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TGS-NOPEC Victory in Franchise Tax Case has Broad Implications for Texas Businesses

By **Maryellen Shea, James T. McBride and Steven D. Moore**

On May 27, 2011, The Texas Supreme Court found in favor of TGS-NOPEC Geophysical Company in a dispute involving how TGS' receipts from the licensing of its geophysical data should be apportioned for Texas franchise tax purposes. This long-awaited decision has far-reaching effects not only for the seismic and geophysical data industry but for other industries that grant licenses in intangible assets not otherwise apportioned in the sourcing statute.

The dispute involved how TGS' receipts from licensing its data should be sourced under the Texas Tax Code. The sourcing statute provides that a corporation's gross receipts from business done in Texas includes "the corporation's receipts from . . . the use of a patent, copyright, trademark, franchise, or license in this state . . ." § 171.103(a)(4). TGS argued that the revenue from its geophysical data should have been characterized as receipts from the license or sale of an intangible asset rather than from the *use* of a license, and thus should be considered "other business done in this State," which is properly sourced to the company's legal domicile.

TGS argued that the word "license" must be read in the context of the whole statute and that consideration must be given to what it means to "*use* a license." The Comptroller asserted that because TGS employed license agreements to complete its sale of data in Texas the revenue was derived from the *use of a license* and should have been sourced to Texas. The Court rejected the Comptroller's interpretation, finding it inconsistent with the language of the statute itself, its own administrative rule and the treatment of other types of intangible assets.

The Court invoked the canon of statutory construction known as *noscitur a sociis*, or "it is known by its associates," to find that the word "license" must be interpreted in a similar manner as "patent," "copyright," "trademark" and "franchise." The Court analyzed how the statute applies to patents and copyrights, noting that when a business wants to use these intangible assets, it is typically granted permission to do so through a license, but it is the patented or copyrighted item that is actually used. Based on that analysis, the Court determined TGS' clients "use" the underlying geophysical data – not the license. The Court found that the term "license" as used in the sourcing statute refers to licenses that are themselves revenue-producing assets, rather than to the mechanism of licensing the intangible assets. The Comptroller's interpretation would result in the taxing of all intangible assets, which is not provided by the statute. The Court noted that the Texas Legislature could have drafted the sourcing statute to include receipts from the use of *intangible assets* rather than from only certain specified intangible assets, but did not do so.

The Court also found that the Comptroller's interpretation contradicted its own administrative rule, which provides that the underlying asset must be *owned* by the revenue recipient and used by someone else. The Court agreed that TGS owns the seismic data, not the license. Rather, TGS' customers – the licensees – own the license, but use the seismic data.

Finally, the Court noted the Comptroller's unequal treatment given to the licensing of software. The Comptroller does not attempt to tax the software industry based upon the mechanism of licensing, rather it allocates receipts from the licensing of software as sales of intangibles under a catch-all provision and allocates taxes based upon the location of the payor.

James T. McBride, a partner with Jackson Walker in Houston, presented oral argument to the Court on behalf of TGS-NOPEC Geophysical Company with assistance from **Maryellen Shea**, **Elaine Conway** and Jackson Walker's Tax department led by **Steven D. Moore** of the Austin office.

If you have any questions about this e-Alert or how this Texas Supreme Court decision affects your business, please contact any one of the attorneys listed below:

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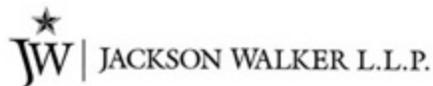
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