State Tax Update

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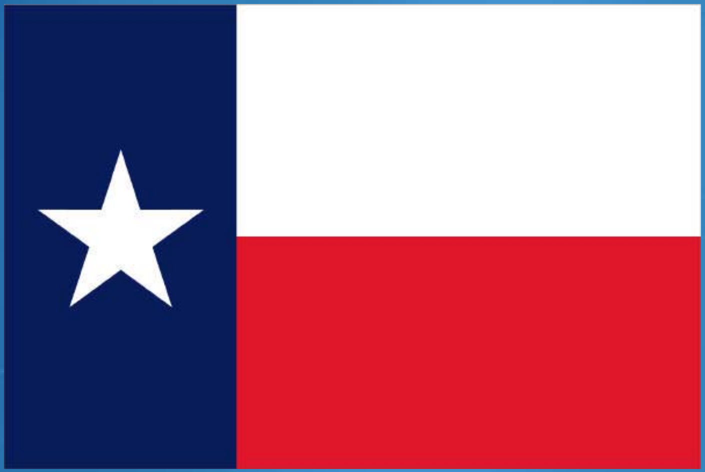
State Sales Tax Update



Legislation Passed During The 83th Regular Session

- **House Bill 1133**
  - Companies who purchase materials & equipment to be used directly in (1) the transmission, conveyance, routing, or reception of telecommunications services, (2) the provision of internet access service; or (3) the distribution of cable television service may apply for a refund of state (not local) sales tax paid on eligible tangible personal property purchased, leased, rented, stored, used, or consumed on or after September 1, 2013.

Legislation Passed During The 83th Regular Session

- **House Bill 1133 (cont)**
  - The amount of the refund of state sales tax paid by all providers and subsidiaries is limited to no more than $50 M for the calendar year.
  - A pro rata method will be used by the state if qualifying claims exceed the $50 M maximum.

Sales Tax on Telecommunications

- Sales Tax Rule 3.334 – Telecommunications Services
  - Telecommunications services billed call-by-call or per transmission are to be taxed based on the location where the call originates. If undeterminable, based on address billed.
  - <u>Taxable Telecommunications</u>
    - Basic local access
    - Enhanced services
    - Intrastate toll
    - Special access to end user
    - Interstate toll originating in Texas and billed to a Texas number
    - Interstate end user charges: SLC and ARC
    - Other separately stated federal, state and local taxes and fees imposed on LEC's (TUSF, FUSF)

Sales Tax on Telecommunications

- Taxable Telecommunications (cont)
  - Installation of telecommunications services, including service connection fees
  - Lease, rental, sale, or other charges for telecommunications equipment if included on the same bill, receipt, or invoice as the sale of a telecommunications service (even if it is identified as a separate line item). This would include inside wire monthly maintenance contract on non-residential customers
  - Prepaid wireless telecommunications services
- TXUSF Considerations
  - Assessment based on taxable intrastate telecommunications reported under Chapter 151 of the Texas Tax Code. (Lifeline service exception.)

Sales Tax on Telecommunications

- Nontaxable Telecommunications
  - Interstate toll not originating in Texas
  - Interstate toll originating in Texas but not billed to a Texas number or address
  - Telecommunications services purchased for resale or by exempt entity. (Obtain certificates in lieu of tax.)
  - Charges for federal, state, or local taxes or fees that are imposed on the purchaser rather than on the seller of the telecommunications service

Sales Tax on Telecommunications

- For mobile and landline telecommunications services that are <u>not sold on a call-by-call basis,</u> service providers should collect local tax based on the <u>customer's place of primary use</u>.
  - The primary use location can be a residential or business street address, but not a post office box.
  - Location from which the call originates or terminates is no longer a factor for mobile and landline telecommunications services that are not sold on a call-by-call basis.

Sales Tax on Telecommunications

- Texas state and local sales taxes are due if the customer's place of primary use is inside the state.
- The primary use rule does not apply for mobile telecommunications if you are traveling in a foreign country, and the calls originated and terminated in the foreign country.
- For prepaid wireless telecommunications services local tax is based on the business address of the seller when the sale occurs in Texas in person. If the sale occurs over the telephone or Internet, tax is due only if the purchaser's address is in Texas.

