




**5th Annual
Weaver-Aventine
Hill CPE Event**

2015 Texas Tax Update



Presented by: 




K. Shane Stewart, CPA
*Director-in-Charge, Indirect Tax
State and Local Tax Services*
972.448.9250
Shane.Stewart@Weaver.com




Michael Regan, JD, CPA
*Manager
State and Local Tax Services*
832.320.3425
Michael.Regan@weaver.com

2

Agenda 

- Introductions
- Texas Limited Sales, Excise, and Use Tax
 - ❑ Legislative Updates
 - ❑ Sales Tax Audits – Are You Next?
 - ❑ Audit Survival Techniques & Tips
- Texas Income/Franchise Tax
 - ❑ Legislative Updates
- Q&A

3



**Texas Limited Sales, Excise,
and Use Tax**

Applicability of Texas Sales Tax

- Regulatory Authority
 - Texas Tax Code Annotated; Title 2. "State Taxation"; Subtitle E. "Sales, Excise, and Use Taxes"; Chapter 151 "Limited Sales, Excise, and Use Tax" ("**Tax Code**").
 - Texas Administrative Code; Title 34 "Public Finance"; Part 1 "Comptroller of Public Accounts"; Chapter 3 "Tax Administration"; Subchapter O "State Sales and Use Tax" ("**Comptroller's Rule**").

5

Applicability of Texas Sales Tax

- Administration
 - Collected and enforced by the Texas Comptroller of Public Accounts ("Comptroller").
 - Glenn Hegar, effective January 2, 2015.
 - <http://www.window.state.tx.us>
 - The Comptroller may examine, copy, and photograph all records and investigate the character of the business to determine the correctness of a return or the amount of tax due if no return was made.

6

Applicability of Texas Sales Tax

- Sales Tax versus Use Tax
 - The Sales Tax is imposed on each sale of a taxable item in the State of Texas.
 - The Use Tax is imposed on the storage, use, or other consumption in the State of Texas of a taxable item purchased from a retailer for storage, use or other consumption in the State of Texas.

7

Applicability of Texas Sales Tax

- Services versus Tangible Personal Property
 - In general, sales of tangible personal property are considered taxable unless specifically exempted.
 - Services, however, are not subject to tax unless specifically "Enumerated" pursuant to Tax Code § 151.0101.

8

Sales Tax Legislative Update

Legislative Update

Texas Court of Appeals Strikes Down “Invalidates” Provisions of Comptroller’s Rule 3.325 on Refunds

- *Hegar v. Ryan, LLC*, No. 03-13-00400-CV (Tex. App. – Austin, May 20, 2015, no pet. hist.)
 - The Court declared several subsections of the previous version of the rule impose additional burdens, conditions, and restrictions on refund claims in excess of those required by law.
 - At this time, Comptroller has not submitted an appeal.

10

Legislative Update

Texas Comptroller Rules Software Rights Create Remote Seller Use Tax Nexus

- *Texas Comptroller of Public Accounts issued an Order*, SOAH Docket No. 304-13-5657.26 (Sept. 19, 2014)
 - Comptroller acknowledged that the Taxpayer’s Texas activities did not create the requisite “substantial nexus.”
 - Comptroller did determine, however, that the Taxpayer established Texas use tax nexus by retaining rights to the computer programs and digital content licensed to customers.

11

Legislative Update

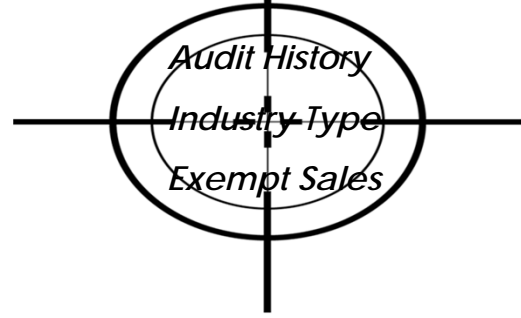
Texas Issues New Rules Related to New Provisions of the 2013 Adopted R&D Sales/Use Tax Exemption

- In 2013, Texas adopted into law House Bill 800, which allowed taxpayers to elect to either claim a sales/use tax exemption for qualifying research expenditures of tangible personal property or take a R&D credit against the franchise tax.
- New rules include issues concerning amended reports applicable where
 - taxpayer desires to claim a credit that was not claimed previously or
 - repayment of a credit taken previously and instead claim exemption from sales and use tax.

