

PRESENTED AT

65th Annual Taxation Conference

December 13-14, 2017

Austin, TX

2017 Texas State and Local Tax Update

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2017 TEXAS STATE AND LOCAL TAX UPDATE

I. INTRODUCTION

In 2017, the Texas Legislature made several minor changes to the franchise and sales and use tax laws. In addition, in 2017, Texas courts also issued some notable decisions clarifying the sales and use and franchise tax laws, and some interesting cases are currently pending. This article summarizes these developments.

II. LEGISLATIVE CHANGES

A. Franchise tax changes. The Texas Legislature made no major changes to the Texas franchise tax during the 2017 regular session. Of the 60 franchise tax bills filed, only four passed. However, it remains possible that the Legislature may make additional changes in a special session. The Legislature passed the following franchise tax bills:

1. Production does not include installation.

The most significant franchise tax change the Legislature made was to amend the definition of “production” for the purposes of the cost of goods sold deduction. In general, taxpayers may only include in cost of goods sold the costs of acquiring and producing the goods sold. Previously, the statute stated that “Production includes construction, manufacture, development, mining, extraction, improvement, raising, or growth.” The amendment changes the word “includes” to “means” and removes the word “installation” from the definition. This amendment is likely a result of the Autohaus case, discussed in more detail below. (HB 4002)

2. Reduced rate for telephone prepaid calling card sellers.

The Legislature made it easier for sellers of telephone prepaid calling cards to qualify for the reduced franchise tax rate for retailers and wholesalers. The statute provides a reduced franchise tax rate for those “primarily engaged in retail or wholesale trade,” provided that the taxpayer “does not provide retail or wholesale utilities, including telecommunications services, electricity or gas.” The amendment adds a provision to this statute expressly stating that selling telephone prepaid calling cards is not the provision of telecommunications services. (HB 2126)

3. Exemption for certain farmers’ cooperatives.

The Legislature clarified what types of farmers’ cooperatives are exempt from the Texas franchise tax. The definition now includes both farmers’ cooperative societies incorporated under Chapter 51 of the Agriculture Code, as well as a cooperative whose single member is a farmers’ cooperative described in Section 521(b)(1) of the Internal

Revenue Code, that has at least 500 farmer-fruit grower members. The statute states that this change is a clarification of existing law. (SB 550)

4. Insurance companies may use historic structure rehabilitation credits.

Companies that pay insurance premium taxes may now claim Texas franchise tax historic structure rehabilitation tax credits they purchase or are assigned against their insurance premium taxes. (SB 550).

B. Sales and use tax changes. As with the franchise tax, the Legislature only made a few minor changes to the Texas sales and use tax. The Legislature passed five of the 58 sales and use tax bills filed – four became law and the governor vetoed one. The Legislature passed the following sales and use tax bills:

1. Bakery items sold by bakeries exempt.

The Legislature made all bakery items sold by bakeries exempt from sales and use tax. Previously, bakery items were only exempt from sales and use tax if not sold with plates or other eating utensils and not sold in a heated state. Bakery items sold at retail locations other than bakeries continue to be exempt only if sold unheated and without plates or other eating utensils. (HB 4054)

2. Temporary employment services exempt, not excluded, from tax.

The Legislature made temporary employment services exempt from sales and use tax, rather than excluded, as they were previously. This means that a taxpayer must now meet the higher burden of proof associated with exemptions to show that a service is a temporary employment service not subject to tax. The bill also changes the applicable statute to state that the host employer, not the temporary employment service, must supervise the employee and provide the equipment necessary for the employee to perform the service, in order for the service to qualify for the exemption. This bill is likely in response to the *Allstate* case, discussed in more detail below. (SB 745)

3. “Qualifying job” definition for data center exemption expanded.

The Legislature expanded the definition of “qualifying job” for the purpose of the data center exemption to include a job staffed by a third-party employer under a contract with an entity that qualifies for the exemption that provides that the employment position is permanently assigned to an associated qualifying data center. (HB 4038)

4. Insurance claims adjustment services performed by CPA firms.

The Legislature excluded insurance claims adjustment services performed by CPA firms from the definition of taxable insurance services if less than one percent of the CPA firm’s revenue in the prior calendar year is from insurance services. This bill is effective January 1, 2018. (SB 1083)

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First appeared as part of the conference materials for the
65th Annual Taxation Conference session

"State and Local Tax Update"