

The Texas Business Tax

A Brief Look

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Disclaimer

- o This outline is not intended as legal or tax advice. Any specific legal or tax advice should be sought from a qualified professional.
- o The new Texas law was passed in 2006, and amended in 2007. There may be amendments in 2009.

Overview

- o Effective 1-1-07 with reports due 5-15-08 for calendar year taxpayers.
- o Greatly broadens the tax base and lowers the tax rates.
- o Requires reports from many entities even though no tax may be due.

Overview

- o Company with limited liability for owners generally pays Texas tax
- o Charities, trusts and estates are exempt, as well as REIT's, REMIC's
- o Passive entities are exempt- that is, where at least 90 % of total revenue is passive income
- o Passive entity cannot be a corp or LLC

Entities - In General

- | | |
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| <ul style="list-style-type: none">o Exempt<ul style="list-style-type: none">• Estates• Trusts• Escrows• REITS• REMICS• Passive entities• Some ltd psp's• Sole proprietorships• General psp's w/ natural persons• Qualified retirement Plans | <ul style="list-style-type: none">o Taxable<ul style="list-style-type: none">• LLC's- even Sch C• Corps• Business trusts• Active business LLP's• Entities with operating minerals• PA's and PLLC's• Active business limited psp's |
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Passive Entity

- o A family limited partnership whose ownership is at least 80 % in the same family (including siblings)
- o A limited partnership which has at least 90 % of its gross income from passive sources (excluding rents)

Passive Entity

- o Real estate investment trust (REIT)
- o Real estate mortgage investment conduit (REMIC)
- o Family ltd psp with more than 10 % of total receipts in rents is NOT passive.

Passive Income

- o Non-operating mineral income is passive
- o Rents are NOT passive
- o Dividends, interest, capital gains are passive

Tax Rates

- o .5 % of tax base for retail and wholesale
- o 1 % of tax base for all others
- o No tax due if tax is less than \$1,000
- o No tax due if gross revenue is less than \$300,000 (indexed for CPI every even year, beginning in 2010)

Alternate Tax Calculation

- o For entities with less than \$ 10 million in gross receipts (Sec. 171.016)

Tax Discounts

- o For entities with gross receipts of less than \$ 900 K (Sec 171.0021)

Tax Base

- o Tax Base is total revenue, less exclusions, but then is limited to the LESSER of:
 - 70 % of total revenue,
 - Total revenue less cost of goods sold, or
 - Total revenue less personnel costs
 - o (not more than \$ 300,000 per employee)
 - o Plus employer paid fringe benefits

Total Revenue

- Total revenue (including interest, dividends, rents, royalties, capital gains) per the federal income tax return less exclusions

Exclusions

- Bad debts (accrual basis only)
- Foreign royalties or dividends
- Flow-thru funds (e.g. escrow funds)
- Gov't payments
 - Medicaid, Medicare, Tricare, ChiPs, received by a physician or clinic
 - Hospitals, Hospices, nursing homes, pharmacies, and others - 50 % excluded

Exclusions

- Government payments
 - Workers compensation
 - Costs for uncompensated services
- Up to \$500 out of pocket costs per pro bono case for attorneys
- Dividends and interest from federal obligations

Deduction for Cost of Goods Sold

- Direct costs of production or acquisition
- Indirect costs properly allocated to production or acquisition
- Capitalization of interest follows federal requirements
- Applies to sale (lease?) of property
- Interest deductible only if paid by financial institution lender

Deduction for Personnel Costs

- W-2 wages as shown in Medicare wage box (limited to \$ 300k per employee) – indexed after 2008
- Fringe benefits paid by company are not limited to \$ 300k per employee
- No deduction for wages to undocumented worker
- Deductible stock options

Deduction for Personnel Costs

- Payroll taxes are not deductible for the Texas tax.
- New additional deduction for cost of NEW employee healthcare benefits= 50 % cost in 1st yr, 25 % of cost in 2nd yr. (Sec. 171.013 (b-1))

Tax Reports

- Taxable entity makes annual report if tax is due – So if tax less than \$1000, then statute says no report.
- Taxable entity may be required to report even if no tax is due, if Comptroller requires it.

Combined Reporting

- Affiliated group engaged in a unitary business files a single report
- Affiliated group is one or more entities controlled by 80 % common ownership
- Unitary business is one where several factors indicate single economic enterprise

Tax Reports – Not Due

- Sole proprietors or general partnerships of natural persons are NOT taxable entities
- Trusts, estates and escrows are NOT taxable entities
- "Passive entities" are NOT taxable entities

Importance of .5 % rate

- .5 % rate applies to retail/wholesale which includes eating and drinking businesses
- 1 % rate applies to all others

Retail / Wholesale vs All Others

- Use 1987 SIC Manual (OMB) to determine whether a business is retail/wholesale.
- Combined retail/wholesale AND service business means tracking gross receipts. More than ½ total revenue = retail/wholesale.
- AND less than ½ of retail/wholesale revenue can be self-produced.

Apportionment to Texas

- Tax apportioned to Texas based upon % of total revenues allocated to Texas business

Tax Credit

- For 2007 and later, a credit equal to 10 % of the net operating loss and net deductible temporary differences multiplied by the new applicable tax rate (1% or .5%)
- Credit is available until used up or 2027, whichever is first

Tax Credit

- Election to take credit is made by written notice to Comptroller by due date of first return (2008).
- If taxable entity is "purchased" by another entity, the credit is not transferred.

