



This Week in State Tax (TWIST)

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Texas: Appellate court finds franchise tax preempted by AHTA as applied to taxpayer

A Texas Court of Appeals has upheld the determination of a lower court in holding that the Texas franchise tax is preempted by the federal Anti-Head Tax Act (AHTA) as applied to the taxpayer, a Texas-based air carrier. Congress enacted the AHTA in 1973; the U.S. Supreme Court has interpreted it to prohibit states and localities from levying or collecting a tax, fee, head charge, or other on charge “on or measured by gross receipts” from air commerce or transportation. The Texas franchise tax is imposed on the “taxable margin” of Texas taxpayers. The calculation of taxable margin begins with a taxpayer’s total revenue computed by adding certain entries from the federal income tax return and deducting certain types of receipts specified in law. A taxpayer’s “taxable margin” is computed by taking one of four specified deductions (30 percent of total revenue in this instance) and apportioning the remaining amount among all jurisdictions by an apportionment factor of Texas receipts over total receipts of the taxpayer. The question in this matter was whether the structure of the franchise tax was such that it impermissibly taxed the gross receipts the taxpayer derived from air commerce.

This matter began when the taxpayer filed its 2014 franchise tax report under protest, claiming that the inclusion of receipts from passenger tickets and air freight services in the franchise tax base violated AHTA. Following receipt of a U.S. Department of Transportation (administrator of AHTA) opinion, the Comptroller refunded amounts attributable to inclusion of the ticket and freight receipts in the tax calculation. The taxpayer filed its 2015 report in the same manner but later sought a refund of franchise tax attributable to inclusion of baggage fees in total revenue, contending they also constituted receipts from air transportation. The Comptroller denied the refund and counterclaimed that receipts from ticket sales and air freight services should also be included in the franchise tax calculation. A trial court granted the refund related to baggage fees and denied the Comptroller’s counterclaim. The Comptroller appealed.

Before the Court of Appeals, the Comptroller argued the franchise tax did not run afoul of AHTA because it is a “composite tax” based on the entirety of a taxpayer’s business and levied on the taxable margin apportioned to Texas. It is not, as the taxpayer claimed, a tax on individual streams of revenue, including those from air commerce and transportation. After reviewing both AHTA case law and the franchise tax mechanics, the court determined that the various deductions and exclusions “do not save [the tax] from AHTA preemption insofar as taxable margin ultimately contains the gross receipts from [the taxpayer’s] transportation revenues.” While the franchise tax is not a “straight-forward gross receipts tax,” it is preempted by AHTA “insofar as taxable margin is measured by gross receipts” from transportation revenues. The appellate court agreed with the trial court that the franchise tax as applied to the taxpayer was an impermissible tax on gross receipts from air commerce or air transportation and the refund related to baggage fees to the taxpayer was correct. For questions on [Kelly Hancock, Acting Comptroller of Public Accounts v. American Airlines](#), Fifteenth Court of Appeals, please contact [Jeffrey Benson](#) or [Karey Barton](#).

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