



State and Local Tax Update

November 2, 2017

Introductions

TODAY'S PRESENTERS



Section 1: Income And Franchise Tax

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Section 2: Sales Tax

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Section 3: Texas Property Tax

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Section 1: Income & Franchise Tax

Hurricane Harvey

TEXAS TAX RELIEF



- ▶ For the 2017 franchise tax reports with valid extensions to Nov. 15, the Comptroller's office is granting an automatic extension to Jan. 5, 2018, to businesses located in the federally declared disaster area in Texas. Businesses located in these counties do not need to request an extension for their franchise tax reports.
- ▶ Service providers who file franchise tax reports on behalf of other taxpayers can request a franchise tax extension if the provider is affected by Hurricane Harvey and is located in a Texas county designated by the Federal Major Disaster Declaration.

Hurricane Harvey

TEXAS TAX RELIEF



- ▶ Extensions can be requested via phone or email
- ▶ Information required to receive a valid extension includes:
 - » Taxpayer name
 - » Taxpayer number
 - » Name of person making request
 - » Email or phone contact information of person making request
 - » Tax type(s) for which extension is requested
 - » Affected filing period
- ▶ Extension requests due to disasters are handled on a case-by-case basis

Facts & Figures

TAX REVENUE BY SOURCE

- ▶ Franchise tax: 10%
- ▶ Sales tax (includes motor vehicle sales tax): 70%
- ▶ Natural gas production tax: 2.2%
- ▶ Oil production and regulation taxes: 4.6%
- ▶ Alcoholic beverage taxes: 2.7%
- ▶ Cigarette and tobacco taxes: 3.1%
- ▶ Hotel occupancy tax: 1.1%



Facts & Figures

TAX REVENUE BY SOURCE

- ▶ Federal income: 37%
- ▶ Total tax collections: 43%
- ▶ Licenses, fees, permits, fines and penalties: 10%
- ▶ Interest and investment income: 1%





Key legislative themes

- » Repeal and?????
- » Comptroller/technical corrections

Approximately 60 bills introduced

- » Elimination: 15
- » Exemptions/deductions: 18
- » Credits: 20
- » Other: 7

Franchise Tax

BILLS TO PHASE OUT THE TAX



HB 28 (Bonner)
Phase-out
by 2024, at best

- » Relied on future revenue growth to reduce the rates of the franchise tax
- » Rates would have decreased in 2020
- » Did not pass because this session did not have money
- » Likely be addressed in 2019



SB 17 (Nelson)



HB 4002 (D. Bonnen)

- » Removes installation from the list of activities that qualifies as productions (responses to AutoHaus case)



HB 2126 (Button) (SB 1726, Birdwell)

- » Provides that the sales of pre-paid calling cards does not disqualify an entity from qualifying for the reduced, wholesale/retail tax rate



HB 3992 (Murphy)

- » Exemption for farmer-fruit grower co-operatives
 - » No state revenue loss

In Focus: Texas

COMPTROLLER PRIORITIES

- ▶ Move Texas from **performance** state to **benefit** state for sourcing service revenues
 - » Likely years of legislative action
- ▶ Improve **refund process**
 - » Reduce processing time
- ▶ Improve **website**
 - » Update posted publications
 - » Usability, navigation, speed
- ▶ Update Texas **margin tax** rules
 - » Better interpretation of existing laws



Reminder!!

Combined groups that have added a member during the accounting period may now use the prior report year “100% tax due” safe harbor extension option.

- ▶ Prior to this policy change, combined groups that added a member did not have this option
- ▶ Under the amended rule, this revised policy is effective for reports due on or after January 1, 2017

In Focus: Texas

NOTABLE PRECEDENTS AND RULINGS

Texas High Court Parses 'Net Gain' In Hallmark Tax Case

By Eric Kroh

Law360, New York (December 9, 2015, 12:35 PM EST) -- The Texas Supreme Court on Wednesday heard arguments in a case involving Hallmark Marketing Co. LLC in which the company's requested \$200,000 tax refund could hang in the balance of the interpretation of the phrase "net gain" in the state's franchise tax law.

Hallmark is seeking a refund of corporate taxes it paid on its income for 2011. The state comptroller incorrectly calculated the income the company earned for that year. According to Hallmark, the comptroller should not have

Hallmark: Conflict between rule and law

representing Hallmark, told the high court justices. "It's as simple as

NEWS & INSIGHTS

Texas Court of Appeals Rules that Cost of Goods Sold Does Not Include Installation of Sold Auto Parts

TAX DEVELOPMENT / Mar 01, 2017

Autohaus: Defining cost of goods sold (COGS)

Texas Oil And Gas Servicer Wins \$1.3M Franchise Tax Appeal

By Alex Wolf

Law360, New York (March 9, 2016, 7:00 PM EST) -- A Texas company that maps undersea formations for oil and gas drillers prevailed against the state comptroller and attorney general in a \$1.3 million tax row for a second time Wednesday, when a state appeals court affirmed that the company qualifies for a "cost of goods sold" tax deduction.

