TODAY’S PRESENTERS

Section 1: Income And Franchise Tax
George Rendziperis, JD
Director-in-Charge, State and Local Income Tax

Section 2: Sales Tax
Shane Stewart, CPA
Director-in-Charge, Indirect Tax, State and Local Tax

Section 3: Texas Property Tax
Desmond Ward, Registered Senior Property Tax Consultant
Manager, State and Local Tax
Section 1: Income & Franchise Tax
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

» 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

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

SB 17 (Nelson)
**Franchise Tax**

**COMPTROLLER TECHNICAL BILLS**

**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
Key legislative themes

» Oversight and compliance
  • Throughout the US
  • States not just handing out money to companies - as perceived

Approximately 50 bills introduced

» Chapter 313: 16
» State Funds: 9
» Local Programs: 26
Economic Development

KEY BILLS

HB 3360 (Button)
» Directs economic incentive oversight board to study the effectiveness of chapter 313 in meeting legislative objectives
  • No action by Senate by May 24 deadline

HB 1251 (Sanford)
» Section 501.0721 is added to the Local Government Code to require development corporations to broadcast open meetings
  • Never got out of the House
Economic Development

KEY BILLS

HB 3172 (Button)
- Establishes an economic development portal re: economic incentives offered by state and local governments
  - Never made it out of the Senate committee

SB 277 (Campbell)
- Requires the Comptroller to verify the information provided in compliance reports using information from the Texas Workforce, chief appraiser, and other reliable sources
  - Awaiting Governor action
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
In Focus: Texas

NOTABLE PRECEDENTS AND RULINGS

**Hallmark:** Conflict between rule and law

**Autohaus:** Defining cost of goods sold (COGS)

**CGG Veritas:** Eligibility for COGS deduction

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**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 first franchise tax bill, which the state comptroller incorrectly calculated the income for the company's first year. According to Hallmark, the comptroller should not have included income from a joint venture.

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**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)

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

By Alex Wolff

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 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* that a company that leased heavy equipment to contractors could not include its delivery/pick-up fees for the equipment in its cost of goods sold deduction for Texas franchise tax and state income tax purposes. In doing so, the Third Court of Appeals overruled a trial court decision in the company’s favor. The Third Court of Appeals found that the delivery/pick-up fees were not part of the cost of the equipment itself and therefore not deductible.

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

**AMC: Definition for inclusion of COGS**

The taxpayer in this case, American Multi-Cinema (AMC), a national movie theater chain, argued that COGS included the cost of AMC stock. The Supreme Court of Texas agreed, holding that COGS includes the cost of additional services related to the sale of film prints, including the cost of AMC stock. The case was *AMC v. Hegar*, No. 03-14-00097-CV.
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
Pennsylvania: Begin April 27, 2017 and end June 19, 2017
- Taxes as of December 31, 2015
- If you participated in 2010 tax amnesty, prohibited to participate in 2017 amnesty

Virginia: Start sometime between July 1, 2017 and June 30, 2018
- For a period of 60 to 75 days
- 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
Recent Texas Rulings

HEARING NO. 109,074

- Lessor claimed sale-for-resale exemption on purchase of aircraft it leased on a nonexclusive basis.

- Lessor contended that Ch. 163 definition of leasing an aircraft should apply to transactions prior to effective date of Sept. 1, 2015.

- Ch. 163 provides that leasing an aircraft includes the transfer of “operational control”.

ALJ concluded that Chapter 163 did not codify existing sales tax law. Prior to adoption of Ch. 163, the validity of the sale for resale with regards to aircraft turned on whether “absolute control and possession” transfers to the lessee.
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 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
Applicability

KEY BILLS

HB 4038 (Bohac)

» “Qualifying Job” for Data Center Exemption
  • Expands definition of “qualifying job”
  • Includes new employment position staffed by 3rd party employer
  • Requires a written contract with a qualifying owner, operator, or occupant
  • Signed by Governor June 1, 2017
  • Effective Immediately
Applicability

KEY BILLS

SB 1083 (Perry)
» Relates to the applicability of sales and use tax to certain insurance services
  • Insurance service provided by CPA firm not taxable if <1% of firm’s annual revenue
  • Signed by Governor on May 22, 2017 and effective January 1, 2018
 Clarification/Transparency

KEY BILLS

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 an exemption for services provided by temporary employees
  • Tax Code 151.057 which includes the exclusion for temporary
SB 745 (Kolkhorst)

- Relates to the exemption of certain services performed by certain employees
  - Raises burden of proof
  - Documentation Heavily Scrutinized
  - Sent to Governor on May 28
  - Effective September 1, 2017
HB 2475 (Davis S.)

» Relates to the sales tax exemption for certain amusement services

• Exempts touring Broadway productions performed under contract with a non-profit or charitable organization

• Sent to Governor on May 25, 2017
Exemptions

KEY BILLS

HB 4054 (Murphy, Bettencourt)

» the “Kolache Bill” relates to application of sales taxes to certain food items

• Exempts “bakery items” sold by a “bakery” regardless of whether the items are:

  • Heated or unheated; or
  • Sold with utensils

• 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
  • Sent to Governor on May 28, 2017
  • Effective September 1, 2017
5,623 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 15th** w/o extension; **May 15th** w/ extension

▶ Primary Exemptions
  » **Freeport** inventory
  » **Goods in transit**
  » **Interstate/foreign commerce**
  » **TCEQ** pollution control equipment
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

**REM EMB E R**

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
Statutory exemptions per Interstate Commerce Clause and TPTC 1.12

Cannot be processed, sliced or diced

Must demonstrate continual movement out of state
Applies to **qualified pollution control equipment**
  » Includes structures and site improvements

Tier I, II or III

Must secure approval from TCEQ and Appraisal District
Real Property

OVERVIEW

► 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

JAN  FEB  MAR  APR  MAY  JUN  JUL  AUG  SEP  OCT

Jan 1
Assessment lien date

Apr 15
Renditions due (w/o extensions)

Apr 30
Exemption applications due

May - June
Assessment notices mailed

Jun 1 - Aug 31
Hearings

May 15
Renditions due (w/extensions)

May 31
Protest due (or 30 days from notice)
Property Tax Timeline

IMPORTANT DATES TO REMEMBER

Oct 1 - Jan 31
- Property tax statements

Jan 31
- Property tax payment due
- 25.25(d) correction deadline

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

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