Sales Tax on Telecommunications

- State and local sales tax is due on Texas intrastate calls, while only state sales tax is due on interstate calls.
- Not all local taxing jurisdictions impose sales tax on telecommunications services. For a list of jurisdictions that do impose the tax, see:
  - **Publication 96-339 – "Jurisdictions That Impose Local Sales Tax on Telecommunications Services**"
  - Located on the Comptroller's website @ **http://www.window.state.tx.us/taxinfo/taxpubs/tx96_339.html**
  - This publication is updated quarterly.

Internet Services

- Local Tax on Taxable Internet Services
  - One place of business - local tax based on the place of business from which the service is provided.
  - More than one place of business:

    - Ordered in person – local tax based on the place of business from which the service is ordered

    - Order via internet / phone – local tax based on the place of business from which the service is provided
- SB 997 – allows optional local sales tax sourcing rules until September 1, 2024 for parties affected by certain economic development agreements
- $25 monthly exemption per entity for internet access

Taxability of Miscellaneous Computer Related Services

- **Taxable Data Processing** (Subject to 20% exemption)
  - Monthly website connection fees
  - Monthly website hosting fees
  - Scanning information or data into the net and the creation of "HTML" documents
  - Posting web pages on a server
  - Website Creation
  - Website Maintenance

Taxability of Miscellaneous Computer Related Services

- **Non-Taxable Services**
  - Separate fees for licensing and completing applications for domain names
  - Charges for training
  - Charges for submitting website information to search engines
  - Software installation, repair or support if software is bought from vendor other than the one providing the installation, repair, or maintenance

Taxability of Miscellaneous Computer Related Services

- **Taxable Services**
  - Software installation, repair or support if provided by the vendor that sold the software
  - Installing network wiring and cabling in the walls or roof of existing commercial client offices
  - Computer assembly (including initial set up, connecting monitor, keyboard, and printer) if in connection with the sale of the hardware
  - Installation is not taxable if hardware was purchased from 3rd party
  - Repair, remodel, or maintain hardware

Other Taxable Services (commercial property)

- Cleaning Charges (Janitorial Services)
- Lawn Care Services & Landscaping
- Repair, remodel & maintenance of non-residential real property
- Repair, remodel & maintenance of tangible personal property
- Security services
- Information services
- Debt collection services

Miscellaneous Sales Tax Issues

- **Contract services for the repair of damaged cable are taxable**
- **Contract services for the remodel of cable are taxable**
- **Contract services for labor to install <u>new</u> cable are not taxable**
- **Services integral to the performance of the taxable service being provided may be purchased tax free**

Miscellaneous Sales Tax Issues

- **Products transferred to the customer as a part of the taxable service being provided may be purchased tax free if care, custody, and control is transferred to the customer.**

- **Phones given to customers or sold below cost in connection with the sale of the taxable service**

Providers & Marketers:

- May purchase phones to be given away tax free
- Must collect sales tax on any amount charged for phone.

SALES TAX APPLICATIONS

	Taxability Material	Taxability Labor
Repair, remodeling, and restoration of commercial building or commercial real property when charges for material and labor are billed lump-sum or separately.	Y	Y
Repair, remodeling, maintenance, and restoration of equipment or any tangible personal property when charges for material and labor are billed lump-sum or separately.	Y	Y
Maintenance contract on equipment or any tangible personal property.	Y	Y
Maintenance contract on building or real property.	N_1	N
New construction of real property when charges for material and labor are billed lump-sum. (New construction includes the addition of new footage to an existing structure.)	N_1	N

SALES TAX APPLICATIONS

	Taxability	
	Material	Labor
New construction of real property when charges for materials and labor are billed separately.	Y	N
Repair, remodeling, and restoration of residential real property when charges for material and labor are billed lump-sum.	N[1]	N
Repair, remodeling, and restoration of residential real property when charges for material and labor are billed separately.	Y	N

[1]The materials used in fulfilling the contract would be taxable to the contractor.

