In The
Court of Appeals
Seventh District of Texas at Amarillo

No. 07-20-00301-CV

RTU, INC., APPELLANT

V.

GLENN HEGAR, COMPTROLLER OF PUBLIC ACCOUNTS FOR THE STATE OF TEXAS, AND KEN PAXTON, ATTORNEY GENERAL OF THE STATE OF TEXAS, APPELLEES

On Appeal from the 98th District Court
Travis County, Texas
Trial Court No. D-1-GN-17-001941; Honorable Karin Crump, Presiding

January 3, 2022

OPINION

Before ore QUINN, CJ., and PIRTLE and DOSS, JJ.

Appellant, RTU, Inc., appeals from the trial court's judgment denying its motion for summary judgment and granting the motion for summary judgment of Appellees, Glen Hegar, Comptroller of Public Accounts for the State of Texas, and Ken Paxton, Attorney

General of the State of Texas (hereafter "the Comptroller").[1] The underlying suit resulted from RTU's unsuccessful exhaustion of administrative proceedings attempting to establish an exemption from paying sales tax for electricity it consumed between 2007 and 2011. RTU presents three issues in its original brief challenging the trial court's final judgment and by its reply brief, it argues against the Comptroller's position that it was not entitled to an exemption as to the payment of sales tax. By its first two issues, RTU asserts the trial court erred in granting summary judgment in favor of the Comptroller and rendering a take-nothing judgment. Pivotal to resolution of issues one and two, is issue three by which RTU questions whether its printing of third-party advertising on the reverse side of register tapes qualifies as "manufacturing" under section 151.318 of the Texas Tax Code which exempts it from sales tax for electricity use. We reverse and render judgment in favor of RTU, in part, and remand, in part.

BACKGROUND

RTU, a manufacturer of cash register tapes, was founded in 1989. At that time, it was predominantly a marketing company that sold advertising and outsourced all the printing for and production of register tapes. In 2003, however, RTU transitioned into the printing business and began producing register tapes and selling them to grocery stores, restaurants, and retail stores for use in their point-of-sale machines. Grocery stores comprise the largest segment of RTU's customer base.

[1] Originally appealed to the Third Court of Appeals, sitting in Austin, this appeal was transferred to this court by the Texas Supreme Court pursuant to its docket equalization efforts. TEX. GOV'T CODE ANN. § 73.001 (West 2013). Should a conflict exist between precedent of the Third Court of Appeals and this court on any relevant issue, this appeal will be decided in accordance with the precedent of the transferor court. TEX. R. APP. P. 41.3.

According to deposition testimony from RTU's CEO, the company's former comptroller suggested conducting a "predominant use" study on electricity consumption to accelerate depreciation on its building at its plant located at 17015 Park Row in Houston. RTU hired an engineer to conduct a twelve-month utility study to ascertain "whether the electricity was predominantly used to produce register tapes and/or to light, heat, or cool the manufacturing area of the plant." The study spanned a twelve-month period from July 2010 to June 2011. The result of the study was that 66.74 percent of the electricity consumed at the plant was used to power exempt manufacturing equipment and to light, heat, or cool the manufacturing area. Based on that percentage and apart from the depreciation issue, the engineer concluded that RTU was also entitled to an exemption from sales tax on electricity purchased from its provider for its Houston plant.

Based on the predominant use study and the engineer's conclusion, RTU filed a claim with the Comptroller for a tax refund in the sum of $68,178.90 for the period beginning November 1, 2007, through November 30, 2011. RTU argued that based on certain provisions of the Texas Tax Code, it qualified for a tax exemption because over fifty percent of the electricity used during that period was for manufacturing. When RTU's refund claim was denied, it requested and was granted a hearing on the claim. At the initial administrative level the claim was again denied and, in April 2017, RTU's motion for rehearing was also denied. RTU then filed its original petition seeking a refund of sales tax paid for electricity purchased between 2007 and 2011.

