

Sample Margin Tax Form

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A Form a Business May Use in Calculating the Potential Tax Consequences of One Possible Approach to Property Tax Relief Involving a “Margin Tax” in Lieu of the Franchise Tax

– DRAFT –

This is a description of the draft tax bill submitted by the Texas Tax Reform Commission, including a **draft** margin tax form prepared by the Texas Taxpayers and Research Association.

This information is to assist businesses in estimating a portion of the potential financial effects of ideas currently under consideration to provide school property tax relief and replace the corporate franchise tax with a “margin tax” on all businesses (except sole proprietorships, general partnerships and passive income entities).



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Key Elements of the Tax Reform Commission Working Draft Plan

Plan Component	2006	2007	2008	Additional Notes
Tax Relief				
School Property Tax	School maintenance and operations tax rates reduced by 17 cents	School maintenance and operations tax rates reduced by an additional 33 cents (50 cents total reduction over two years); "cap" reduced to \$1.30	No further changes	Schools generally may increase their maintenance and operations tax rates by 6 cents per year above these levels
Tax Increases				
Business Tax	Texas franchise tax remains in place; May 2006 tax payment based on business in 2005	Margin tax is effective January 1 and applies to business done after that date; however, May 2007 tax payment will be based on the old franchise tax (business in 2006)	In May of 2008, businesses pay margin tax based on business in calendar year 2007	Franchise tax on corporations and limited liability companies with more than \$150,000 in receipts; margin tax on all businesses with liability protection with more than \$300,000 in receipts
Cigarette Tax	Tax on a pack of cigarettes is increased from \$0.41 per pack to \$1.41 per pack	No further changes	No further changes	
Motor Vehicle Sales Tax	Sales tax on used cars based on reported "blue book" value, as opposed to buyer-stated value	No further changes	No further changes	
Other Fiscal Provisions				
Use of State Surplus	Approximately \$1.4 billion of state surplus will be used to balance package			The net effect of the package is a \$1.4 billion net tax cut, although businesses and individuals will be affected differently



Margin Tax Instructions

Who is subject to tax: An entity that is a corporation, partnership, limited liability company, business trust, professional association, or other legal entity is subject to the tax with the following exceptions: a sole proprietorship, a general partnership owned by natural persons, a passive income entity (including a Real Estate Investment Trust), an entity specifically exempted under current Subchapter B, Chapter 171, Tax Code, a grantor trust, an estate of a natural person, an escrow, or a real estate mortgage investment conduit. An entity is a passive income entity if it is a general partnership, limited partnership or trust and 90 percent or more of its income is from investments such as dividends, interest, returns on financial instruments, distributive shares of a partnership, capital gains, and minerals royalties (rent is not considered passive income). An entity that owes less than \$100 in tax, or that grosses \$300,000¹ or less in total revenues, is not required to pay tax.

Filing Date: Regular annual returns are due May 15 for the current privilege period (calendar year), based on calculations on financial data from January 1 – December 31 of the previous calendar year. First return is due May 15, 2008 on business done from January 1, 2007 to December 31, 2007.

Combined return requirements: An affiliated group of entities engaged in a unitary business must file a single consolidated return to waters edge including all taxable entities within the group (including taxable partnerships and taxable entities not subject to the federal corporate income tax). An affiliated group includes all entities of which a controlling interest (i.e., it is 80 percent or more owned) is owned by a common owner, and *includes entities with no nexus* in Texas except those entities in which 80 percent or more of its property and payroll is assigned to locations outside the United States are excluded from the unitary group. A “unitary business” means a single economic enterprise that is made up of separate parts of a single entity or a commonly controlled group of entities that are sufficiently interdependent, integrated and interrelated through their activities. The affiliated group is a single taxable entity for the purposes of the filing a tax return. An exempt entity that is a part of an affiliated group which includes taxable entities should not be included in the consolidated return.

Line 1: Total Revenue. Total revenue is the affiliated group’s total income. It is calculated as the amounts the affiliated group would file on the federal return, as follows:

	Line 1c: gross receipts less returns and allowances
Plus	Lines 4-10: dividends, interest, gross rents and royalties, capital gain net income, net gain from form 4797 and other income,
Minus	Bad debt
Minus	Foreign royalties and foreign dividends

Receipts across affiliated entities (sales, dividends, distributive shares of a partnership, etc.) are excluded in calculating total revenues of the group. Specific exceptions which are **not** included in total revenue are certain funds received in trust, such as a plaintiff’s damage award handled by an attorney and sales taxes, as well as sales commissions to non-employees, principal value of securities, and a general contractor’s flow-through payments to construction subcontractors. A lending institution may exclude proceeds from the repayment of principal on loans. A staff leasing company may exclude revenue from staff leasing.

Line 2a: Cash Compensation. Compensation includes wages, salaries, stock options, and other income to an entity’s officers, directors, owners, partners, and employees. The deduction for compensation may

¹ This threshold will be indexed to inflation beginning in 2009..



Margin Tax Instructions, *continued*

not exceed \$300,000² for any single person (be they owner or employee). Compensation includes payments a taxpayer makes to a staff leasing company for wages and benefits of leased employees.

Line 2b: Employer's Cost of Employee Benefits. This is the sum of all non-cash benefits paid to all officers, directors, partners, owners, employees, etc., including workers compensation benefits, health care, and retirement to the extent deductible for federal income tax purposes.

