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August 24, 2007

Gross Receipts Tax

The Texas margin tax was enacted in 2006 with the expectation that a technical corrections bill would be required before the tax became effective on Jan. 1, 2008. That bill—H.B. 3928—was enacted on June 15. In this article, authors Karen Currie, Kirk Lyda, and Kelvin Sellers of Jones Day, in Dallas, provide an overview of H.B. 3928 and various proposed amendments to the bill that were included in, or rejected from, the final version.

The 'Technically Corrected' Texas Margin Tax Law: What Amendments Made the Cut, What Got the Axe

BY KAREN CURRIE, KIRK LYDA, AND KELVIN SELLERS

On the last day of the 2007 legislative session, the Texas Legislature signed off on the much anticipated H.B. 3928, the Texas margin tax technical corrections bill. Between the filing of the bill on March 9 and presentment to the governor on May 28, numerous amendments were proposed in both the House and the Senate. Many of the proposed amendments were truly technical corrections to the margin tax bill enacted in 2006. Other amendments proved to be significant changes resulting from lobbying efforts of Texas businesses and the state Comptroller of Public Accounts. After significant debate and numerous iterations, on June 15, 2007, the governor signed the final version H.B. 3928 into law. The Texas margin tax is now officially one for the books.

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A BRIEF HISTORY OF THE MARGIN TAX

In 2006, the Texas Legislature passed H.B. 3, which replaced the previous capital- and earned surplus-based

 ISSN 1078-845X

franchise tax with the margin tax.[1] The margin tax substantially changes the computation of the Texas franchise tax by adopting several unique provisions that differ from those of every other state. The revised tax base is the ''taxable entity's margin'' (thus the name given to the new tax), which is generally computed as total revenue, minus either cost of goods sold or compensation, at the election of the taxpayer. The resulting taxable margin is generally capped at 70 percent of total revenue.

By the stroke of a pen, decades of Texas franchise tax law requiring separate reporting and prohibiting consolidated reporting was replaced by a new unitary combined water's edge reporting methodology. The tax rate was reduced from 4.5 percent under the earned surplus component of the former franchise tax to 0.5 percent for certain retailers and wholesalers and 1 percent for other taxpayers under the margin tax. The single receipts factor apportionment scheme was left largely intact. Credits under the former franchise tax were generally repealed and a new ''temporary credit on taxable margin'' was developed.

The margin tax applies to most, if not all, legal entities with limited liability protection. Because the original list of taxable entities was not comprehensive, and the general catchall ''or other legal entity'' was not defined, some had previously questioned whether certain types of entities (*e.g.*, limited liability partnerships) were subject to the tax.

The margin tax enacted in 2006 was generally slated to take effect Jan. 1, 2008, leaving the entire 2007 legislative session to ''technically correct'' the details. Even before H.B. 3 was off the press, taxpayers, tax practitioners, and the comptroller began targeting ''technical corrections'' to fine-tune the margin tax. The results of the tinkering (to date) are set forth in H.B. 3928. This article summarizes the amendments that made the cut and some that got the axe. Taxpayers should expect some ''axed'' provisions to be revisited in the next legislative session and proposed regulations to be released soon.

WHAT MADE THE CUT

H.B. 3928 includes a host of changes to the original margin tax provisions originally passed in 2006. These modifications range from clarification of the tax base and entities subject to the tax, to the adoption of an alternative taxing regime for small business taxpayers. As expected, many of the adopted changes resulted from debate among various lobbying groups. Others appeared to have come out of nowhere.

Affiliated Group Expanded By Reduced Control Percentage

One of the more consequential amendments adopted in H.B. 3928 is the expanded definition of ''controlling interest'' for determining whether an entity is included in an affiliated group. The technical corrections bill reduced the control threshold required to be included in an affiliated group from ''80 percent or more'' to ''more than 50 percent'' and clarified the application of the rule for limited liability companies.[2]

By the stroke of a pen, decades of Texas franchise tax law requiring separate reporting ... was replaced by a new unitary combined water's edge reporting methodology.