In its petition, RTU alleged it was a manufacturer and that based on the results of the predominant use study, it was entitled to an exemption for sales tax paid on its use of electricity at its Houston plant during the relevant time period. According to RTU's

pleading, the Comptroller agreed that the machinery and equipment used to print and cut blank register tapes and tapes with customer-only advertising qualified for the manufacturing exemption. However, the Comptroller refused a sales tax refund on the ground that third-party advertising printed on the reverse side of register tapes did not qualify for the Tax Code's manufacturing exemption.

Both parties filed motions for summary judgment. The Comptroller reasoned that the predominant use study was flawed because it included the imprinting of register tapes with third-party advertising as nontaxable manufacturing. It concluded that RTU failed to meet its burden to clearly show it was entitled to an exemption from payment of sales tax for electricity consumption. After considering the competing motions and summary judgment evidence, the trial court granted the Comptroller's motion and denied RTU's motion. A take-nothing judgment was rendered against RTU resulting in this appeal.

ISSUE THREE—DOES PRINTING OF THIRD-PARTY ADVERTISING QUALIFY AS MANUFACTURING?

We address RTU's issues in a logical rather than sequential order. Thus, we first address issue three, which RTU contends is the ultimate point of disagreement. It contends that its printing of third-party advertising on certain register tapes as opposed to customer-specified advertising does not preclude it from qualifying for the manufacturing exemption under section 151.318 of the Texas Tax Code.

APPLICABLE LAW

Texas law requires that every sale of property be taxed unless it is exempt. *See* TEX. CONST. art. VIII, § 2. *See also* TEX. TAX CODE ANN. § 151.051(a) (imposing sales tax on all taxable items). The purchase of electricity is generally subject to a sales and use

tax. *Geo Grp.*, *Inc. v. Hegar*, No. 03-15-00726-CV, 2017 Tex. App. LEXIS 7559, at *1 (Tex. App.—Austin Aug. 10, 2017, pet. denied) (mem. op.). An exception to the general rule to impose a sales tax on electricity is found in the following statutes:

> **Section 151.317. Gas and Electricity**
>
> (a) Subject to [certain sections], gas and electricity are exempted from the taxes imposed by this chapter when sold for:
>
> * * *
>
> (2) use in powering equipment exempt under Section 151.318 or 151.3185 by a person processing tangible personal property for sale as tangible personal property, other than preparation or storage of prepared food described by Section 151.314(c-2);
>
> (3) use in lighting, cooling, and heating in the manufacturing area during the actual manufacturing or processing of tangible personal property for sale as tangible personal property, other than preparation or storage of prepared food described by Section 151.314(c-2)[.]
>
> * * *
>
> (d) Natural gas or electricity used during a regular monthly billing period for both exempt and taxable purposes under a single meter is totally exempt or taxable based on the predominant use of the natural gas or electricity measured by that meter. The comptroller may prescribe by rule the procedures by which a purchaser must establish the predominant use of the natural gas or electricity.
>
> **Section 151.318. Property Used in Manufacturing**
>
> (a) The following items are exempted from the taxes imposed by this chapter if sold, leased, or rented to, or stored, used, or consumed by a manufacturer:
>
> * * *
>
> (2) tangible personal property directly used or consumed in or during the actual manufacturing, processing, or fabrication of tangible personal property for ultimate sale if the use or

> consumption of the property is necessary or essential to the manufacturing, processing, or fabrication operation and directly makes or causes a chemical or physical change to:
>
> > (A) the product being manufactured, processed, or fabricated for ultimate sale;
> >
> > * * *
>
> (t) [i]n addition to the other items exempted under this section, pre-press machinery, equipment, and supplies, including computers, cameras, photographic props, film, film developing chemicals, veloxes, plate-making machinery, plate metal, litho negatives, color separation negatives, proofs of color negatives, production art work, and typesetting or composition proofs, that are necessary and essential to and used in connection with the printing process are exempted from the tax imposed by this chapter if they are purchased by a person engaged in:
>
> > (1) printing or imprinting tangible personal property for sale . . . .

TEX. TAX CODE ANN. § 151.317(a)(2), (3); § 151.318(a)(2)(A), (t).

