



**THE ATTORNEY GENERAL
OF TEXAS**

AUSTIN 11, TEXAS

**JOHN BEN SHEPPERD
ATTORNEY GENERAL**

November 1, 1956

Hon. Tom Reavley
Secretary of State
Capitol Station
Austin, Texas

Opinion No. S-217

Re: Proper treatment in a franchise tax return of an amount shown as "reserve for vacation pay" for vacations earned during the taxable year but to be taken during the succeeding year.

Dear Mr. Reavley:

You have requested an opinion of this Office as follows:

"We have a fact situation involving the proper classification of a certain reserve item. Our tentative decision to classify the reserve as a part of the surplus or net worth for franchise tax purposes has been challenged by the taxpayer.

"The reserve is identified in the liability section of the balance sheet presented in the corporation's franchise tax return as 'Reserve for Vacation Pay'. Upon our requesting information as to the exact nature of the use to be made of the amount so set aside, the corporation submitted the following facts:

"This amount represents an estimate of the liability to employees existing December 31 for vacation pay earned on and prior to such date but which will not be paid until the following year. Even though an employee completes his vacation for one year in December, he may start his vacation for the following year on January 1. An employee's right to a vacation beginning on January 1 is established by virtue of his having performed services during the preceding year. Thus, the Company has a definite liability for vacations at the end of each year. Since it is the general accounting policy to charge against income the expense

attributable thereto, even though the expense is not paid until the subsequent year, it was decided that this liability should also be accrued on the corporate books. It is not considered proper accounting to treat such a liability as a surplus reserve. As further evidence of this liability, the Federal Government has allowed . . . deductions for income tax purposes, on an accrual basis for all years audited after 1941.'

"With the foregoing facts before you, please advise this office if an amount designated in the balance sheet as 'Reserve for Vacation Pay' should under the franchise tax law, be classified as a surplus item for franchise tax purposes."

It is immaterial what the Federal Government does concerning deductions for income tax purposes. The Secretary of State is not bound by Federal Income Tax Laws in the administration of the franchise tax laws of this State. This position is based on an analogous situation concerning decisions of federal courts construing the income tax statutes. In Houston, Belt & Terminal Ry. Co. v. Clark, 122 S.W.2d 356 (Tex.Civ.App., 1938, sustained in 135 Tex. 388, 143 S.W.2d 373, 1940) the Court said:

"Appellant contends that the part of said opinion relied upon by appellees is pure obiter dictum; and that the decision is out of harmony with later decisions of Federal Courts construing the income tax statutes. As to such alleged conflicts we have made no search, because they are not material. Such decisions are not binding on this Court."

The only question to be determined is, does the "Reserve for Vacation Pay" constitute "surplus" within the purview of the franchise taxing statute? A. B. Frank & Co. v. Latham, 145 Tex. 30, 193 S.W.2d 671, 672 (1946).

Article 7084, Vernon's Civil Statutes, levies a franchise tax against corporations based upon that proportion of the outstanding capital stock, surplus and undivided profits, plus the amount of outstanding bonds, notes, and debentures,

as the gross receipts from the business done in Texas bear to the total gross receipts of the corporation.

Article 7089, V.C.S., provides that all corporations required to pay a franchise tax shall between January First and March 15th of each year make a report to the Secretary of State, on forms furnished by that officer, showing the condition of such corporation on the last day of the fiscal year. It further requires, among other things, that "Said report shall give the cash value of all gross assets of the corporation." (Emphasis ours.)

In United North & South Development Co. v. Heath, 78 S.W.2d 650 (TexCiv.App. 1935, error ref.), the Court said in defining the surplus account of a corporation:

" . . . The surplus account represents the net assets of a corporation in excess of all liabilities including its capital stock."

Article 1.02, Section A (12), of the Business Corporation Act of Texas, states that "surplus" means excess of the net assets of a corporation over its stated capital.

In our opinion, a liability, within the terms of our franchise tax laws is not created by the fact that employees may take their paid vacations in a year subsequent to the year in which the paid vacations were earned. Employee A begins his employment on the first of the corporation's fiscal year and earns a vacation for that year but does not take same during that year. The following year he also earns a paid vacation and takes only one vacation that year in that his second paid vacation is taken the following year. It is thus seen that in no one year does the employee take more than one vacation-- the same amount of paid vacations as he actually earns during that particular year.

In our opinion a "Reserve for Vacation Pay" set-up on the books of a corporation in any one year, to pay employees for that period of time in the future when the employees take their vacation, should be treated as "surplus" for franchise tax purposes.

SUMMARY

A "Reserve for Vacation Pay" set up on the books of a corporation in any one year, to pay the employees for that period of time in the future when the employees take their vacation, should be treated as "surplus" for franchise tax purposes, under Article 7084, V.C.S.

APPROVED:

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Taxation Division

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Reviewer

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Yours very truly,

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By *Henry Gates Steen*
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