This change is important for taxpayers owning or engaging in business with multiple subsidiaries. For margin tax purposes, taxable entities in an affiliated group that are engaged in a unitary business are required to file a combined report, rather than individual reports. The combined group apportions its taxable margin based on the total receipts and apportionment factors for the combined group. The term ''affiliated group'' is defined as ''a group of one or more entities in which a controlling interest is owned by a common owner or owners, either corporate or noncorporate, or by one or more of the member entities.''[3]

Under H.B. 3, a ''controlling interest'' was defined as owning directly or indirectly ''80 percent or more'' of either the total combined voting power of all classes of stock of a corporation, or the beneficial ownership interest in the voting stock of a corporation. For a partnership or other entity, ''controlling interest'' was defined as owning directly or indirectly ''80 percent or more'' of the capital, profits, or beneficial interest in the partnership or other entity. H.B. 3928 expanded the definition of controlling interest to ''more than 50 percent'' direct or indirect ownership of stock, capital, profits or beneficial interest.

This expanded definition of controlling interest in H.B. 3928 will clearly impact those companies owning between 50 and 80 percent of a subsidiary entity. The combined report for these companies may now have a larger number of entities.

Although expanding the affiliated group was likely done to raise additional revenue, this amendment could have either a positive or negative impact on an individual taxpayer, depending on the facts and circumstances of the particular taxpayer. The inclusion of additional companies may increase a taxpayer's administrative burden, or alternatively may increase efficiency if these companies would otherwise file numerous separate company returns. Similarly, while the inclusion of additional revenue often increases the tax burden, to the extent the newly included companies lack nexus with Texas, the companies' sales factor apportionment will be diluted.

[1] During legislative hearings in 2007 following the passage of H.B. 3, legislators were careful to point out they did not enact a ''new tax.'' The politically correct term is ''reformed franchise tax.'' Whether the franchise tax was ''reformed'' or ''replaced with a new tax'' is open to debate. In any event, the statutorily ''reformed'' tax is generally referred to as the '' margin tax.''

[2] *See* H.B. 3928, §1, 2007 Leg., 80th Sess. (Tex. 2007), *amending* Tex. Tax Code Ann. §171.0001(8) (2006).

[3] *See* Tex. Tax Code Ann. §171.0001(1) (2006).

   ISSN 1078-845X

Limited Liability Partnerships Are Taxable Entities

Not surprisingly, H.B. 3928 confirmed that limited liability partnerships are ''taxable entities'' subject to the margin tax.[4] Prior to this amendment, there was some debate as to the taxability of certain limited liability partnerships owned entirely by natural persons.

The Texas margin tax is limited to those entities that are ''taxable entities'' doing business in the state. Originally, a limited liability partnership was not specifically enumerated as a ''taxable entity'' subject to the margin tax. Further, the definition of ''taxable entity'' specifically excluded any general partnership whose direct ownership is composed of natural persons.

Although the stated intent of the margin tax was to tax entities with limited liability, because a limited liability partnership is technically a type of general partnership (that has made an election to limit liability), a limited liability partnership owned by natural persons arguably was not subject to tax. H.B. 3928 rejected this position by adding limited liability partnerships to the list of enumerated ''taxable entities'' subject to the margin tax, as well as limiting the exclusion for general partnerships to those general partnerships that do not have limited liability.

Partnerships Taxed On 'Gross' Rental Income

Another anticipated change was the adjustment to the calculation of total revenue for partnerships. Under H.B. 3928, partnerships are now treated similarly to corporations and taxed on *gross* rental income, rather than *net* rental income.[5]

The Texas margin tax is generally based on total revenue. Total revenue is defined by reference to specific line items on the federal corporate and partnership tax returns. For entities other than corporations or partnerships, total revenue is determined in a manner substantially equivalent to the total revenue calculated for a corporation or partnership. As originally enacted, H.B. 3 contained an inconsistency in the line items referenced from the federal tax return for corporations and partnerships. Based on the line item references, corporations were required to include *gross* rental income in total revenue, while partnerships were required to include only *net* rental income.

Many viewed this discrepancy as inequitable. Thus, there was likely little surprise when H.B. 3928 amended the line item references for partnerships so that they now also include *gross* rental income in total revenue.