To aid in enforcing section 151.317, the Comptroller promulgated tax Rule 3.295. *See* 34 TEX. ADMIN. CODE § 3.295 (Natural Gas and Electricity); *Tex. Citrus Exch. v. Sharp*, 955 S.W.2d 164, 167 (Tex. App.—Austin 1997, no pet.). The predominant use (i.e., use greater than fifty percent) determines whether all of the electricity flowing through one meter is exempt or taxable. *Cafeteria Operators*, *L.P. v. Rylander*, 96 S.W.3d 460, 461 n.2 (Tex. App.—Austin 2002, pet. denied) (on reh'g). It is an all-or-nothing proposition for each meter. *Spencer Gifts*, *Inc. v. Bullock*, 766 S.W.2d 593, 599 (Tex. App.—Austin 1989, no writ). A business may have both taxable and non-taxable uses of electricity. *Id.* If a meter measures both kinds of uses, then the taxpayer must demonstrate that more than fifty percent of the use is non-taxable to claim an exemption. *Id.*

A taxpayer demonstrates that its predominant use of electricity is exempt by performing a utility study. *Rylander v. Haber Fabrics Corp.*, 13 S.W.3d 845, 849 (Tex. App.—Austin 2000, no pet.). "The study must list all uses of the utility, both exempt and nonexempt, the times of usage, the energy used, and whether the use was taxable or exempt." *Id.* The study must cover a period of twelve consecutive months and be certified by an engineer. *Id.* The business owner must certify that all items using the utility are listed and that hours of use for each item are correct. *Id.*

ANALYSIS

The Comptroller's motion for summary judgment was supported by deposition testimony from RTU's CEO and copies of agreements between RTU and three of its largest grocery chain customers—Kroger, H-E-B, and Albertson's. The Comptroller also included a copy of RTU's predominant use study certified by the engineer who performed the study.

RTU filed its own motion for summary judgment on the same day but subsequent to the Comptroller's motion. It presented as the threshold issue whether its electricity purchases for its Houston plant were exempt from sales tax. RTU asserted it was a "manufacturer"[2] and posited that its electricity purchases "involve[d] equipment directly used in the production of thermal tapes sold to customers and [did] not involve

[2] A "manufacturer" is defined as a person engaged in manufacturing. 34 TEX. ADMIN. CODE § 3.300(a)(8). Under section 151.318 of the Tax Code, "manufacturing" includes each operation beginning with the first stage in the production of tangible personal property and ending with the completion of tangible personal property having the physical properties (including packaging, if any) that it has when transferred by the manufacturer to another. TEX. TAX CODE ANN. § 151.318(d).

advertising."[3] It also alleged, that in addition to its pre-press equipment (computers), its printing press, ultraviolet dryers, and convertors qualified for the manufacturing exemption because they were "necessary and essential" to the production of the register tapes and were directly used to create a physical or chemical change to the register tapes sold.

In support of its motion for summary judgment, RTU included copies of its pleadings and an affidavit from its CEO attesting to facts that corresponded with his deposition testimony. RTU also submitted as evidence a copy of the predominant use study, its electricity bills from its plant for the relevant years with proof of payment, and copies of agreements with Kroger and H-E-B.

The deposition testimony and affidavit from RTU's CEO presented the following facts:

- RTU has a single electric meter at its Houston plant located at 17015 Park Row;
- RTU is a "print vendor," and a "register tape provider";
- RTU owns the equipment used to make register tapes, specifically, a printing press, an automatic splicer, a converter roll, ultraviolet dryers, and a computer;
- RTU purchases jumbo rolls of thermal paper;
- the jumbo rolls are fed through printing presses where ink is applied;
- the ink is dried with ultraviolet dryers;
- the jumbo rolls are then fed through a converter that cuts and cores each jumbo roll into 3,264 individual register tapes;

[3] RTU does not deny that in addition to manufacturing register tapes, it also sells advertising on the reverse side of third-party register tapes and in the form of placards on shopping carts.