Line 2c: Total Compensation. Sum Lines 2a and 2b.

Line 2d: Cost of Goods Sold. A "good" is real or tangible personal property sold in the ordinary course of business and is **not** a service. "Cost of goods sold" includes all direct costs of acquiring or producing goods, including production costs for labor, materials, handling (such as processing, assembling, packaging, and *inbound* transportation), utilities, storage, control, storage, licensing and franchising costs, and production taxes. Also includable are certain indirect costs for *production-related* facilities, land and equipment, such as depreciation, depletion, amortization, renting, leasing, and repair and maintenance, as well as costs attributable to research and design, geological and geophysical costs for locating minerals properties, and insurance. Excluded from "cost of goods sold" are costs for facilities, equipment, and land not used for the production of goods, selling costs, advertising, distribution and outbound transportation costs, interest or financing costs, income and franchise taxes. Up to four percent of administrative and overhead expenses may be included to the extent they are allocable to the costs of acquiring or producing the goods. Cost of goods sold shall be capitalized to the extent required by Section 263A, Internal Revenue Code. A bank or savings and loan may include interest expense as a part of cost of goods sold.

Line 2e: Enter Greater of 2c or 2d. 3. A taxpayer may choose to deduct either Compensation or Cost of Goods Sold. An affiliated group may make only one election for the entire group.

Line 3: Raw Margin Tax Base. Subtract line 2e from line 1. This is the taxpayer's raw margin tax base before constraint.

Line 4: Tax Base Limit. Multiply Line 1, Total Revenues by 0.7. The margin tax base may not exceed 70 percent of a business's total revenues.

Line 5: Margin Tax Base. Enter the lesser of Line 3 or Line 4. This is the base on which the tax rates will apply.

Line 6a: Gross Receipts Everywhere. "Gross receipts" includes receipts from the group's sale of tangible personal property, services, rentals, royalties, and other business. Receipts excluded from "total revenue" on Line 1 are to be excluded from gross receipts. Receipts across taxable entities within the affiliated group net out.

Line 6b: Texas Gross Receipts. Texas gross receipts includes receipts from the sale of tangible personal property delivered or shipped to a buyer in this state, services performed in this state (except that real estate loan servicing are in this state if the real property is in this state), the use of a patent, copyright, trademark, franchise, or license in this state, sale of real property in this state (including royalties from minerals) and other business done in this state. Only gross receipts from those entities within the group which have nexus in Texas shall be included in the calculation of Texas receipts. Receipts across taxable entities within the affiliated group net out.

Line 6c: Percentage of Gross Receipts Attributable to Texas. This is line 6b divided by line 6a.

Line 7: Texas Margin Tax Base. Line 5 multiplied by line 6c.

² This amount will be indexed to inflation beginning in 2009.



Margin Tax Instructions, *continued*

Line 8. Margin Tax Rate. The margin tax rate is 1.0%, except for businesses predominately engaged in wholesale or retail, which pay at a rate of 0.5%. The terms “wholesale” and “retail” are as defined by the 1987 Standard Industrial Classification system. A business is considered to be wholesale or retail if more than half of its total revenues is from wholesale and retail sales of tangible personal property which it does not itself produce.

Line 9. Texas Margin Tax. Line 5 multiplied by line 6.

Line 10. Less Credits. Taxable entities which have accrued used credits for incentives under previous franchise tax law may claim those credits against the margin tax under the terms and conditions provided for at the time they were accumulated; however, no *new* credits may be accumulated against the margin tax (unless a written agreement exists effective before June 1, 2006 between the state and the taxpayer), as all existing credit provisions are repealed. Net operating losses are **not** a credit.

Line 11. Margin Tax Due. Line 9 minus line 10. If the amount is less than zero, enter zero.



Sample Margin Tax Return

Line and Item	Amount
Form to be filed and taxes paid on a unitary combined basis.	
1. Total Revenue (if less than \$300,000, enter "0" on line 7).....	
2. Less Certain Deductible Expenses	
a. "Cash" Compensation, such as wages, salaries, partner compensation, stock options, etc., not to exceed \$300,000 for any single earner.....	
b. Employer's Cost of Employee Benefits.....	
c. Total Compensation (sum of a & b above).....	
d. Cost of Goods Sold (<i>generally</i> similar to federal definition).....	
e. Enter greater of line c or line d.....	
3. Raw Margin Tax Base (line 1 minus line 2e).....	
4. Tax Base Limit. Enter Line 1 multiplied by 0.7.....	
5. Margin Tax Base. Enter the lesser of line 3 or line 4.....	
6. Texas Apportionment (<i>generally</i> same as current franchise tax)	
a. Gross Receipts Everywhere.....	
b. Texas Gross Receipts.....	
c. Percentage of Gross Receipts Attributable to Texas (line 6b divided by line 6a).....	
7. Texas Margin Tax Base (line 5 multiplied by line 6c).....	
8. Margin Tax Rate (wholesalers & retailers, 0.5%; all others, 1%).....	
9. Texas Margin Tax (line 7 multiplied by line 8).....	
10. Less Previously Accumulated Franchise Tax Credits (not NOLs).....	
11. Margin Tax Due (line 9 minus line 10 but not less than zero)	