Texas Sales and Use Tax Prepayment Report

- Prepayment discount - 1.25%
  Timely filing discount - .50%
  Total discount 1.75%

- Prepayment must be:
  - at least 90% of tax that will be due for the reporting period, or
  - 100% of the total tax due and paid in the same reporting period of the preceding year

Texas Sales and Use Tax Prepayment Report

▪ Monthly taxable sales	$500,000
Tax rate	.0825
Monthly tax payments	$ 41,250
Prepayment discount	1.25%
Additional annual revenue	$ 6,200

- Equivalent to an annual Rate of Return of 15% on your money

Texas Sales and Use Tax Prepayment Report

- Prepayment report due on the 15th of each month
- Prepayment report and payment for July sales due July 15th
- Regular sales tax report for July sales still due August 20th

Telephone Cooperative Issues

- Exempt from Sales Tax – **No "purpose" test is required to be met.**
- Exempt from Hotel Occupancy Tax
- Exempt from Texas Motor Vehicle Tax
- Exempt from Gasoline and Diesel Fuels Tax

Telephone Cooperative Issues

- Lump-sum contractors may not use telephone cooperative's exemption certificate to purchase materials they use in completing a contract for a cooperative.
- Lump-sum contractors are the consumers of all materials and must pay tax on them.
- Consider requesting separated contracts

Transfer of Completed Work Order from Coop to Subsidiary

January 20, 2005

To: Sandra Hilliard, Auditor

From: Al Van Allen, Tax Policy

Subject: [redacted] Telephone Cooperative
Sale of Fiber Optic Network to a For-profit Subsidiary

Facts:

[redacted] Telephone Cooperative, a telephone cooperative formed under the Telephone Cooperative Act (Utilities Code, Chapter 162) is exempt from paying sales tax based on the language in Utilities Code Sec. 162.062.

[redacted] Telephone Cooperative created a wholly owned for-profit subsidiary, [redacted] Communications Ltd ([redacted]) that is not exempt from payment of sales tax. [redacted] Telephone Cooperative built a buried fiber optic network and sold a portion of the completed network to the for-profit subsidiary. The fiber network is an improvement to realty when completed.

You examined work orders provided by [redacted] Telephone Cooperative that show separate amounts for:

Material
Supply Expense
Total Material & Supply
Labor
Benefits
Other Charges
Total Labor & Other
AFUDC
Cumulative Total

Transfer of Completed Work Order from Coop to Subsidiary

Based on internal calculation, the costs were allocated (by percentage) to [redacted] and Co-op; when the W/O was closed. You believe the Co-op is, in essence, acting like a general contractor presenting separated billings and ask if the Coop is responsible to collect sales tax on its itemized charges for materials.

Question: Is the Coop required to collect sales tax from [redacted] on any part of the charge for the fiber network?

Response: I understand that no contract or other agreement exists that shows that the Coop built the network under contract with [redacted]. The Coop sold a completed improvement to realty rather than tangible personal property and so is not required to collect tax on any part of the transaction. The Coop was within its statutory authority to buy the incorporated materials tax-free and so does not incur a sales or use tax liability on those purchases.

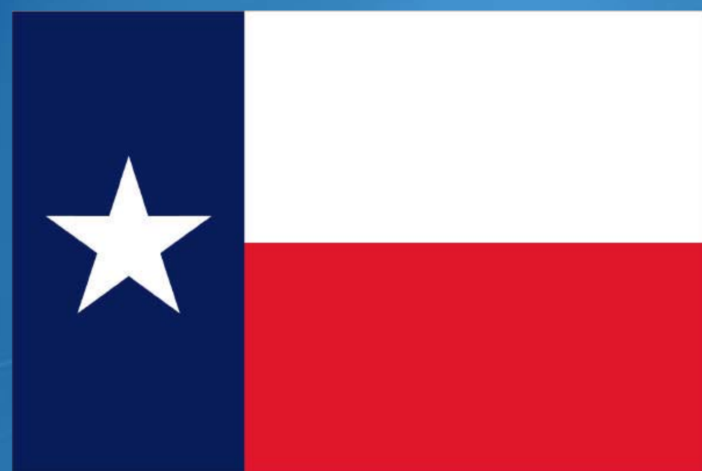
Organizational Considerations

- Should businesses collapse entities?
  - <u>Business Considerations</u>
    - Simplified legal structure
    - Simplified financial accounting reporting
    - Is separate legal entity needed for operating other services
    - Regulatory reporting and recovery

Organizational Considerations

- Tax Considerations
  - Is the Parent company a telephone Cooperative?
  - Unless Parent company is a Cooperative, franchise tax liability is not likely to change if current structure simplified
  - Possible sales tax savings
  - Possible federal income tax savings
  - Possible loss of federal NOL’s