Total Revenue Ties To Amounts 'Reportable' as Income

Additional language was adopted to prevent taxpayers from reducing their Texas margin tax liability by manipulating certain line items on their federal income tax return. As originally enacted, H.B. 3 determined total revenue by referencing amounts ''entered'' on specific line items of the federal income tax return. Concern was raised that taxpayers may intentionally report certain federal income on other line items that were not referenced, thereby decreasing their Texas margin tax liability.

This methodology effectively provided an incentive for taxpayers to decrease the amount reported on the referenced line items, while reporting the revenue elsewhere on the federal return. The theory was that for federal income tax purposes, the IRS may not be as concerned about on which line the amount is entered so long as all the income is reported. Thus, a taxpayer could decrease its Texas tax liability but still report all of its income for federal income tax purposes.

To remedy the issue, H.B. 3928 amended the statute to refer to amounts that are ''reportable'' as income on a particular line, if the amount ''complies with federal income tax law.''[6] Under the revised language, a taxpayer can shift income between line items but must ensure that the specific line items reported comply with federal tax law.

Cost of Goods Sold: Elective Expensing or Capitalizing Costs

In the aftermath of H.B. 3, there was considerable debate between the comptroller and taxpayers (and even among members of the Comptroller's Office) over whether cost of goods sold should be computed on a ''period cost basis'' (*i.e.*, expensing costs in the period in which they are incurred) or on some type of ''capitalized cost basis.'' H.B. 3928 partially resolves this issue by generally permitting taxpayers to elect to expense or capitalize,[7] subject to anti-abuse and reporting consistency provisions.[8]

Some groups had advocated adopting a bright-line rule for calculating cost of goods sold based on some number that companies already have to calculate (*e.g.*, cost of goods sold according to generally accepted accounting principles or some existing calculation from federal income tax returns). H.B. 3928 did not enact such a bright-line rule. Instead taxpayers must apply the ''direct cost'' and ''indirect cost'' regime enacted by H.B. 3. Comptroller auditors will likely focus intensely

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[4] *See* H.B. 3928, §2, 2007 Leg., 80th Sess. (Tex. 2007), *amending* Tex. Tax Code Ann. §171.0002(a) (2006).

[5] *See* H.B. 3928, §12, 2007 Leg., 80th Sess. (Tex. 2007), *amending* Tex. Tax Code Ann. §171.1011(c)(2)(A)(iv) (2006).

[6] *See* H.B. 3928, §12, 2007 Leg., 80th Sess. (Tex. 2007), *amending* Tex. Tax Code Ann. §171.1011(b) (2006).

[7] *See* H.B. 3928, §15, 2007 Leg., 80th Sess. (Tex. 2007), *amending* Tex. Tax Code Ann. §171.1012(g) (2006) (taxable entity ''may'' capitalize costs in the same manner and to the same extent that the taxable entity capitalized that cost on its federal income tax return ''or may expense those costs . . . .'').

[8] *See* H.B. 3928, §15, 2007 Leg., 80th Sess. (Tex. 2007), *amending* Tex. Tax Code Ann. §171.1012(f) (2006). Specifically, if a taxable entity elects to capitalize costs, it must capitalize each cost allowed under Tex. Tax Code Ann. §171.1012 that it capitalized on its federal income tax return. If the taxable entity later elects to begin expensing an allowable cost, the entity may not deduct any cost in ending inventory from a previous report. If the taxable entity elects to expense an allowable cost, a cost incurred before the first day of the period on which the report is based may not be subtracted as a cost of goods sold. If the taxable entity elects to expense a cost of goods sold and later elects to capitalize that cost of goods sold, a cost expensed on a previous report may not be capitalized.

on the cost of goods sold computation in any audited margin tax report. Due to the complexity, the cost of goods sold calculation may also lead to refund claims resulting from "reverse" audits of amounts claimed on the reports.

