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# Summary of Comptroller's Proposed Franchise Tax Rules Changes: October 2008

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## **3.582. Passive Entities.**

- Definition of “federal gross income” is amended to that which is “reportable” for federal tax purposes,
- Partnership income from rent that flows to the partners is NOT considered to be passive income (this will effectively deny passive status to many existing passive entities),
- Enhanced reporting requirements:
  - passive entities must file information annually to the Comptroller to verify they are passive,
  - if a passive entity has notified the Comptroller that they are doing business in Texas, they must file an annual information report,
  - if a passive entity has not notified the Comptroller they are doing business in Texas, they must notify the Comptroller only when they no longer qualify as a passive entity,
  - a passive entity must respond within 30 days to a question from the Comptroller asking if they are taxable.

## **3.583. Exemptions.**

- Corrects references in the original rule.

## **3.584. Reports and Payments**

- Conforming amendments relating to rule 3.582 for non-taxable entities,
- Deletes language relating to “privilege period,” which the Comptroller sees as superfluous because it does not affect the calculation of the tax,
- Deletes language concerning new entities within a combined group,
- Requires a taxpayer to annualize their receipts in qualifying for the small business provisions,
- Combined groups owing less than \$1,000 are not qualified to file a No Tax Due Information Report,
- Specific references to 3.587 for information concerning the tiered partnership provision are added,
- Additional language is added relating to the methods of determining margin in filing an amended report,
- It is explicitly stated that financial institutions must file a public information report,
- It is explicitly stated that all other taxable entities must file an ownership information report and that it is the legal formation of the entity that determines if it is a corporation, limited liability company or a financial institution.

## **3.585. Annual Report Extensions.**

- A separate entity that was included in a combined report originally due in the previous calendar year may not use the 100% extension option,



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- A combined group is required to make its franchise tax payments by electronic funds transfer if any member of the combined group receives notice of the requirement,
- A correction is made to require entities subject to electronic funds transfer that receive an extension to file by August 15,
- A separate entity that was included in a combined report originally due in the previous calendar year may not use the 100% extension option,
- Clarifies that for EFT filers, the second extension is to November 15.

### **3.587. Total Revenue.**

- For health care providers, new rules require calculation of an uncompensated care ratio which is to be applied to the cost of goods sold and compensation deductions, so that proportionate amounts excluded from total revenue are also excluded from amounts deducted,
- For health care providers, patient copayments, deductibles, and supplemental insurance relating to exempt coverages may be excluded from total revenue,
- Language providing that any amounts excluded from total revenue must be excluded from amounts deducted is tightened,
- Reporting requirements for tiered partnerships is modified. It is expressly stated that tiered partnership reporting is not an alternative to combined reporting,
- The exclusion of principal repayments is expressly limited to lending institutions,
- A staff leasing company is prohibited from excluding from total revenues those payments relating to independent contractors hired by the leasing services company,

### **3.588. Cost of Goods Sold**

- New language is added restricting the choice of whether to expense or capitalize cost of goods sold so that a taxpayer may not alter the method once they have filed their report (this is not in statute),
- New provision expressly states "Any expense excluded from total revenue may not be included in the determination of cost of goods sold." ("reasonable basis" provision is deleted),
- Language is clarified so that only those taxable entities electing to capitalize costs may include a beginning inventory value in calculating their cost of goods sold,
- Restaurants are allowed to include acquisition costs as part of cost of goods sold, and expenses relating to beverages are includable as cost of goods sold,
- It is expressly provided that "storage costs" may not include any expenses specifically excluded under other provisions within the rule.

### **3.589. Compensation**

- Wages and tips includable as compensation are specifically limited to those for the period on which the tax is based.
- Wages and cash compensation includes net distributive income regardless of whether it is a positive or negative amount,



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- In calculating the \$300,000 per person limit on wages and cash compensation, the amount must be annualized,
- Payments made to independent contractors are those payments that are reportable on Internal Revenue Form 1099 even if the IRS minimum reporting requirement is not met,
- New provision expressly states "Any expense excluded from total revenue may not be included in the determination of compensation." ("reasonable basis" provision is deleted),
- Staff leasing companies may not include as compensation payments to independent contractors for which they were not required to report on a form 1099,
- A client company of a staff leasing company may not include as compensation any amounts used by the staff leasing company to pay independent contractors,
- Language clarifies how and when a taxable entity that elects to deduct compensation shall determine margin and what restrictions apply when amending that election (they may later opt for the 70 percent of gross receipts limitation or the EZ calculation, but they may not switch to cost of goods sold).

### **3.590. Combined Reporting.**

- Deletes provision that insurance companies are not included in a combined group, holding that the language is unnecessary because a combined group may not include an exempt entity,
- Language clarifies that the 70% limitation in lieu of the compensation or cost of goods sold deduction is not an election,
- It is expressly stated that the E-Z Computation is only allowed for qualifying taxable entities,
- Per statute, a member of a combined group that does not have nexus individually must report, for information purposes only, the member's gross receipts from business done in this state and the member's gross receipts from business done in this state that are subject to taxation in another state under a throwback law,
- Members of a combined group with different accounting periods must prepare a separate income statement based on federal income tax reporting methods, not the books and records of the taxable entity as originally noted,
- Language that allows a combined group to file a no tax due report is deleted,
- A combined group will file only annual reports. Members of a combined group that join or leave the combined group during the accounting period may be required to file separate initial, annual, and final reports. Examples are included.

### **3.591. Additional Tax**

- Deletes reference to final report information for combined groups, which is instead included as a part of the newly proposed 3.590.

### **3.594. Temporary Credit for Business Loss Carryforwards.**

- Taxpayers owing less than \$1,000 in tax (and consequently are exempt) are no longer required to claim business loss amounts.