12

Sales Tax Audits – Are You a Target?

Sales Tax Audits: Are You a Target?



Sales Tax Audit Survival

Sales Tax Audit Survival

IMPRESSIONS



First Impressions Matter

Set Good Tone for Remainder of Audit
Smile, Be Courteous, Be Professional

INFORMATION

- DO** Timely Provide Records
- DO** Make Records Easily Accessible
- DON'T** Over Share
- DON'T** Allow Auditor to Speak with "Non-Essential" Personnel Auditor Contact

LOCATION

- DON'T** Put Auditors in Places Difficult to Work

Difficult Places Put Auditors in Bad Mood

Questions?

K. Shane Stewart, CPA
Director-in-Charge, Indirect Tax
State and Local Tax Services
972.448.9250
Shane.Stewart@Weaver.com

17

Texas Franchise Tax

By: Michael Regan JD, CPA

Presentation Goals

Provide for you answers to Mike's FAQ:

1. Registration tips and best practice
2. Filing tips and best practices
3. Case studies and examples of creative filing methods (COGS Related)

Interesting Stance on Property Tax

January 6, 2014- "I don't like the property tax, never have...I think we should replace it"..."the best thing to replace it with is a consumption type tax sales tax per se"



Most Weaver Clients "Nexus in Texas"



Texas Nexus Questionnaire **Baker Tilly**

The screenshot shows a web browser displaying the 'Texas Nexus Questionnaire' form. The form includes fields for 'Tax number', 'Main address', 'City', 'State', and 'ZIP code'. Below these are checkboxes for 'Entity type' with options: Profit corporation (C), Professional corporation (PC), S corporation (S), Limited liability company (LLC), General partnership (GP), Professional association (PA), Business association (BA), Business trust (BT), Joint venture (JV), Joint stock company (JS), Holding company (HC), and Railroad company (RC). There are also instructions and a 'PRINT FORM' button.

TX- Nexus Questions **Baker Tilly**

The screenshot shows a web browser displaying the 'TX- Nexus Questions' form. It contains a table with 12 rows of questions and columns for 'Start Date' and 'End Date'. The questions include: 1. Inventory, 2. Open production activities, 3. Active activities in Texas, 4. Substantial, 5. Employees/independent representatives, 6. Sell and license software in Texas, 7. Procuring, manufacturing, shipping goods, 8. (Not making) an LP agreement, 9. Substantial, 10. Provide a service, 11. Federal structure, 12. Franchise. Question 13 asks for a full description of the entity's activities in Texas.

Texas Franchise Tax

Interpretation of 'doing business' for Nexus purposes

- 1) Performing a contract in Texas even if you use Independent Contractors.
- 2) Deliver items to customers using Seller's vehicle.
- 3) Having Employees or representatives in Texas.
- 4) Having a franchise in Texas.
- 5) Acting as a GP and not as an LP.
- 6) Any Real Estate in Texas.
- 7) Providing any Service in Texas.

Tip #1 First Franchise Tax Filing



With regards to the first Franchise Tax Filing:

- There is no initial report [Texas did away with this]
- There is no short period reporting in Texas
- The privilege period covered by the first annual report will be from the date the entity becomes subject to franchise tax through December 31 of the following calendar year.
- For example, an entity becoming subject on 11/15/2014 will file a 2015 annual report due 05/15/2015 for the privilege period 11/15/2014 through 12/31/2015. [longer than 1 year]

Nexus For Affiliated Groups



Texas Adopts a "**Joyce Approach**"

"only those in-state activities that are conducted by or on behalf of a company shall be considered for apportionment purposes. Activities that are conducted by any other person or business entity, whether or not the person or business entity is affiliated with the company at issue, shall not be considered attributable to that company, unless the other person or business entity was acting in a representative capacity on behalf of that company."