Deadline to Elect Deduction Of Cost of Goods Sold or Compensation

H.B. 3928 eliminated the ability of a taxpayer to change its election to deduct cost of goods sold or compensation on an amended return.[9]

For Texas margin tax purposes, a taxpayer is entitled to a deduction for either cost of goods sold or compensation. Alternatively, a taxpayer can elect to pay tax based on 70 percent of total revenue. Although the original election was required to be made by the due date of the annual report, H.B. 3 had permitted the taxpayer to change the election by filing an amended report.

Pursuant to H.B. 3928, a taxpayer is no longer permitted to change an election by filing an amended report. The election to deduct cost of goods sold or compensation must be made no later than the due date for filing the annual report. Though the election can be changed from year to year, a taxpayer will not be permitted to change the election for a prior year.

Revised Limitations On Temporary Credit for Losses

H.B. 3928 refines the calculation of the temporary credit on taxable margin and imposes new limitations on the use of the credit.[10] The revised credit is now based on business loss carryforwards of the taxable entity under existing Tex. Tax Code Ann. §171.110(e) that were not exhausted on a report originally due prior to Jan. 1, 2008. The credit is calculated by multiplying such carryforwards by either 2.25 percent (for reports originally due on or after Jan. 1, 2008, and before Jan. 1, 2018) or 7.75 percent (for reports originally due on or after Jan. 1, 2018, and before Sept. 1, 2027),[11] and then by 4.5 percent, the former tax rate applicable to the earned surplus component of the franchise tax.

Notably, a taxable entity loses the right to claim the credit if the entity changes combined groups after June 30, 2007. Based on preliminary guidance from the comptroller, the credit applicable to the entity leaving the group is lost to both the entity (the entity cannot claim the credit on a separate report) and the combined group. A taxable entity may not claim the credit unless the taxable entity was subject to the franchise tax on May 1, 2006. A combined group may claim the credit for each member entity that was subject to the franchise tax on May 1, 2006. The amount of the credit claimed may not exceed the amount of tax due for the report.

The intent behind disallowing credits in the case of transfers is to prevent a market for "loss" companies from forming, which of course is not a new concept.

These changes in part expand and in part limit the temporary credit under H.B. 3. The credit under H.B. 3 involved a bizarre combination of "deductible temporary differences" and "net operating loss carryforwards" that few, if any, could understand.[12] In light of H.B. 3928, taxpayers are now able to calculate the temporary credit amount.

The intent behind disallowing credits in the case of transfers is to prevent a market for "loss" companies from forming, which of course is not a new concept in Texas even under the "old" franchise tax.[13] Under H.B. 3, a credit could not be conveyed. H.B. 3928 adds the additional penalty that the credit is lost if a taxable entity "changes combined groups," but does not clearly explain what "changes combined groups" means.

For example, if Corporations A, B, and C (each with its own business loss carryover) are members of the same combined group, and Corporation C is sold to a third party, the credit applicable to Corporation C is lost. But, what happens if instead Corporation D is acquired and becomes part of the combined group? It seems unlikely that the Legislature intended for Corporations A, B, and C to be deemed to have changed their combined group. The provision could be more clear.

Benefits to Small Businesses

One of the more taxpayer-friendly modifications to the original version of the margin tax is the additional tax discount for small businesses.[14]

Pursuant to the original margin tax bill of 2006, taxable entities with less than $1,000 of tax or $300,000 of total revenue were not required to pay tax. H.B. 3928 added an additional tax discount for certain businesses with total revenue of less than $900,000. Businesses having total revenue from $300,000 to $900,000 are entitled to a graduated discount from tax liability ranging from 80 percent (where total revenue is between $300,000 and $400,000) to 20 percent (where total revenue is between $800,000 and $900,000). Those companies with total revenue less than $300,000 will continue to pay no tax. The adoption of this discount could be a significant benefit for some small businesses in Texas.

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[9] *See* H.B. 3928, §12, 2007 Leg., 80th Sess. (Tex. 2007), *amending* Tex. Tax Code Ann. §171.1011(b) (2006).

[10] *See* H.B. 3928, §23, 2007 Leg., 80th Sess. (Tex. 2007), *amending* Tex. Tax Code Ann. §171.111 (2006).

