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Is Your Company Paying Too Much in Texas Margin Tax?

June 8, 2010

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Now that the Texas margin tax has been around for a while, we know many companies that conduct business in Texas have seen their Texas corporate tax increase by a substantial amount. Corporate taxpayers who previously mitigated their Texas franchise tax through the use of 1 percent/99 percent general/limited partnerships now find themselves paying from tens of thousands to hundreds of thousands more under the new Texas tax regime. Further, since the Texas margin tax is a gross receipts tax, even companies that are experiencing tax losses are still paying significant taxes to the State.

Can anything be done to mitigate this onerous tax?

Since Texas provides for the payment of the lesser amount of tax under a default tax base (70 percent of revenues) or two alternative tax bases (revenues less cost of goods sold or revenues less compensation), corporate taxpayers should carefully consider whether one of the two alternative methods should be utilized. Failure to timely do so eliminates most opportunities to reduce this tax, especially since Texas allows taxpayers to amend their returns to comply with the default method but does not allow an amended return to depart from the default method in order to use an alternative method.

Despite the three year existence of the Texas margin tax, many companies still have not properly computed their potential cost of goods sold deduction or compensation deduction in arriving at the appropriate Texas margin tax liability. This is commonly true, for instance, for companies in industries that traditionally do not maintain cost of goods sold for GAAP purposes, but are allowed to compute cost of goods sold under Texas law. Cost of goods sold may exceed 30 percent of revenues (making this option more favorable than the default method). In other cases, Texas allows additional costs to be included as a cost of sale for certain types of expenses that are typically deducted as other deductions. Failure to include all allowable costs, whether costs of goods sold or costs of compensation, could result in paying unnecessary Texas margin tax.

Other areas of potential overpayment result from taxpayers including sales of related companies not having nexus with Texas in the numerator of the gross receipts factor. Under Texas law, sales are only included in the numerator of the gross receipts factor if the company has nexus. Additionally, including or excluding companies that are not unitary in the unitary Texas filing can result in an improper Texas margin tax payment. Further, one taxpayer determined it was paying several hundred thousand dollars in excess margin tax based on an issue unrelated to any mentioned above.

Regardless of the strategy used, it is important for corporate taxpayers to very carefully and thoroughly compute their Texas margin tax under each method to ensure they are not overpaying. If you have any questions about this newsletter, please contact Geoff Christian at 864-241-2009 or Rusty Little at 864-241-2005.

About Dow Lohnes Price

Dow Lohnes Price is comprised of forward-thinking professionals focused on resolving state tax controversies in all tax arenas. Dow Lohnes Price succeeds in the effective resolution of cases through careful analysis and consideration of a taxpayer's entire operational profile – past, present, and future. Through its affiliation with Dow Lohnes PLLC, a long-standing law practice with offices in Washington, D.C., Atlanta, and Oklahoma City, Dow Lohnes Price provides resources and expertise encompassing both an accounting and a legal perspective for all tax issues, thereby providing a well-rounded and cost-effective alternative to Big 4 firms and traditional law firms. Dow Lohnes Price is committed to handling each client with an individual focus. This focus, when coupled with an undeterred tenacity in resolving complex matters and advocating for taxpayers against adverse parties, allows Dow Lohnes Price to provide the best business solutions for each of its clients. To learn more, visit www.dlptax.com.

Reference number 159531.

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