

YOUR TEXAS FRANCHISE TAX QUESTIONS: ANSWERED

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Agenda

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Objectives

By the end of this course, you will be able to:

- Describe recent changes to Texas franchise tax that impact tax return and tax provision positions
- Recognize recent developments in judicial decisions that have an impact on prospective tax positions and planning

Nexus

What's the real impact of economic nexus?

Tex. Admin. Code § 3.586

A taxable entity will be deemed to have nexus for Texas franchise tax:

1. The date the entity has physical presence

On or after January 1, 2019:

1. the date the entity obtains a use tax permit, or
2. The first day of the federal income tax accounting period in which the entity has **gross receipts** from doing business in Texas of \$500,000 or more as determined under section 3.591 (Margin: Apportionment).

Costs of goods sold

What's the big takeaway from recent COGS controversy?

On April 3, 2020, three Texas Supreme Court cases were issued

1. *Hegar v. American Multi-Cinema, Inc.*
2. *Hegar v. Gulf Copper and Manufacturing Corp.*
3. *Sunstate Equipment Co. v. Hegar*

Comptroller's "cost-by-cost" approach affirmed

1. Review of each activity for qualification
2. Review of each expense for inclusion

Apportionment: The new administrative rules

How did apportionment of advertising services change?

- Sourcing: Location of advertising audience, considering information reasonably available
 - Now applies for all advertising services: newspaper, magazine, radio/television, et. al.
 - If Nationwide audience can't be reasonably determined: 8.7% to Texas
- Retroactive with exception for radio and television
 - Prior to 2021: Radio/television, may source under old rule (transmitter location) or new rule? Prospectively, new rule applies

Do the new rules convert the state to market based sourcing?

Exposition of existing Comptroller policy:

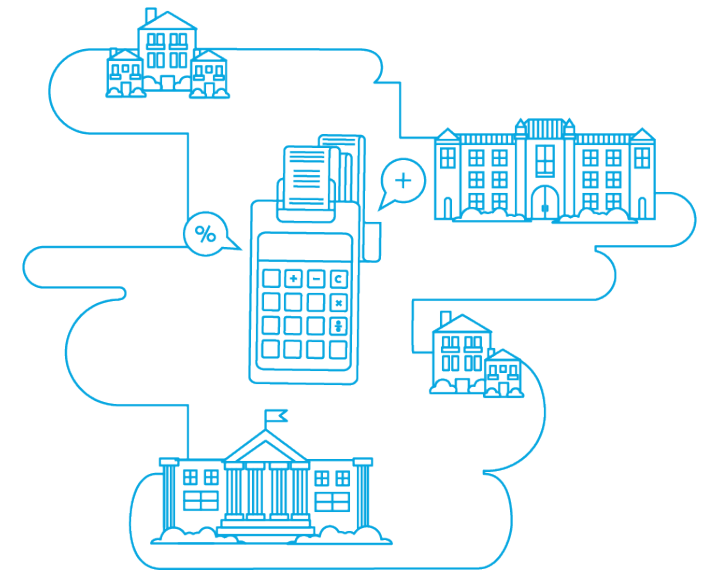
- Section 3.591(e)(21): Use of Intangible / Sale of Intangible
- Section 3.591(e)(13): Internet Hosting Service
- Section 3.591(e)(26): Services (Catch-all)
- Section 3.591(e)(3): Computer Hardware and Digital Property

Term definitions depart from their ordinary meaning

What is internet hosting and how is it sourced?

Definition (*High Level*):

- Providing computer services
- Over the internet
- With property managed by the provider



Sourcing: The physical location where the purchaser or the purchaser's designee consumes the service, considering information reasonably available

Section 3.591(e)(13)(E): Internet hosting service – examples

How are computer hardware and digital property sourced?

Section 3.591(e)(3): Computer hardware and digital property. May be sourced in one of four ways, as a:

- Sale or lease of TPP
- Internet Hosting Service (IHS)
- Service
- Use/Sale of Intangible

Section 3.591(e)(3)(A – H): Computer hardware and digital property

(A,B) Sale/Lease computer hardware w/software installed = TPP Rules

(C,D) Sale/Lease digital property on physical media = TPP Rules

(E) Sale/Lease digital property not on physical media = Intangible Rule

(F) Digital property as a service = Service Rules

(G) Digital property as part of internet hosting service = IHS Rules

(H) Use of digital property = Intangible Rule

Do we have clearer guidance on how to source services?

Section 3.591(e)(26): Receipts from Services (catch-all)

Rule: “sourced to the location **where the service is performed**”

- Focus: Receipt producing, end product act(s) of each unit of service
- Concentrate on: Location where value of service paid for was performed

Unique Rule! This is not market based or cost of performance

“Where the service is performed” examples:

- Admissions
- Architecture

Why is the *Sirius XM* case so important?

Hegar v. Sirius XM Radio, Inc.

Facts: Subscription-based satellite radio service

- Outside of Texas: Most all production and transmission
- Inside of Texas: Subscribers & their radios

Court of Appeals Holding:

- Services sourcing rules applied
- Receipt producing, end-product act = customer access location

How are gains apportioned now?

Tex. Admin. Code § 3.591(e)(2)

For reports due prior to January 1, 2021, a taxable entity may add the net gains and losses from sales of investments and capital assets to determine the total receipts from such transactions.

For reports due on or after January 1, 2021, only the net gain from the sale of a capital asset or investment is included in gross receipts. A net loss from the sale of a capital asset or investment is not included in gross receipts.

Are there any other apportionment changes to be aware of?

Tex. Admin. Code § 3.591

- Regulated Investment Company Services
- Employee Retirement Plan Services
- Financial Derivatives
- Banking Corporations
- Finance Companies
 - Servicing of loans not secured by real property
 - Gross proceeds from sale of loans held as inventory
- Transportation Companies: Compensated Miles

Research & development

What are the recent developments around R&D in Texas?

Tex. Admin. Code § 3.599

- Backlog of examinations with Comptroller's office
- Adopts IRC as of December 31, 2011 which differs from the application of IRC for the rest of franchise tax
- IRC Section 41
- Contemporaneous documentation and project sampling

Paycheck Protection Program



What is the Comptroller policy on Payroll Protection Program?



Impact of Internal Revenue Code adoption date of January 1, 2007



Debt forgiveness income sourced to legal domicile of the creditor



Timing of the debt forgiveness

Closing comments

THANK YOU FOR
YOUR TIME AND
ATTENTION