UT LAW CLE THE UNIVERSITY OF TEXAS SCHOOL OF LAW

PRESENTED AT

67th Annual Taxation Conference

December 4-5, 2019
Austin, Texas

Texas Tax New Developments

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Lacy Leonard is a trial attorney, is a partner with Martens, Todd, Leonard & Ahlrich a tax litigation law firm located in downtown Austin, Texas. She and other members of her law firm limit their practices to Texas tax controversies and litigation. Ms. Leonard represents clients in administrative proceedings before the Texas Comptroller's office, the Texas State Office of Administrative Hearings, and in Texas state courts.

Notable trial and appellate cases include:

- *Hegar v. 1st Global, Inc.*, No. 03-18-00411-CV (Tex. App.—Austin, filed June 15, 2018), No. D-1-17-005832 (126th Judicial Dist. Ct., Travis County, Tex.);
- *Hegar v. Compass Directional Guidance, LLC*, No. 03-18-00597-CV (Tex. App.—Austin, filed Sept. 12, 2017), No. D-1-15-003797 (419th Judicial Dist. Ct., Travis County, Tex.);
- *Hegar v. CGG Veritas Services (U.S.), Inc.*, No. 03-14-00713-CV, 2016 Tex. App. LEXIS 2439 (Tex. App.—Austin Mar. 9, 2016, pet. withdrawn).
- *Hegar v. CGG Veritas Services (U.S.), Inc.*, No. 03-14-00713-CV, 2016 Tex. App. LEXIS 2439 (Tex. App.—Austin Mar. 9, 2016, pet. withdrawn);
- *Titan Transportation, LP v. Combs*, 433 S.W.3d 625 (Tex. App.—Austin 2014, pet. denied); *Combs v. Newpark Resources, Inc.*, 422 S.W.3d 46 (Tex. App.—Austin 2013, no pet.); and
- *Taylor & Hill, Inc. v. Combs*, No. D-1-GN-10-004429 (200th Judicial Dist. Ct., Travis County, Tex. July 27, 2011).

Ms. Leonard also represents federal tax clients in administrative appeals, before the United States Tax Court, and in the Courts of Appeals. Ms. Leonard has fifteen years of substantial trial experience. She has successfully tried numerous cases to judgment before courts throughout Texas. She speaks at Texas Franchise Tax and Texas Sales and Use Tax seminars throughout the state and assists in preparing the Texas Sales and Use Tax course materials. She received her J.D. degree from Southern Methodist University School of Law in May of 2003. She also earned a bachelor of arts in government from the University of Texas.

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Introduction

This paper discusses a variety of important Texas tax developments, including the 2019 legislative amendments to both the franchise tax and sales tax, four franchise tax cases pending at the Texas Supreme Court, the Comptroller's new Cost of Goods Sold Rule and the most important US Supreme Court sales tax case arising in the past several decades.

I. Franchise Tax

Nexus

Comptroller's Draft Proposed Amendments Regarding Economic Nexus. In response to the U.S. Supreme Court's decision in *South Dakota v. Wayfair*,[1] the Texas Comptroller recently issued draft proposed amendments to Comptroller Rule 3.586 which will state the conditions when an out-of-state entity has franchise tax nexus with Texas.[2] Under the proposed rule, out-of-state taxable entities whose gross receipts from business done in Texas meet or exceed $500,000 have franchise tax nexus with Texas, even if those taxable entities do not have a physical presence in the state.

If the Comptroller's amendments are enacted as proposed, taxable entities will be deemed to be "doing business" in Texas the earliest of:

(1) The date the entity has a physical presence in Texas;

(2) The date the entity obtains a use tax permit; or

(3) The first day of the accounting period in which the entity has gross receipts from business in Texas in excess of $500,000.

According to the comments issued with the proposed amendments, the Comptroller's office will apply the new economic nexus standard beginning with reports due on or after January 1, 2020.

Physical Presence. Under prior U.S. Supreme Court precedent, an out-of-state taxpayer did not have to comply with a state's tax laws unless it was physically present in that state. After the U.S. Supreme Court handed down the *S. Dakota v. Wayfair* decision, physical presence in a state continued to create taxing nexus with that state, but it was no longer a **mandatory** requirement. Now, a taxpayer will have taxing nexus with states in which it does not have a physical presence, when it is "economically" present in those states. "Economic" presence arises when the taxpayer makes sales into a state that exceed the thresholds established by that state's laws. The thresholds may be the dollar amount of sales, the number of sales or both.

Use Tax Permits. Anyone who buys taxable goods and services that are stored, used or consumed in Texas from a seller who does not charge Texas sales tax owes Texas use tax. Businesses remit Texas use tax on Form 01-0156. The apparent presumption is that if a business is liable for Texas use tax,

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1 *South Dakota v. Wayfair Inc.*, 138 S.Ct. 2080 (2018). *See* full discussion of *Wayfair* case infra. p. 32.

2 *See* 34 Tex. Admin. Code § 3.586.

then it must have a physical presence in Texas since the use tax applies when taxable items are acquired to be stored, used or consumed in Texas.

$500,000 Threshold. Once a "foreign taxable entity" has gross receipts from doing business in Texas of $500,000 or more for a federal income tax accounting period ending in 2019 or later, then the "foreign taxable entity" has an economic presence in Texas and is liable to comply with Texas's franchise tax laws.

> *Example*
>
> Tulsa Furniture Store sells high-end furniture to customers located throughout the United States, including Texas. It does not have a physical presence in Texas; nor does it hold a Texas use tax permit. Tulsa Furniture Store adopted a calendar year-end for federal income tax reporting. For the federal income tax year ending December 31, 2019, Tulsa Furniture Store sold $600,000 worth of furniture to Texas customers. Tulsa Furniture Store must begin filing Texas franchise tax report in year 2020.

Business Done in Texas. The rule refers taxable entities to Rule 3.591 Margin: Apportionment, to the extent of business done in Texas. Rule 3.591(c) provides that the numerator of the apportionment factor (i.e. Texas gross receipts) equals the taxable entity's gross receipts from "*business done in the state*." Rule 3.591 then prescribes specific rules for determining when gross receipts generated under different types of revenue categories constitute "Texas gross receipts."

No-Nexus Members. The franchise tax statute allows a combined group to exclude the Texas gross receipts generated by a 'no-nexus' member from the calculation of combined Texas gross receipts. Under prior rules, a combined group member would qualify as 'no-nexus' when it did not have a physical presence in Texas. Under the new rule, these former 'no-nexus' members will no longer qualify for this preferential treatment when their gross receipts generated from business done in Texas exceeds $500,000.

Rate

Background. A taxable entity primarily engaged in retail or wholesale trade qualifies for the reduced Texas franchise tax rate. A taxable entity is primarily engaged in a retail or wholesale trade only if:

(1) the total revenue from its activities in retail or wholesale trade is greater than the total revenue from its activities in trades other than the retail and wholesale trades;

(2) less than 50% of the total revenue from activities in retail or wholesale trade comes from the sale of products it produces or products produced by an entity that is part of an affiliated group to which the taxable entity also belongs; and

(3) the taxable entity does not provide retail or wholesale utilities, including telecommunications services, electricity, or gas.[3]

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[3] Tex. Tax Code § 171.002 (c); 34 Tex. Admin. Code § 3.584(d)(3).

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