- the register tapes are sold, packaged, and a ninety-day supply is shipped to customers;

- Kroger receives 8.4 million rolls at no charge and then pays $0.89 per roll; at times, Kroger purchased up to 12 million rolls and always exceeded the number of "free rolls";

- H-E-B does not receive any free rolls and pays $0.2360 per roll or $11.80 per case;

- Albertson's does not receive any free rolls and pays $0.34 per roll or $17.00 per case;

- RTU sells three types of register tapes: (1) blank register tapes, (2) register tapes with in-store advertising on the reverse side, and (3) register tapes with third-party advertisement space on the reverse side;

- RTU hired an engineer to perform a twelve-month (July 2010 through June 2011) study of its electricity consumption at the Houston plant which showed that 66.74 percent of the electricity consumed was to power exempt manufacturing equipment and to light, heat, or cool the manufacturing area;

- RTU sells advertising space on the reverse side of some of its register tapes and also on placards attached to shopping carts.

Kroger Agreement

In consideration of the number of rolls offered to Kroger and the pricing arrangement, paragraph 1 of the agreement provided that "Kroger will provide to RTU the exclusive right to sell advertising messages for Kroger register receipt tape, to be printed on the reverse side . . . ." Paragraph 2 provided that "Kroger has the first right to the advertising space on the reverse side of the receipt tape . . . ." The agreement listed exclusions of the types of content that could be printed on the reverse side of the register tapes. For example, advertisements for Kroger's competitors and for items such as alcohol, tobacco, banks, and numerous other content were prohibited.

H-E-B Agreement

RTU agreement's with H-E-B provided for the sale of register tapes—"both printed and blank register roll paper . . . ." Paragraph D provided that "RTU shall have the right to imprint or cause to be imprinted upon the reverse side of such cash register tapes advertising messages that comply with the provisions of this Agreement." The agreement prohibited RTU from printing or selling advertising space to H-E-B's competitors and businesses such as pharmacies, gas stations, attorneys, and others at H-E-B's sole discretion.

Albertson's Agreement

RTU entered into an agreement with Albertson's for register tapes and grocery cart placards. Paragraph 1 gave RTU "the exclusive right to sell advertising to be imprinted on the reverse side of Albertson's cash register tapes and installed on Albertson's shopping carts." Paragraph 10 provided that "Albertson's shall have the option to utilize one (1) advertising space on the Register Tapes delivered . . . free of charge to advertise or promote Albertson's own products or services." The agreement included a list of categories that could not be advertised on the reverse side of register tapes.

Distilled to their essence, the arguments raised by the Comptroller are that (1) RTU's imprinting of advertisements is a pre-production activity that does not fall within the manufacturing exemption; (2) printing is not manufacturing; and (3) the equipment used to imprint advertisements on the reverse side of register tapes is not necessary or essential to produce the register tapes RTU sells to its customers. To support its arguments, the Comptroller asserts that the predominant use study is flawed because it intermingles the electricity used in manufacturing of blank register tapes and customer-

only advertising register tapes with third-party advertising tapes which it contends is not an exempt manufacturing activity.

Essential to resolution of the parties' dispute is a careful analysis of the statutes involved. "Manufacturer" is defined in the Texas Administrative Code as "a person engaged in manufacturing." 34 TEX. ADMIN. CODE § 3.300(a)(8). The Tax Code defines "manufacturing" as including "each operation beginning with the first stage in the production of tangible personal property and ending with the completion of tangible personal property having the physical properties (including packaging, if any) that it has when transferred by the manufacturer to another." TEX. TAX CODE ANN. § 151.318(d). As these definitions are provided by statute, there is no ambiguity. Here, the "first stage in the production" includes jumbo rolls of thermal paper (tangible personal property) purchased by RTU. The completion of the operation involves production of individual register tapes (tangible personal property) packaged and distributed to customers.