In its ruling, the Texas Court of Appeals for the Third District agreed with a lower court that CGG Veritas Services Inc. was entitled to a refund it sought for state franchise taxes in 2008, when the state comptroller of public accounts characterized CGG as a service provider that

CGG Veritas: Eligibility for COGS deduction

to generate subsurface images — they disagree "as to what statutory label should apply to

In Focus: Texas

NOTABLE PRECEDENTS AND RULINGS

Appeals Court: No COGS for Heavy Equipment Delivery/Pick-up Fees

The Texas Third Court of Appeals [recently held in *Hegar v. Sunstate Equipment*](#) a company that leased heavy equipment to contractors could not include its delivery and pick-up fees for the equipment in its cost of goods sold deduction for Texas franchise deduction purposes. In doing so, the Third Court of Appeals overturned a trial court ruling in the company's favor. The Third Court of Appeals found that the company could not deduct its delivery and pick-up fees under the provision that allows a taxpayer to deduct the cost of goods sold.

Sunstate Equipment: No COGS for heavy equipment delivery/pick-up fees

Same Result, Different Reason, Crisis Averted? Texas Court of Appeals Issues Revised COGS Opinion in *American-Multi-Cinema*

January 13, 2017 by [Stephen Long](#) and [Nicole Ford](#)

Texas—never known for doing anything on a small-scale—is starting off 2017 with what is likely to be billions of dollars worth of good news for the Comptroller. On January 6, the Third District Court of Appeals released a substituted opinion in *American Multi-Cinema Inc. v. Hegar*, No. 03-14-00397-CV.

AMC: Definition for inclusion of COGS

The taxpayer in this case, American Multi-Cinema ("AMC"), a national movie theater chain, argued that the costs it incurred to exhibit films should be included in its COGS deduction. The Comptroller

Did you know ?

Nexus is a legal term that refers to the requirement for whether companies doing business are subject to tax in that state

- » Ohio Supreme Court: uphold economic nexus
- » Oregon tax court: economic presence in the state was enough to establish nexus
 - › Earning significant income from the state created nexus
 - Bank earned over \$150M from Oregon customers
 - › Taxpayer had over 400K customer in Oregon

- ▶ **Virginia: September 13, 2017 – November 14, 2017**
 - » Tax liabilities prior to 2016 tax year
- ▶ **Oklahoma: Voluntary disclosure initiative**
 - » Waiver of penalty and interest if taxpayer voluntarily files the delinquent tax returns and pays or agrees to pay pursuant to a written agreement
 - *Beginning September 1, 2017 – November 30, 2017*

- ▶ **Arkansas: Will accept Federal S election starting 1/1/18**
 - » No separate state election required
 - *NY and NJ require separate S election*
- ▶ **California: Taxpayer's LLC interest does not constitute doing business in the state**
 - » Manager-managed LLC
 - » Would not apply to member-managed LLC



Section 2: Sales Tax

Taxpayers in a disaster area can claim exemption from Texas sales tax on the following repair charges on items damaged by the disaster:

- ▶ Nonresidential real property
- ▶ Personal property
- ▶ Launder or dry clean clothing or other items
- ▶ Cutting down damaged branches or cutting up a damaged tree

Recent Texas Rulings

STAR DOCUMENT NO. 201701013L



- ▶ Service provider worked for lenders to ensure that borrowers maintained insurance coverage
- ▶ Comptroller determined services provided were not taxable data processing services
- ▶ Ancillary and incidental to professional services provided

STAR Document No. 201701013L: Insurance Monitoring Not Taxable

The Comptroller determined that services provided were not taxable insurance services

The service provider merely reviewed policies to ensure sufficient coverage

Recent Texas Rulings

CHECKFREE SERVICES

- ▶ Checkfree sought refund of \$3M assessed for “sales taxable data processing services”
- ▶ Court ruled **in favor** of the claim based on provisions in several sections of the tax code
- ▶ Comptroller **appeal** was denied



RATIONALE OF THE COURT

- Checkfree provides a **professional service** (bill pay services) that is **facilitated by** the use of computers and eCommerce
- Relying on bill pay data directly **input by Checkfree's users** did not constitute data processing services

