

Texas Supreme Court clarifies franchise tax services sourcing

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TAX ALERT | March 31, 2022

In a long anticipated decision, the Texas Supreme Court has held in [Sirius XM Radio, Inc. v. Hegar](#) that Sirius XM's receipts from Texas subscribers are apportioned based on where the company's personnel or equipment performing the service are physically located. The Texas Comptroller had argued that receipts should be apportioned based on the location of the satellite-enabled radio. The high court reversed a Texas Court of Appeals ruling that found the taxpayer's receipts should be sourced where the "receipt-producing end-product act" of decrypting radio signals occurred.

The comptroller had assessed additional franchise tax and interest on Sirius XM asserting that the service performed in Texas was the decryption of radio signals and that revenue from Texas subscribers should be sourced to the state. Essentially, the comptroller argued that the service – the decryption – takes place on each subscriber's radio in Texas. Texas has not adopted market-based sourcing for services. Sirius XM challenged the assessment contending that under Texas Tax Code section 171.103(a) (relating to sourcing of gross receipts for purposes of the franchise tax), service receipts are apportioned to Texas if the service is performed in the state. In this case, Sirius XM argued that its receipt-producing activities were the creation of broadcast content, most of which occurred outside Texas.

Interpreting section 171.103(a), the supreme court stated "[t]he most natural reading of 'service performed in this state' supports locating the performance of the service at the place where the taxpayer's personnel or equipment is physically doing useful work for the customer." The court noted that where a taxpayer's employees conduct their work indicates the location of the services rendered. Ultimately, the court recognized and emphasized the economic reality of the transaction, that Sirius XM was a radio production and broadcasting company.

Takeaways

The *Sirius XM* decision provides important clarification for all businesses selling services or intangible property into Texas. The decision comes on the heels of regulations addressing sourcing of services [promulgated last year](#) by the comptroller. Appropriately determining where services are performed will be critical in determining the sourcing receipts of services which can have a significant impact on Texas franchise tax liabilities.

Many businesses sell services via electronic and other nontangible methods. As a result of *Sirius XM*, it is anticipated that the Texas Comptroller will provide clarifying guidance and possibly revised policy. Taxpayers should consider reviewing their historic sourcing methodology to identify refund opportunities. Taxpayers with questions about the decision should speak to their Texas state and local tax advisers.

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