In harmonizing the relevant statutes, we begin with section 151.318(t)(1) which specifically provides that "pre-press machinery, equipment" and "computers . . . that are necessary and essential to and used in connection with the printing process are exempted" from taxation if purchased for "printing or imprinting tangible personal property for sale." Section 151.317 exempts tax on electricity sold for "use in powering equipment under Section 151.318" for processing "tangible personal property for sale as tangible personal property." The statute also exempts tax on electricity sold for "use in lighting, cooling, and heating in the manufacturing area during actual manufacturing or processing of tangible personal property for sale as tangible personal property . . . ."

Section 151.318(a)(2) exempts from taxation "tangible personal property directly used . . . during the actual manufacturing . . . of tangible personal property for ultimate sale if the use or consumption of the property is necessary or essential to the manufacturing . . . and directly makes or causes a chemical or physical change . . . ."

The Comptroller argues that printing third-party advertisements on the reverse side of register tapes is not "manufacturing" because RTU was not engaged in "actual manufacturing" when doing so and because its equipment was not "necessary or essential" to the manufacture of the register tapes. The Comptroller posits that RTU's customers are "contracting for the side of the paper that the printing is *not* on" and concludes that the electricity that powers RTU's equipment is not used in an exempt manner.

Section 151.318(t) unambiguously provides that the imprinting of tangible personal property for sale is manufacturing. RTU correctly notes that the statute does not make a distinction about the type of content that may be printed on the tangible personal property. The Comptroller ignores the fact that RTU's agreements with each customer include bargained-for provisions regarding the sale of register tapes. Each agreement gives RTU the right to sell advertising and imprint it on the reverse side of register tapes. Furthermore, the agreements give each customer complete control over the type of third-party advertising that may be printed on the reverse side of register tapes and includes a list of categories of advertisements that may not be printed on the reverse side of register tapes. Each customer also receives a price incentive for the use of register tapes with third-party advertising. As such, RTU established that to fulfill its agreements with its

customers, its equipment was "necessary and essential" to the actual manufacture of the register tapes it sold.

Finally, RTU presented evidence that it hired an engineer to certify whether the predominant use of electricity consumption at its Houston plant was to power exempt manufacturing equipment and to light, heat, or cool the manufacturing area. The predominant use study shows a detailed analysis of specific equipment and its electricity use. Based on the engineer's analysis of the twelve-month period from July 2010 to June 2011, he concluded that 66.74 percent of RTU's electricity consumption was for exempt purposes.

Based on the summary judgment evidence, we conclude the electricity used by RTU from November 1, 2007 through November 30, 2011, in its Houston plant for the manufacture of register tapes, whether blank or printed with customer-only advertising or third-party advertising on the reverse side, did not preclude RTU from claiming the manufacturing exemption in the Tax Code. Issue three is sustained.

ISSUES ONE AND TWO—DID THE TRIAL COURT ERR IN GRANTING SUMMARY JUDGMENT IN FAVOR OF THE COMPTROLLER?

Having determined that RTU was entitled to the manufacturing exemption for sales tax of its electricity use, we now address its first and second issues to consider whether the trial court erred in denying its motion for summary judgment and granting the Comptroller's motion for summary judgment.

STANDARD OF REVIEW

We review a grant of summary judgment *de novo*. *Trial v. Dragon*, 593 S.W.3d 313, 316-17 (Tex. 2019). When, as here, both parties move for summary judgment, each party bears the burden of establishing that it is entitled to judgment as a matter of law. *City of Richardson v. Oncor Elec. Delivery Co.*, 539 S.W.3d 252, 259 (Tex. 2018); *Garland v. Dallas Morning News*, 22 S.W.3d 351, 356 (Tex. 2000). When, as here, the trial court grants one motion for summary judgment and denies the other the reviewing court considers the summary judgment evidence presented by both sides, determines all questions presented, and if the reviewing court determines that the trial court erred, renders the judgment the trial court should have rendered. *Seabright Ins. Co. v. Lopez*, 465 S.W.3d 637, 641-42 (Tex. 2015). Neither party can prevail because of the failure of the other to discharge its burden. *Tigner v. First National Bank of Angleton*, 153 Tex. 69, 264 S.W.2d 85, 87 (1954).