Recent Texas Rulings

FITNESS INTERNATIONAL

- ▶ Fitness International claimed a **refund** for items under a sale-for-resale exemption
- ▶ Court **denied** the claim, saying 151.006 (a) (1) and (2) did not apply
- ▶ Court **set precedent** by **defining** key terms such as “transfer” and “possession”



RATIONALE OF THE COURT

- Membership agreement **could not be construed** as a lease or rental agreement
- Equipment was not transferred to members; **membership** merely **provided access** to the equipment



Key legislative themes

- » Applicability
- » Clarification/Transparency

Approximately 100 related bills introduced, 12 sent to Governor

- » Exemptions: 3
- » Applicability/Definition: 2
- » Transparency: 5
- » Other: 2



HB 4038 (Bohac)

Relates to the definition of “qualifying job” for purposes of certification as a qualifying data center

- *Expands definition of “qualifying job”*
- *Includes new employment position staffed by 3rd party employer under a contract with a qualifying owner, operator, or occupant*
- *Sent to Governor on May 26, 2017 and signed June 1, 2017 (Effective Immediately)*



SB 745 (Kolkhorst)

Relates to the exemption of certain services performed by certain employees

- *Comptroller “technical correction” bill*
- *Seeks to provide clarification as to when a host employer may claim a sales and use tax exemption for certain services provided by certain temporary employees*
- *To be consistent with the ruling of the 3rd Court of Appeals in Allstate Insurance Co. v. Hegar*
- *Effective September 1, 2017*



HB 4054 (Murphy, Bettencourt)

Otherwise known as the “Kolache Bill”
relates to the application of sales and use
taxes to certain food items

- *Seeks to clarify which bakery items are exempt and to help bakeries collect/remit taxes appropriately*
- *Sent to Governor on May 25, 2017, Signed June 1, 2017 (Effective September 1, 2017)*



SB 1095 (Taylor, L.)

Relates to certain procedures for tax redeterminations and refund claims

- *Filing Deadlines extended from 30 days to 60 days*
- *Petitions for Redetermination and Request for Refund Hearing*
- *Sent to Governor on May 28, 2017 (Effective September 1, 2017)*

Savings Opportunities

COMMONLY MISSED EXEMPTIONS

Manufacturing Exemption

- ▶ Tangible personal property that is necessary or essential to the manufacturing, processing, or fabrication operation AND
- ▶ Directly causes a chemical or physical change to the product being manufactured OR
- ▶ Becomes an ingredient or component part

EXEMPTION EXAMPLES

- Lubricants, chemicals, gases
- Equipment
- Safety apparel or work clothing
- Quality control equipment
- Repair services on manufacturing equipment
- Wrapping, packing, and packaging supplies

Savings Opportunities

COMMONLY MISSED EXEMPTIONS

Items Purchased for Resale

- ▶ Tangible personal property purchased to be resold as a taxable item
- ▶ Tangible personal property purchased to be leased or rented
- ▶ Taxable services purchased to be resold as a taxable item

EXEMPTION EXAMPLES

- Raw materials
- Packaging supplies (Labels, Boxes, etc.)
- Items purchased and rented
- Services

Savings Opportunities

COMMONLY MISSED EXEMPTIONS



Services

- ▶ Texas taxes 17 categories of services
- ▶ Even services listed as a “taxable service” have exemptions
 - » 20% of the charge for information services and data processing services is exempt
 - » Services used or consumed outside of Texas
 - » Performed on exempt items

EXEMPTION EXAMPLES

- Installation services
- Inspection services
- Repair service to exempt items
- Scheduled & periodic maintenance
- Services used/consumed outside of Texas

- ▶ 6,200+ Current Sales Tax Audits-in-Progress
- ▶ Audit = Tool to ensure tax compliance
- ▶ Audit Selection
 - » Priority One Accounts
 - » Prior Productive Accounts
 - » Random Selection
 - » Information Sharing



▶ Audit Defense & Management Services

- » Redetermination Hearings
- » Independent Audit Reviews
- » Penalty Waivers
- » Audit Settlements

▶ Other specialty services

- » Recovery/Reverse Audit
- » State Tax Research
- » Nexus Studies
- » Voluntary Disclosure Agreements
- » Process & Compliance Evaluations



► Recent Client Successes

- » Manufacturer (Audit Defense)
 - › \$250k assessment
 - › Resulted in \$16k refund

- » Oil & Gas Operator (Recovery)
 - › >\$2Million in Refunds
 - › Implemented Corrective Measures

- » Oilfield Service Provider (Recovery)
 - › ~\$400k in Refunds
 - › Implemented Corrective Measures





