

This Week in State Tax (TWIST)

March 24, 2025



Texas: Supreme Court Holds Private Prison Contractor Not Entitled to Sales Tax Refund

In a recent decision, the Supreme Court of Texas ruled that a private prison contractor (taxpayer) was not an agent or instrumentality of the federal or state government and thus was not entitled to a sales tax exemption on certain purchases. The taxpayer owned and operated correctional facilities throughout the United States for the detention of federal and state inmates. The taxpayer, a Florida incorporated entity operating through multiple LLCs, contracted with government clients to operate detention facilities in Texas via a service contract directly with federal or state agencies or by subcontracting with counties that had contracted with the U.S. government to house federal prisoners. The taxpayer purchased items necessary to operate the facilities, such as electricity, natural gas, food, and furniture, and did not pay tax on its purchases under the taxpayer's belief that it was an agent or instrumentality of either the federal or state government and therefore exempt from tax. The Comptroller audited and assessed a deficiency which the taxpayer challenged; on hearing, the Comptroller upheld the assessment. After paying the tax owed, the taxpayer challenged the assessment in district court. The trial court and appeals court upheld the deficiency, and the taxpayer appealed to the Texas Supreme Court.

In Texas, sales tax is imposed on the sale of tangible personal property and certain services unless an exception applies. Texas law provides an exemption for purchases by governmental entities defined as (1) the United States, (2) unincorporated instrumentalities of the United States, (3) a corporation that is an agency or instrumentality of the United States and is wholly owned [directly or indirectly] by the United States, or (4) this state. A Comptroller rule further delineates that certain entities are generally considered exempt if they (1) are unincorporated agencies and instrumentalities funded by the U.S., (2) carry out specific programs of the U.S., (3) are managed and controlled by officers of the U.S., (4) have officers that are appointed by the U.S., (5) perform commitments of the United States under an international treaty, and (6) are not organized for private profit.

The supreme court explained that the taxpayer at best satisfied two of the six characteristics required to be considered an agent or instrumentality of the federal or state government given the taxpayer was partially funded by the federal and state governments and carried out a specific program of housing federal and state detainees. The court ultimately rejected the taxpayer's argument that it should be considered an "instrumentality" based on performing a "quintessential government function." The supreme court emphasized that the statutory criteria for tax exemption required more than simply performing a government-like function; it required a closer nexus to government control and ownership. The taxpayer, as a private, for-profit corporation, did not meet the necessary criteria, such as being wholly owned by the government or being unincorporated and managed by

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government-appointed officers. Consequently, the Texas Supreme Court affirmed the lower courts' rulings, holding that the taxpayer did not qualify for the sales tax exemption as a government instrumentality. Contact [Karey Barton](#) for more information on *GEO Grp., Inc. v. Hagar*.

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