States Vary On Approach:



State	Approach
AK	Apportion
AL	Apportion
AR	Apportion
CA	Apportion
CO	Apportion
CT	Apportion
DC	Apportion
DE	Apportion
FL	Apportion
GA	Apportion
HI	Apportion
IA	Apportion
IL	Apportion
IN	Apportion
KS	Apportion
KY	Apportion
LA	Apportion
MA	Apportion
MD	Apportion
ME	Apportion
MI	Apportion
MN	Apportion
MO	Apportion
MS	Apportion
MT	Apportion
NC	Apportion
ND	Apportion
NH	Apportion
NJ	Apportion
NM	Apportion
NV	Apportion
OH	Apportion
OK	Apportion
OR	Apportion
PA	Apportion
RI	Apportion
SC	Apportion
SD	Apportion
TN	Apportion
TX	Apportion
UT	Apportion
VA	Apportion
VT	Apportion
WA	Apportion
WI	Apportion
WV	Apportion
WY	Apportion

Texas Franchise Tax



Changes for 2014 Franchise Tax Calculation Include:

1. Compensation deduction adjusted to \$350,000/person
2. Tax rate change from 2014 to 2015 [HB 32 – Reduce franchise tax rate on Texas businesses by 25 percent]
3. Retail trade: expanded to include activities in SIC Group namely activities involving:
 - a. Rental or leasing of tools, of party and event suppliers, and furniture
 - b. Heavy construction equipment rentals or leasing
 - c. Rental purchase agreement regulated by Chapter 92 Business and Commerce Code

Tip #2 – Review SIC CODE



Texas Franchise Tax Report - Page 1

Report number: 2014, Report date: 05/15/2014, Filing period covered by the report: 01/01/2014 – 12/31/2014

Accounting year: 12/31, Reporting year: 12/31

REVENUE	Amount	Code
1. Gross receipts or sales	0.00	00
2. Dividends	0.00	00
3. Interest	0.00	00
4. Rents (to be reported amount)	0.00	00
5. Royalties	0.00	00

Tax Rates- SIC Importance



Subject to Tax

EZ computation

- Total Revenue times 70%
- Total Revenue minus Cost of Goods Sold (COGS)
- Total Revenue minus Compensation
- Total Revenue minus \$1 million

Tax Rates

The election to use COGS or compensation is made by filing the franchise tax report using one method or the other. An amended report may be filed within the time allowed by Texas Tax Code Section 111.107 to change the method of computing margin.

Expanded for 2014



Minimum Franchise Tax

There is no minimum tax requirement under the franchise tax provisions. An entity that calculates an amount of tax due that is less than \$1,000 or that has annualized total revenue less than or equal to \$1,000,000 is not required to pay any tax. (See note for tiered partnership exception.) The entity, however, must submit all required reports to satisfy its filing requirements.

If an entity meets the \$1,000,000 no tax due threshold in the previous paragraph, it may file a No Tax Due Information Report (Form 05-183).

EZ Computation

Entities with \$10 million or less in annualized total revenue may choose to file using the EZ Computation Report (Form 05-189).

Combined groups are eligible for the EZ computation. Upper and lower tier entities, when the tiered partnership election is made.

Tip #3 Passive Entity Rules



- Must be a GP, LP, LLP, or trust (other than business trust – defined by I.R.C. Treasury Reg. § 301.7701-4(b)).
- Federal gross income must consist of at least 90% of “passive income.”
 - Dividends, interest
 - Distributive shares of partnership income, income from a SMLLC
 - **Capital gain from** the sale of real property, gain from the sale of commodities traded on commodities exchange, and gain from the sale of securities, and
 - Royalties, bonuses, or delay rental income from mineral properties and income from nonoperating mineral interests.
- Cannot receive more than 10% of federal gross income from conducting an active trade or business.
- Passive income does **not include RENT**