Section 3: Texas Property Tax

Primary Provisions

TEXAS PROPERTY TAX CODE (TPTC) BASICS

► Taxability

- » **Chapter 11:** All real and tangible personal property that this state has jurisdiction to tax is taxable unless exempt by law

► Market value

- » **Chapter 23:** All property is required to be assessed at Market value

► Renditions

- » **Chapter 22:** Required for all tangible personal property used for the production of income



Primary Provisions

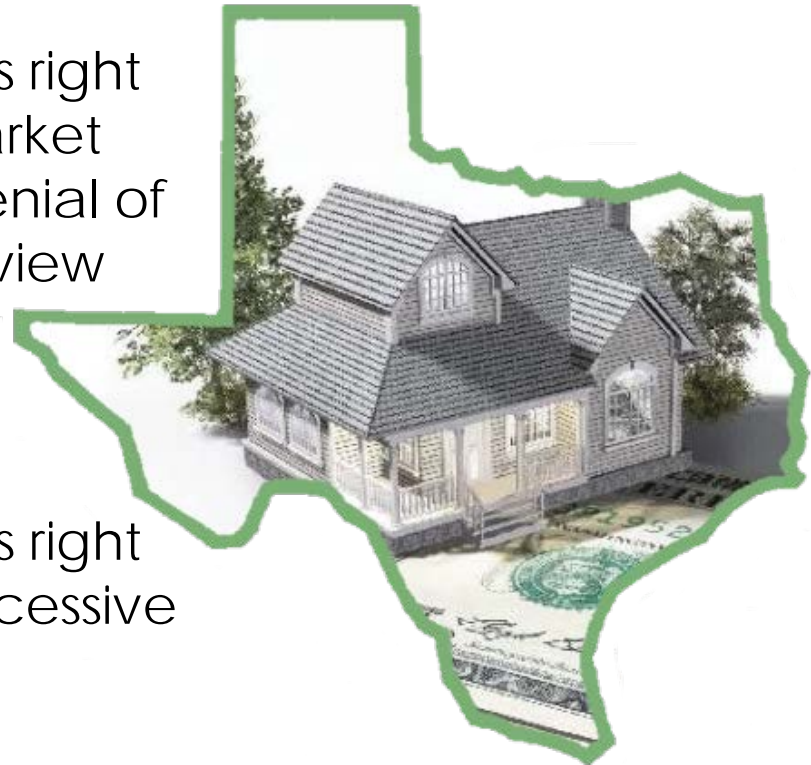
TEXAS PROPERTY TAX CODE (TPTC) BASICS

► Appeals

- » **Chapter 41:** Property owner has right to appeal determination of market value, unequal appraisal, or denial of exemption to the Appraisal Review Board

► Corrections

- » **Chapter 25:** Property owner has right to file correction petition for excessive appraisal or clerical error



Business Personal Property

UNDERSTANDING THE BASICS

► Renditions

- » **Required** per TPTC
- » Generally **report cost**
- » May report **opinion of value only**
- » CAD may issue “**21 day letter**” requesting basis for value
- » Due **April 1st** w/o extension; **May 1st** w/extension



► Primary Exemptions

- » **Freeport** inventory
- » Goods **in transit**
- » **Interstate/foreign** commerce
- » **TCEQ** pollution control equipment

Business Personal Property

FREEPORT INVENTORY EXEMPTION

- ▶ Applies to inventory:
 - » **Acquired or imported** into Texas to be forwarded out of state
 - » **Detained** in Texas for assembling, storing, manufacturing, processing, or fabricating by the person who acquired or imported it
- ▶ Must be transported out of state **within 175 days** after the date the person acquired or imported into Texas



REMEMBER

Petroleum products DO NOT qualify for Freeport Tax Exemption.

Business Personal Property

GOODS IN TRANSIT EXEMPTION

- ▶ Applies to product stored in **third-party warehouse**
- ▶ **Cannot** be owned or controlled by person owning inventory
- ▶ Must meet the **175 day** turnover requirement
- ▶ Not required to be **shipped out** of Texas



Business Personal Property

INTERSTATE/FOREIGN COMMERCE EXEMPTION

- ▶ Statutory exemptions per **Interstate Commerce Clause** and **TPTC 1.12**
- ▶ **Cannot** be processed, sliced or diced
- ▶ Must demonstrate **continual movement** out of state



Business Personal Property

TCEQ POLLUTION CONTROL EXEMPTION



- ▶ Applies to **qualified** pollution control **equipment**
 - » Includes structures and site improvements
- ▶ Tier I, II or III
- ▶ Must secure approval from TCEQ and **Appraisal District**