When the trial court's order does not specify the grounds for summary judgment, we must affirm the judgment if any of the theories presented to the trial court and preserved for appellate review are meritorious. *Provident Life & Accident Ins. Co. v. Knott*, 128 S.W.3d 211, 216 (Tex. 2003). When the trial court's summary judgment does specify a ground on which it was granted, we generally limit our review to the grounds on which the trial court granted summary judgment. *Cincinnati Life Ins. Co. v. Cates*, 927 S.W.2d 623, 625-26 (Tex. 1996).

APPLICABLE LAW

Exemptions from taxation are not favored by the law and will not be favorably construed. *North Alamo Water Supply Corp. v. Willacy County Appraisal Dist.*, 804

S.W.2d 894, 899 (Tex. 1991) (citation omitted). Tax exemptions are subject to strict construction and are narrowly construed because they undermine equality and uniformity by placing a greater burden on some taxpaying businesses and individuals rather than placing the burden on all taxpayers equally. *Odyssey 2020 Academy*, *Inc. v. Galveston Cent. Appraisal Dist.*, 624 S.W.3d 535, 540 (Tex. 2021) (citing *North Alamo Water Supply Corp.*, 804 S.W.2d at 899). The taxpayer has the burden to "clearly show" that it falls within a statutory exemption. *Southwest Royalties*, *Inc. v. Hegar*, 500 S.W.3d 400, 404 (Tex. 2016); *Tex. Student Hous. Auth. v. Brazos County Appraisal Dist.*, 460 S.W.3d 137, 140-41 (Tex. 2015). All doubts are resolved in favor of the taxing authority and against the granting of an exemption. *Brazos Elec. Power Coop.*, *Inc. v. State Comm'n on Envtl. Quality & Richard A. Hyde*, 576 S.W.3d 374, 384 (Tex. 2019); *Instill Corp. v. Hegar*, No. 03-18-00374-CV, 2019 Tex. App. LEXIS 4482, at *11 (Tex. App.—Austin May 31, 2009, pet. denied) (mem. op.).

By issues one and two, RTU challenges the summary judgment entered in favor of the Comptroller and alleges error by the trial court in denying its motion for summary judgment. RTU contends it established as a matter of law its entitlement to the manufacturing exemption set forth in the Tax Code. We agree that it did.

The summary judgment rendered in favor of the Comptroller does not specify the ground on which it was granted. However, based on the language in the relevant statutes and the summary judgment evidence presented, the Comptroller did not meet its burden to show its entitlement to summary judgment while RTU discharged its burden to show that it was entitled to have its motion for summary judgment granted. As discussed above relevant to issue three, RTU established that printing is a manufacturing activity. It also

proved that more than fifty percent of the electrical consumption at its Houston plant was for power operating its equipment for processing tangible personal property (jumbo rolls of thermal paper) to sell to its customers as tangible personal property (individual register tapes). RTU also demonstrated that its predominant use of electricity was for use in lighting, cooling, and heating the manufacturing area during the actual manufacturing of register tapes and that it was billed under a single meter. As such, RTU showed as a matter of law that it was entitled to the manufacturing exemption from payment of sales tax for its electricity use during the relevant period. We conclude the trial court erred in granting summary judgment in favor of the Comptroller and in denying RTU's motion for summary judgment. Issues one and two are sustained.

CONCLUSION

The trial court's *Final Judgment* that RTU, Inc. take nothing in its suit against Glenn Hegar, Comptroller of Public Accounts for the State of Texas, and Ken Paxton, Attorney General for the State of Texas, is reversed and judgment is hereby rendered, in part, that RTU is entitled to a sales tax refund of $68,178.90 for sales tax paid on electricity purchased for use at RTU's Houston Plant from November 1, 2007 through November 30, 2011, and this cause is remanded, in part, for the entry of a final judgment. Upon entry thereof, the clerk of the trial court is ordered to furnish a copy of that judgment to the clerk of this court.

Patrick A. Pirtle
Justice