Tip #4: Exclusions From Revenue



Accounting year begin date	Accounting year end date	SIC code	NAICS code
REVENUE (All in dollars only)			
1.	Gross receipts or sales		00
2.	Dividends		00
3.	Interest		00
4.	Rents (can be negative amount)		00
5.	Royalties		00
6.	Gains/losses (can be negative amount)		00
7.	Other income (can be negative amount)		00
8.	Total gross revenue (Add items 1 thru 7)		00
9.	Exclusions from gross revenue		00
10.	TOTAL REVENUE (can be negative amount)		00
COST OF GOODS SOLD (All in dollars only)			
11.	Cost of goods sold		00

Exclusions from Income



- Exclusions from Income on LN 9 include:
 - Bad Debt Expense ***
 - Net Distributive Income
 - Schedule C Dividends
 - Revenue from Disregarded Entities
 - Flow Through Funds ***
 - Other Exclusions:**
 - 100% of revenues from Medicaid, Medicare, Chip, Workers Comp, Etc. ***
 - Management Company excludes amount equal to reimbursements of specified costs. ***

Exclude from LN 9- Get out of LN 24



Transaction number	Report year	Due date	Transaction name
MARGIN (All in dollars only)			
19.	70% revenue (Item 19)		00
20.	Revenue less COGS (Item 19 - Item 16)		00
21.	Revenue less compensation (Item 19 - Item 18)		00
22.	Revenue less \$1 million (Item 19 - \$1,000,000)		00
23.	MARGIN		00
APPORTIONMENT FACTOR			
24.	Gross receipts in Texas		00
25.	Gross receipts everywhere		00
26.	APPORTIONMENT FACTOR (Gross Item 24 by Item 25, rounded to 4 decimal places)		00
TAXABLE MARGIN (All in dollars only)			
27.	Apportioned margin (Margin Item 23 by Item 26)		00
28.	Allowable deductions (can be negative)		00
29.	TAXABLE MARGIN (Item 27 minus Item 28)		00

RULE §3.591 – Rev Exclusion



- Any item of revenue that is **excluded from total** revenue under Texas law or United States law is excluded from **gross receipts everywhere** and **gross receipts in Texas** as provided by Tax Code, §171.1055(a). For example, any amount that is excluded from total revenue under the Internal Revenue Code, §78 or §§951 - 964, is excluded from gross receipts.

COGS – Cattle Ranch



- COGS on a Cattle Ranch?



COGS – CASE Study



Generally, the following costs will be allowed if they are **direct costs**:

- Labor
- Cattle
- **Feed** ***
- **Medicine** *** [Veterinarian fees]
- Storage of feed and grain
- Depreciation of production equipment (does not include barns used to house
- cattle)
- Repair and maintenance of production equipment
- Utilities to operate production equipment
- Rental of production equipment
- **Insurance** on the cattle and **production** equipment***

COGS – Retail Store [clothing]



- COGS on a Retail Store?



COGS – Retail



A department store chain that sells clothing for men, women and children has several retail stores throughout Texas. The department store chain owns a centrally located distribution center that supplies the retail stores with the acquired apparel.

The following costs are allowed as COGS :

- the cost of acquiring the apparel;
- **compensation and other expenses** (travel, etc.) related to purchasing agents; ***
- the cost **of transporting apparel to the distribution center**; ***
- depreciation of the distribution center;
- depreciation on equipment used in the distribution center;
- **distribution center** utility costs; ***
- the cost of transporting apparel from the distribution center to the retail stores; and
- the cost of utilities for the storage area only at the retail stores.

Retail – NOT COGS



- The following costs are **NOT** allowed as **COGS** :
- rent paid to shopping centers for retail store space;
 - utility costs for the retail store display areas;
 - display racks and display shelving;
 - compensation paid to sales managers and sales personnel;
 - the cost of cash registers;
 - credit card company fees;
 - shopping bags; and
 - tissue.