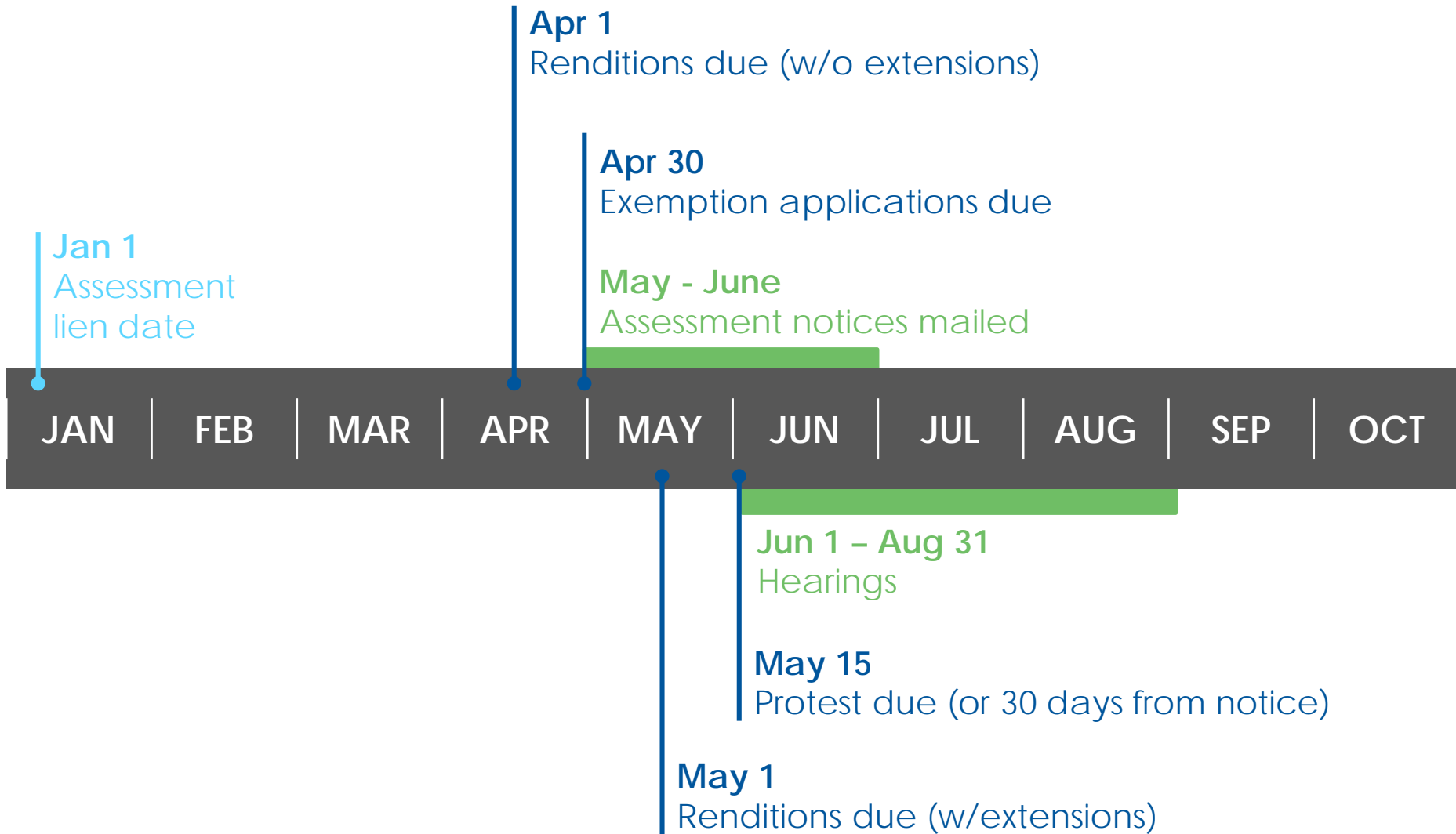
- ▶ Assessed at the **lower** of **market value** or the **median level** of appraisal



- ▶ Three **approaches** for determining value: cost, market/sales approach or income
- ▶ Basis for **appeal**: uniformity

Property Tax Timeline

IMPORTANT DATES TO REMEMBER



Property Tax Timeline

IMPORTANT DATES TO REMEMBER

Oct 1 – Jan 31

Property tax statements

OCT

NOV

DEC

JAN

Jan 31

- Property tax payment due
- 25.25(d) correction deadline



REMEMBER

Petitions must be filed with the District Court within 60 days of ARB order.



Questions?

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