[11] Question: why the differences in the dates? Answer: implications on the fiscal note.

[12] As with other aspects of H.B. 3, the temporary credit provision was prepared in haste seemingly with different constituents (*i.e.*, companies focused on net deferred tax differences and companies focused on business loss carryforwards) in mind.

[13] *See, e.g.*, *Sergeant Enterprises Inc. v. Strayhorn*, 112 S.W.3d 241 (Tex. App. 2003) (in the case of a merger of two affiliates, the business loss carryover of the non-survivor is lost).

[14] *See* H.B. 3928, §8, 2007 Leg., 80th Sess. (Tex. 2007), *amending* Tex. Tax Code Ann. §171.0021 (2006).

   ISSN 1078-845X

E-Z Computation and Rate

H.B. 3928 created a new, simplified computational formula for businesses with less than $10 million of total revenue, similar to the small business discount.[15] Under the simplified computation, tax is imposed at the rate of 0.575 percent of apportioned total revenue.

The margin tax is generally imposed at the rate of 1 percent (0.5 percent for retail or wholesale businesses) of taxable margin, not to exceed 70 percent of apportioned revenue. For nonretail or wholesale taxpayers with little or no cost of goods sold or compensation, the tax could be imposed at a rate as high as 0.7 percent (1 percent of 70 percent) of apportioned total revenue.

The simplified computation adopted in H.B. 3928 allows taxpayers with less than $10 million in total revenue to pay tax at the rate of 0.575 percent of apportioned total revenue. Taxpayers that qualify must elect the simplified treatment and waive the ability to take any credit, deduction, or other adjustment.

The potential benefit of this provision will need to be determined on a case-by-case basis. It will likely be advantageous to nonretail businesses with few credits or other deductions, that would otherwise pay tax at 0.7 percent of apportioned total revenue. Conversely, it is unlikely that an entity engaged in retail or wholesale trade that is eligible for the 0.5 percent retail or wholesale rate with a deduction for cost of goods sold or compensation would benefit from using the simplified tax computation at a 0.575 percent rate.

Transition Rules For Terminating Partnerships

The transition rules have been of particular interest as the effective date of the margin tax approaches. The margin tax continues the Texas tradition of calculating tax based on prior year activity. Thus, taxpayers enjoying limited liability and doing business in Texas on Jan. 1, 2008, will compute the margin tax based on their activity during the calendar or fiscal year ending in 2007. Prior to the transition rules, if a partnership or other entity not subject to the prior franchise tax was terminated or otherwise ceased doing business before Jan. 1, 2007, the entity was never subject to the margin tax.

The transition rule amendments set forth in H.B. 3928[16] limit an entity's ability to avoid the margin tax by imposing an ''exit'' tax on businesses that exit the tax base prior to Jan. 1, 2008, but otherwise would be subject to the margin tax if the tax had begun on July 1, 2007. An entity that is not doing business on Jan. 1, 2008 (the effective date for the Texas margin tax), but:

- would have been subject to the tax if it were doing business in the state, and
- was doing business at some time after June 30, 2007

is subject to an additional ''exit'' tax for the privilege of doing business between June 30, 2007, and Jan. 1, 2008. The exit tax is based on the entity's margin for the period beginning the later of Jan. 1, 2007, or the date it began doing business in Texas, and ending the date it became no longer subject to tax.

H.B. 3 had included a similar provision that was limited to entities subject to the franchise tax as it existed prior to the effective date of the margin tax. H.B. 3928 removed the originally proposed rule and adopted a broader rule applicable to any entity that would be subject to the franchise tax as amended *if it were doing business in Texas on or after Jan. 1, 2008*. Thus, an entity that was not previously subject to the franchise tax but which would be subject to the margin tax (*e.g.*, a partnership) will be required to pay an exit tax if it ceases doing business after June 30, 2007.

Implicit in the rule is the notion that an entity that ceases doing business on or before June 30, 2007, will not be required to file such a return. Because the margin tax is based on 2007 taxable margin, this premise was of particular interest to taxpayers and tax practitioners alike, as many postured to take advantage of changes in tax structure before the exit tax began on June 30, 2007.