COGS - Restaurants



- Can a Restaurants/Bar take COGS?
[Tricky]



COGS- Bars



Bars are allowed to include the following in COGS:

- Acquisition of food;
- **Equipment** (such as such as refrigerators, ovens, stoves, pots, pans, etc.)***used to store and prepare the food or the depreciation of such equipment (see Cost of Goods Sold FAQ #24 for Section 179 computation limits);
- Production labor (payments made to food preparers, including IRS Form W-2 wages, IRS Form 1099 wages, temporary labor wages, payroll taxes and employee benefits);
- **Rent** allocable to the **production area (kitchen) only**: *** **[SQUARE FOOT]**
- Cleaning and janitorial costs allocated to the production area and food storage area.
- Supervision of production labor;
- **Property taxes** allocable to the production area. *** **[SQUARE FOOT]**

Bars NOT - COGS



The following were not added to COGS: [Removed]

- Rent allocable to the dining area and other non-production areas;
- **Dining area furniture**: ***
- Dishware, silverware, linens;
- Utilities allocable to the dining area;
- Cleaning and **janitorial costs allocated to the dining area**: ***
- Payments made for hosts, wait staff and busboys (including any uniforms provided);
- Credit card commissions/fees;
- Mixed beverage gross receipts tax;
- Advertising;
- Officers' compensation.

Movie Theatres



- Can a movie theatre take COGS? [also tricky]



COGS – Movie Theatres



The following are in COGS: [Removed]

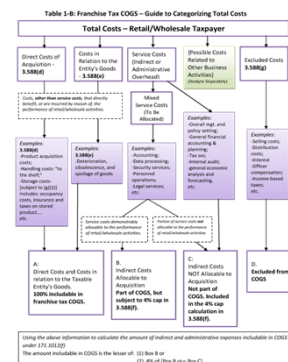
- A movie theater qualifies for cost of goods sold for its concession sales. [big business]
- Royalties or other licensing fees that the theater pays to exhibit a motion picture.
- Other expenses associated with the commercial display of a motion picture.
- American Multi-Cinema, Inc. v. Combs, et al., Cause No. D-1-GN-12-003831

American Multi-Cinema, Inc. v. Combs

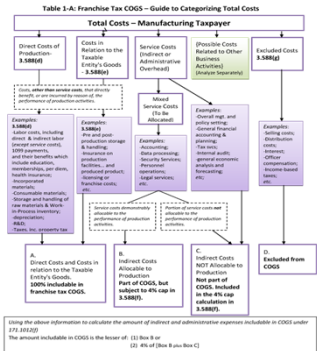


- The legislature defined “tangible personal property” to include “personal property” that can be “seen” or **“that is perceptible to the senses in any other manner.”**
- AMC asserted that the costs associated with the entire square footage of its auditoriums should be included in the COGS calculation, and AMC’s witness testified about the sight, sound, and the controlled environment in its auditoriums.

COGS – Retail 201307727L



COGS – Manufacture 201307727L

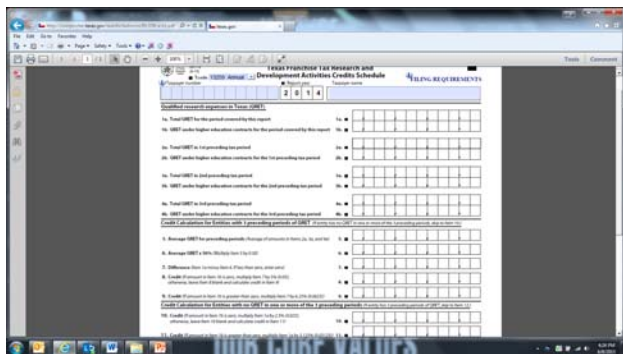


Texas R&D Credit



- March 30, 2015, the adopted TAC § 3.599.
- Provides either a franchise tax credit or sales tax exemption for research and development activities conducted in Texas.
- Amount of Credit = 5% of the difference between QRET and 50% of average QRET during the last 3 periods.
- If no prior periods 2.5% of QRET for current period.

Texas R&D Credit



Thanks!



- Call me to chat about SALT issues!

Michael Regan JD, CPA
Manager, State and Local Tax Services

Weaver
248.730.6453

Michael.Regan@Weaver.com