Texas Comptroller Form

- Texas Comptroller's two page form gives initial look at tax calculation.
- See www.window.state.tx.us/taxinfo/franchise/calculator

FAQ

- Q: My friend and I are owners of an LLC which invests in oil and gas interests. We are not operators. What Texas tax should we expect ?
- A: LLC income is taxable.

FAQ

- Q: My parents set up a trust for me under their wills. Is this a problem?
- A: There is no tax on the trust. But a business owned by the trust could face a tax, depending upon its activity, its form, and its gross revenue.

FAQ

- Q: My business is a limited partnership of non-family members. We make widgets. Are we taxable ?
- Possibly. It depends upon your numbers.

FAQ

- Q: Some of my business comes from customers out of state, but my business location is Texas. What now?
- A: You probably cannot apportion gross revenues to the out of state customers since your business is here.

FAQ

- Q: To figure deductible compensation, can I deduct fringe benefits for employees, such as group health premiums, workers compensation premiums, health savings accounts and retirement plan contributions ?
- A: Yes, and these amounts are not limited to \$ 300k per employee.

FAQ

- Q: My LLC basically deals with investments. It had \$100,000 in dividends and interest, and \$210,000 in capital gains. There are no deductions. How am I taxed?
- A: An LLC is not passive. A return is due as gross receipts exceed \$300k. (But, under new law, tax is reduced 80 %.)

FAQ

- Q: My corp maintains a bank line of credit for working capital needs. Can I deduct this interest paid ?
- A: No, only lending institutions may deduct interest for the Texas tax.

FAQ

- Q: What is the starting point for calculating the tax ?
- A: The gross revenue shown in the federal income tax return.

FAQ

- Q: What if I have a single member LLC which does not file a separate federal income tax return ?
- A: Use the Schedule C, F, or E information from your personal tax return.

Planning

- Companies with both passive income and active business income may find a split off possible (BUT, watch federal tax results.)
- Companies with several active businesses which are not functionally related might be split.

Planning

- Businesses that can use cost of goods sold need review of accounts to make sure this is maximized.
- Medical service providers should be able to account for gross revenues from government payments.

Stay Tuned !

- This is an important development for Texas business.
- Stay tuned for further information !

Frst Development:

Texas legislature passed & sent to the Governor a Bill which would increase the no-tax due status of taxable entities from \$300,000 to \$1 million.

NEW FRANCHISE TAX CALCULATION

The worksheet below calculates taxable margin on a separate entity basis. The worksheet will calculate an amount of tax due based upon the amounts that are entered.

HOWEVER, if your annualized total revenue is less than or equal to \$300,000, or your tax due is less than \$1,000, you will owe no tax. All taxable entities must file a report, even if no tax is due.

If your annualized total revenue is \$10 million or less, you are eligible to use the E-Z computation for calculating your tax. See the line 11 instructions for additional information.

SPECIAL NOTE TO TAXABLE ENTITIES THAT ARE PART OF AN AFFILIATED GROUP: Each taxable entity that is part of an affiliated group engaged in a unitary business shall file a combined report in lieu of individual reports. All members of a combined group must use the same method to compute margin (i.e. cost of goods sold, compensation or 70%). See instructions for additional information. However, each member of a combined group may use the worksheet below to provide an estimate of the individual member's portion of the combined group's tax liability before eliminations.

ANNUALIZED REVENUE
(see instructions on back.)
Number of days in report period
365
Total revenue for report period
Annualized amount

STEP 1. MARGIN

See instructions below calculator.

1a. TOTAL REVENUE	_____
1b. COST OF GOODS SOLD - Unless otherwise provided in HB3, taxable entities that provide only services will not have a cost of goods sold and must use the compensation deduction or 70% below.	_____
1c. COGS MARGIN - Line 1a minus line 1b.	_____
2a. TOTAL REVENUE	_____
2b. WAGES AND CASH COMPENSATION - W2 Medicare wages and tips plus stock awards and stock options deducted for federal income tax (may not exceed \$300,000 for any single employee).	_____
2c. EMPLOYEE BENEFITS - Employer's Cost of retirement contributions, employee health insurance and worker's compensation.	_____
2d. COMP MARGIN - Line 2a minus (lines 2b and 2c).	_____
3a. TOTAL REVENUE	_____
3b. % MARGIN - Equals 70% of line 3a.	_____
4. MARGIN - Enter the least of lines 1c, 2d or 3b.	_____

STEP 2. APPORTIONMENT

5. TEXAS GROSS RECEIPTS	_____
6. EVERYWHERE GROSS RECEIPTS	_____
7. APPORTIONMENT FACTOR - Line 5 divided by line 6.	_____

STEP 3. TAXABLE MARGIN

8. TAXABLE MARGIN - Line 4 multiplied by line 7.	_____
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STEP 4. TAX DUE

9. TAX DUE BEFORE DISCOUNT OR CREDITS
- Multiply line 8 by <input type="checkbox"/> 0.5% for wholesalers and retailers or <input type="checkbox"/> 1% for other taxable entities
10. CREDITS
11. E-Z COMPTATION (if eligible) - Line 3a times line 7 times 0.00575
12. DISCOUNT (if eligible)
13. NET TAX DUE - Line 9 minus (lines 10 and 12) OR line 11 minus line 12. (If less than \$1,000, you owe no tax. Cannot be less than zero.)

THIS IS NOT A TAX REPORT - DO NOT FILE THIS DOCUMENT