WHAT GOT THE AXE

As discussed above, H.B. 3928 went through numerous iterations before reaching final form. In addition to the laundry list of enacted provisions, there are numerous provisions that were not implemented. Some of these debated provisions provide insight into areas of concern for the comptroller that may lead to further legislative consideration. Rejected provisions of particular note include the *Finnigan* amendment, a prohibition against reimbursement of tax, and the so called ''poison pill'' provision.

Re-Joyce, But Report Finnigan Information

For margin tax purposes, total revenue is apportioned to Texas using a single-sales factor for the combined group. Currently, the numerator of the sales factor includes only those receipts of entities having nexus with Texas.[17] This is commonly referred to as the *Joyce* method of calculating a combined group's income, based on the California State Board of Equalization's finding in *Appeal of Joyce Inc.*[18]

One proposed amendment to H.B. 3928 would have removed the reference to entities having nexus with Texas from the sales factor computation. Thus, Texas receipts from *all* companies in the combined group would be included in the numerator of the sales factor, not just those companies that have nexus with Texas. This is commonly referred to as the *Finnigan* approach to calculating a combined group's income, based on the

[15] *See* H.B. 3928, §19, 2007 Leg., 80th Sess. (Tex. 2007), Tex. Tax Code Ann. §171.1016 (2006).

[16] *See* H.B. 3928, §35, 2007 Leg., 80th Sess. (Tex. 2007), *amending* §22, Ch. 2, Acts of the 79th Leg., 3rd Called Sess., 2006. *See also* H.B. 1207, §1, 2007 Leg., 80th Sess. (Tex. 2007). The transition provisions included in H.B. 3928 were originally passed by both houses of the Legislature in H.B. 1207. Identical provisions are included in both bills.

[17] *See* Tex. Tax Code Ann. §171.103(b) (2006).

[18] *See Appeal of Joyce Inc.*, SBE-XIV-215, 66-SBE-069 (Nov. 23, 1966) (providing that California destination sales of a unitary group member are to be excluded from the numerator of the combined group's sales factor if the individual member is not itself subject to tax in California).

California State Board of Equalization's finding in *Appeal of Finnigan Corp.*[19]

Although the *Finnigan* approach did not survive as part of the enacted version of H.B. 3928, the Legislature did adopt a reporting requirement for *Finnigan*-type receipts. H.B. 3928 requires that taxpayers report Texas receipts of non-nexus companies, as well as any receipts subject to throwback in another state. Currently, at least, no tax is required to be paid on these receipts. The reporting of non-nexus, Texas receipts is for informational purposes only.

A proposal to expand to *Finnigan* reporting could resurface in future legislative sessions.

The Senate version of the bill included a significant penalty of $10,000 for the failure to report, or the underreporting, of such non-nexus receipts. Fortunately, this penalty was not enacted. Unfortunately, the comptroller has a keen interest in tracking the impact of a switch to *Finnigan* reporting.

A proposal to expand to *Finnigan* reporting could resurface in future legislative sessions. Given estimates that the *Finnigan* method could increase the margin tax by $180 million, it would not be surprising to see this proposed amendment resurface again later, particularly if the margin tax results in a revenue shortfall.

Invoicing of Margin Tax

Another interesting amendment proposed in the Senate was a prohibition against including a separate line item for margin tax reimbursement on a bill or invoice. Many believe this amendment was a response to Sprint's issuance of a notification to its customers earlier this year, stating that Sprint would begin charging a 1 percent ''Texas margin fee reimbursement'' as a separate line item on each bill. The comptroller and the Texas attorney general publicly condemned Sprint's actions, going so far as to issue a press release and letter ruling prohibiting such a pass-through of the tax,[20] and ultimately filing a petition for an injunction in district court to prevent the reimbursement.[21]

For telecommunications companies, the inability to pass through taxes can be a challenge because many companies have adopted national rate plans.

