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## Paid Under Protest: Can Firms Deduct Parking, CLE From Franchise Taxes?

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Jennifer Patterson Rabb, of counsel at Winstead in Austin  
Image: Steven Noreyko



Winstead shareholder Peter Nolan, Austin

A BigTex firm that was audited by the state comptroller's office has filed a suit that could affect the tax payments of any law firm that offers certain employee perks.

The controversy is whether to classify Winstead's expenses for continuing legal education, attorney occupation taxes and parking as deductible "employee benefits" under the Texas Tax Code or as nondeductible "working condition amounts" under state comptroller rules related to the franchise tax, also known as the margin tax.

The firm asks the court for a declaratory judgment that the rule is invalid. It also seeks a refund of the \$29,974.15 it paid under protest after the audit.

Jennifer Patterson Rabb, of counsel at Winstead in Austin, believes the suit "will affect the margin tax liability of all law firms because I think it's typical for law firms to have these types of expenses. . . . Any law firm who pays these kinds of expenses as part of their compensation package has the same interest as Winstead in this suit."

The franchise tax, Texas Tax Code Chapter 171, went into effect on Jan. 1, 2008. Rabb and Austin shareholder Peter Nolan represent their firm in *Winstead PC v. Susan Combs, et al.*, which names Texas' comptroller Combs and state Attorney General Greg Abbott as defendants.

Winstead alleges the following in its Jan. 19 petition, filed in Travis County's 201st District Court: For federal income tax purposes, a taxpayer may deduct expenses incurred in carrying out a trade or business,

"including 'a reasonable allowance for salaries or other compensation for personal services actually rendered.' "

For state franchise tax purposes, the Texas Tax Code permits a taxpayer to deduct compensation, which includes the cost of benefits, to the extent deductible for federal income tax purposes, Winstead continues.

Therefore, Winstead argues it should be allowed to deduct benefits when calculating its franchise tax obligation.

However, the comptroller's rule — 34 Texas Administrative Code §3.589(e)(2), effective in 2008 — drills down further to define what benefits are *not*. For example, they are not "working condition amounts provided so employees can perform their jobs."

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 3(e)(2), examples of working condition benefits include an employee's use of a company car for business, job-related education provided to an employee, and travel reimbursement."

Winstead argues the comptroller's rule conflicts with the Texas Tax Code. "The [comptroller's] rules can't change what the law is," Nolan says, adding, "If you can deduct it [employee-benefit expenses] for federal income tax purposes, you ought to be able to deduct it under franchise tax purposes."

**Deduction Friction**

In its petition, Winstead explains that, for calculating franchise taxes, a taxpayer may choose to deduct from total revenue the cost of goods sold, compensation or 30 percent of total revenue. Winstead chose to deduct compensation. [\[See the Winstead petition.\]](#)

In 2008 and 2009, Winstead filed and paid its franchise taxes, deducting employee-benefits expenses totaling \$1,133,389 and \$1,318,747, respectively. It deducted the same expenses for its federal taxes, according to the petition.

Winstead notes in its petition that the comptroller's office audited the firm's franchise taxes and on May 23, 2011, indicated amounts due of \$11,231.88 for 2008 and \$13,021.31 for 2009. The comptroller determined Winstead owed additional amounts because of the deducted employee-benefits expenses, the firm alleges.

Winstead writes that it filed the suit within 90 days of sending the comptroller letters of protest, which accompanied its protested tax payments.

Nolan says the question is "whether the employee benefits are reasonable amounts included in the compensation of Winstead employees, which is given in exchange for the employee's services. . . . We're saying they are part of the compensation package, and the comptroller is saying they are not."

Nolan says many firms tout their compensation packages when they recruit new lawyers.

"They say, 'OK, firm X says they'll pay you this amount of money. But look: When you add in our firm's benefits and the amount we pay you, we are paying you more.' In a practical matter, these packages are viewed by the employees as their compensation," says Nolan.

Rabb says the issue could affect law firms organized as partnerships, professional corporations or professional limited liability companies.

Tom Kelley, spokesman for the Texas Office of the Attorney General, declines comment. Messages left for Texas Comptroller of Public Accounts spokesman R.J. DeSilva and communications director Brooke Botello were not returned.

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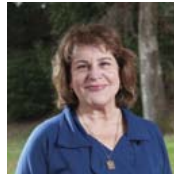
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