Franchise Tax



Legislation Passed During The 83rd Regular Session

- **<u>House Bill 500 – Franchise Tax</u>**
  - Temporary rate reductions:
    - For returns due in 2014, franchise tax rates will be 0.4875% (.5% presently) for retail and wholesale entities and 0.975% (1% presently) for all others.
    - For returns due in 2015, tax rates will be 0.475% and 0.95% respectively, provided the State Comptroller certifies that sufficient revenues will be available.
    - Rates return to current .5% & 1% for returns filed after 2015.

Legislation Passed During The 83th Regular Session

- **House Bill 500-Franchise Tax (cont.)**
  - $1M small-business tax exemption has been made permanent
  - The standard deduction is changed from 30% of total revenue to the greater of 30% of total revenue or $1M.

Legislation Passed During The 83th Regular Session

- **<u>House Bill 500-Franchise Tax (cont.)</u>**
  - An affiliate with no nexus in Texas is no longer required to file in a combined group with other Texas entities.
  - For Internet hosting companies, Texas receipts will be only those receipts from customers located in Texas (TX Code 151.108).

Entities Subject to Franchise Tax

- Applies to most business entities that have statutory liability protection
  - Corporations
  - Limited Liability Companies
  - Professional Associations
  - Partnerships
  - Business Trusts

Exempt Entities

- **Entities with No Owner Protection**
  - Sole Proprietorships
  - General Partnerships (all interests directly owned by natural persons)
  - Grantor Trusts
  - Estates

- **Other Exempt Entities**
  - Telephone Cooperatives
  - Exempt Organizations
  - Passive Partnership or Trust

Unitary Combined Reporting

- An **affiliated group** of entities in a **unitary** business will be required to file a consolidated return including all taxable entities within the group.

- HB 500 – allows entities to exclude affiliates with no nexus in Texas.

Unitary Combined Reporting

- **Affiliated Group**
  - Common Ownership
  - More than 50% Control
    - Direct or Indirect
    - Vote or Beneficial Ownership
- **Unitary Business**
  - Same General Line of Business
  - Vertically Integrated
  - Functionally Integrated
  - Centralized Management
  - Synergy & Mutual Benefit

Franchise Tax Exemptions

- **Small Business Exemption:** now permanently set to $1M in revenue
- If total tax due is less than $1,000 – no tax due
- No tax due report and public information report are still required to be filed annually

Franchise Tax Calculation

- Taxpayers with $10M or less receipts can elect to use the E-Z method

  [Revenues X % of TX business X .575%]

- No deductions are allowed when using the E-Z method but the rate is significantly reduced for service providers

Franchise Tax Calculation

- When not using the E-Z method, taxpayers can elect to deduct the greater of :
  - 30% of gross revenue
  - Cost Of Goods Sold (not available for telecom. providers)
  - Compensation, or
  - $1 M (<u>new for 2014 returns per HB 500)</u>

[Revenues less deduction X % of TX business X Tax Rate]Tax

Rate for Telecommunications Provider:

2013	1%
2014	.975%
2015	.95%
2016	1%

Revenues Subject to Franchise Tax

- **<u>Gross Revenues</u>** (per federal income tax return)
  - Sales
  - Dividends
  - Interest
  - Rents and Royalties
  - Capital Gains
  - Other Income
- **<u>Apportionment %</u>** - Texas vs. Non-Texas receipts

Revenue Reductions & Exclusions

- Flow-through Income from non-passive entities (Partnership K-1)
- Dividends and Interest received from Federal Obligations
- Affiliate Transactions (of combined group)
- Bad Debt Expense
- Sales Commissions paid to non-employees
- Schedule C Deductions

Franchise Tax Accrual Considerations

- 2013 Franchise Tax Report
  - Due May 15, 2013
    1st extension to August 15, 2013
    2nd extension to November 15, 2013
  - Based on revenues per the 2012 Federal Tax Return
- 2013 Monthly Franchise Tax Accrual
  - 1/12 of estimated franchise tax due May 15, 2014
  - Considerations:
    - Combined group
    - New entities
    - Change in operations
    - Non-recurring transactions resulting in tax gains or losses

Thank You!

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