The issue for taxpayers is the ability to recover the tax from their customers, rather than undertaking the burden of the tax directly. For the telecommunications companies like Sprint, the inability to pass through taxes can be a challenge because many of the larger companies have adopted national rate plans. Under these plans, everyone pays the same amount for the base service, and any applicable local taxes are passed through as a separate line item reimbursement. If the tax cannot be passed through as a separate line item reimbursement, the telecommunications company must build the price of the tax into the base rate, thus increasing the rates for all customers, not just those customers in Texas. The telecommunications companies believe that this is inequitable because only those customers located in the jurisdiction in which the tax is imposed should pay the tax.

The state, on the other hand, opined that its reason for prohibiting such a reimbursement is that the reimbursement is misleading. If a taxpayer is passing through a 1 percent margin fee reimbursement, this could give the wrong impression because the company will actually pay tax on less than 1 percent of its total revenue (at most the company will pay at 1 percent of 70 percent of total revenue). The state has expressed concern about whether a reimbursement implies that the tax is actually imposed on the ultimate customer, rather than the company. In addition, the state has taken issue with the fact that ''reimbursement'' assumes the tax has already been remitted to the taxing jurisdiction, when based on the privilege period, the 2007 margin tax is not paid until 2008.

This debate is not limited to telecommunications service providers. Lessors of commercial property would also be affected by such a prohibition. Many commercial leases provide for reimbursements of property taxes and other taxes. Because the original margin tax was coupled with a decrease in property taxes (which are typically passed through to the lessee), the economic burden of taxes might arguably be shifted if the margin tax could not be passed through. To compensate for this burden, some landlords are attempting to negotiate a tax reimbursement.

The Legislature was apparently less concerned about commercial real estate arrangements, as the proposed prohibition was revised to exclude any real property leases. More importantly, the final legislation was silent with respect to margin tax reimbursement so currently, there is no statutory prohibition against such a pass-through. However, it is unlikely that this is the last we have heard on the pass-through limitation given the level of concern expressed by the comptroller.

Poison Pill

Another area considered, but not passed, is often referred to as a ''poison pill'' provision. It is referred to as

[19] *See Appeal of Finnigan Corp.*, 88-SBE-022-A (Jan. 24, 1990) (providing that California sales of all group members were considered in apportioning income to California, including sales attributable to entities exempt under Pub. L. No. 86-272). It is important to note that beginning April 22, 1999, the California State Board of Equalization prospectively abandoned the *Finnigan* rule and readopted the *Joyce* rule. *See, In re Appeal of Huffy Corp.*, 99-SBE-005 (April 22, 1999).

[20] *See* Tex. Atty. Gen., *News Release* (Feb. 5, 2007); Tex. Comp. of Pub. Accts., No. 200701867L (Jan. 29, 2007).

[21] *See Texas v. Sprint Spectrum L.P.*, No. GV4-02057 (Tex. Dist. Ct. filed Feb. 5, 2007).

   ISSN 1078-845X

a ''poison pill'' because the provision is designed to activate in the event the margin tax is held invalid. To address such an event, a proposal was made to add a new chapter, Chapter 172. This chapter would impose an alternative franchise tax at the rate of 0.675 percent of apportioned total revenue except where the taxpayer elected to be taxed pursuant to Chapter 171. Chapter 171 contains the margin tax provisions. The intended effect, as stated in one version of the proposed amendment, was that if the margin tax set forth in Chapter 171 were held invalid in its application to a taxable entity, an alternative tax would be available in another chapter.

This provision was widely debated and did not survive as part of the final bill, but it acknowledges the apparent concern that the margin tax could be held to be invalid in the future. As previously discussed, the final legislation did include an E-Z tax computation imposed at 0.575 percent of total revenue; but this part of the tax remains part of Chapter 171. If Chapter 171 were held to be invalid, it seems likely that the E-Z tax computation would also be invalid.

CONCLUSION

There is little doubt that this will not be the last we hear on changes to the Texas margin tax. Practitioners and taxpayers continue to identify open issues as the new taxing statutes are analyzed and applied. Although H.B. 3928 made considerable strides towards clarifying some of the Texas margin tax statutes, countless questions remain. The comptroller is issuing regulations that are intended to assist with this process. Certainty as to many issues under the new margin tax will likely take years.