Lehrmann dissented on grounds that the court did not have jurisdiction to hear the case.

Last year, the court turned aside an argument from a business partnership that the tax was effectively a personal income tax, which is prohibited by the Texas Constitution.

The stakes were higher in the earlier case because it was the first time the court had examined the tax, which is the second largest source of general revenue for state government. This case, however, induced little nail-biting.

The margins tax was overhauled in 2006 as part of a school finance reform package. The changes were intended to increase the pool of taxpayers and raise more money to help pay for a reduction in school property tax rates.

But the tax has largely under-delivered and created frustration in many business circles.
Will Newton, executive director of the Texas chapter of the National Federation of Independent Business, said the tax is dysfunctional and “has been unfair and burdensome for far too many struggling business owners.”

Newton’s organization, which backed the Nestle challenge, has been pushing legislators to retool the tax when they return to Austin in January.

State Rep. Harvey Hilderbran, the chairman of the tax-writing Ways and Means Committee, has indicated that he expects to tweak some well-documented problems with the tax but was not opening it to a wholesale rewrite.

Kennedy said Friday’s court decision removes another impetus for the Legislature to undertake any significant restructuring of the tax.

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