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**State Tax Considerations for Those Moving to the  
Lone Star State**

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## **Introduction to Texas Tax**

Texas touts itself as a low-tax, business-friendly state. As a result, many businesses are surprised to learn that, while Texas may not impose a personal income tax, the state otherwise maintains a robust and complex state tax scheme. Texas imposes over 60 different state taxes and fees and contains over 1,400 taxing jurisdictions, although many taxes are administered at the state level. <https://comptroller.texas.gov/taxes/>. Texas has a reputation for handling state taxes the Lone Star Way and being aggressive in both audits and tax controversies.

Two Texas taxes capture the majority of attention and resources from the business sector. The Texas sales and use tax is the state's main bread-winner. This tax, alone, accounts for more than half of Texas tax revenue. For 2020, sales tax constituted \$34 billion of the state's \$57 billion tax revenue. *See* State of Texas, *Sources of Revenue*, <https://comptroller.texas.gov/transparency/revenue/sources.php>. In contrast, the Texas franchise tax comprises only a sliver of the state's tax revenue (7.7% in 2020), but has been a source of contention between the Comptroller and taxpayers since the tax base was revamped in 2008. This paper will explore key issues for these two prominent Texas taxes.

## **Texas Sales and Use Tax**

Texas imposes sales tax on “each sale of a taxable item” in Texas at a rate of 6.25% on the sales price of taxable items. Tex. Tax Code § 151.051. Taxable items include tangible personal property and a finite list of taxable services enumerated in Texas Tax Code § 151.0101. Local taxing jurisdictions may also impose up to 2% additional tax for a maximum combined tax rate of 8.25%. *See* <https://comptroller.texas.gov/taxes/sales/>.

In Texas, the seller or retailer is responsible for collecting all state and local sales tax. *See* Tex. Tax Code § 151.052. Prior to the Supreme Court's 2018 *Wayfair* decision, a seller generally needed a physical presence in Texas to be required to collect and remit the state's sales tax. That generally meant that only retailers who had a physical office or store in Texas or who had a representative or agent operating in the state were required to collect and remit Texas sales and use tax. *See* 34 TAC § 3.286(a)(4). Thus, there was an incentive for companies to stay outside the Texas border. By doing so, they could avoid charging Texas customers tax and gain a competitive advantage over in-state vendors. However, after *Wayfair*, Texas, like most other states, amended its nexus laws to impose economic nexus and bring remote sales within the taxing scheme. Sales tax concerns about entering Texas dissipated, and many began eyeing the benefits of a footprint within the Lone Star State.

## **Economic Nexus & Marketplace Providers**

Effective January 1, 2019, Texas amended its definition of “engaged in business” to include businesses with no physical presence in Texas. *See* 34 Tex. Admin. Code § 3.286(a)(4); 43 TexReg 8133. However, Texas also enacted a safe harbor provision for remote sellers, which states that sales and use tax will not be imposed on a “remote seller whose total Texas revenue in the past twelve calendar months is less than \$500,000.” *Id.* § 3.286(b)(2)(B). This is one of the highest economic nexus thresholds offered by a state. Although these economic nexus amendments became effective January 1, 2019, the Comptroller postponed collection until

October 1, 2019, to allow remote sellers to prepare for their new collection obligations. Texas also permits remote sellers to use a single local tax rate to reduce the administrative burden imposed by local taxes. The rate varies annually; this year it is 1.75%.

<https://comptroller.texas.gov/taxes/sales/remote-sellers.php#:~:text=The%20current%20single%20local%20use,use%20tax%20rate%20for%20sales.>

Additionally, effective January 1, 2020, Texas enacted marketplace provider legislation. Marketplace providers are required to collect sales and use tax on all sales of taxable items made through a marketplace. *Id.* § 3.286(b)(3); 44 TexReg 8317. A marketplace is a physical or electronic medium through which persons other than the owner or operator of the medium make sales of taxable items, which includes a store, internet website, software application, or catalog. *Id.* § 3.286(a)(8). A marketplace provider is a person who owns or operates a marketplace and directly or indirectly processes sales or payments for marketplace sellers. *Id.* § 3.286(a)(9). Examples include Amazon, eBay, Walmart Marketplace, and Etsy.

With these two changes, businesses now selling into Texas, through an online retail site or other means, have a collection responsibility even if they are not physically present in Texas. Even businesses who are not selling their own goods in Texas, but are providing a medium for other sellers to sell to Texas residents, now have a collection responsibility. Texas' marketplace legislation is yet another means by which the state can place remote and in-state and large and small sellers on more equal footing with Texas consumers. Both economic nexus and the marketplace legislation have worked to remove barriers to physically conducting business within Texas' border.

### **Data Processing Services**

In recent years, tech companies have generated many of the “We’re Moving to Texas” headlines splashed across internet news. And, many of them have been surprised by the Comptroller’s broad interpretation of taxable data processing, which is a taxable service in Texas.

Data processing is defined as “the processing of information for the purpose of compiling and producing records of transactions, maintaining information, and entering and retrieving information.” 34 Tex. Admin. Code §3.330(1). “Data processing does not include the use of a computer by a provider of other services when the computer is used to facilitate the performance of the service.” *Id.* Therein lies the rub. The Comptroller views services with any sort of tech component as taxable data processing while taxpayers maintain that they provide non-taxable services for which computers are incidental. Litigation over this issue has increased significantly in recent years. *See Hegar v. CheckFree Servs. Corp.*, No. 14-15-00027-CV, 2016 Tex. App. LEXIS 4039 (Tex. App.—Houston, Apr. 19, 2016, no pet. h.); *Instill Corp. v. Hegar*, No. 03-18-00374-CV, 2019 Tex. App. LEXIS 4482 (Tex. App.—Austin, May 31, 2019, pet. denied); *Hegar v. Black, Mann, & Graham, LLP*, No. 03-20-00391-CV (Tex. App.—Austin Jul. 31, 2020, pet. filed); *Wag Labs, Inc. v. Hegar*, D-1-GN-20-005717 (53rd Dist. Ct., Travis County, Tex. filed Oct. 06, 2020).

In *CheckFree Services*, the Comptroller attempted to tax the taxpayer’s electronic bill pay service sold to banks as taxable data processing. *CheckFree*, 2016 Tex. App. LEXIS 4039, \*1.

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