

State Tax Update

TSTCI – July 11, 2007

Presented by:

Debbie A. Broyles, CPA

Curtis Blakely & Co., P.C.

P. O. Box 5486

Longview, TX 75608

903.758.0734

dbroyles@cbandco.com

www.cbandco.com



Legislation Passed During The 80th Regular Session

■ House Bill 735

- Discontinuance of the Telecommunications Infrastructure Fund (TIF)
- Effective September 1, 2008

Legislation Passed During The 80th Regular Session

■ House Bill 1459

- Pay telephone coin sent-paid telephone calls become exempt from sales and use tax - (Exemption applies only to the telecommunication service that is paid by coin.)
- Effective September 1, 2007

Legislation Passed During The 80th Regular Session

- House Bill 3928
 - Relates to approximately 50 technical changes to the revised franchise tax (Margin Tax).

Legislation Passed During The 80th Regular Session

■ Senate Bill 377

- Tax payments \geq \$10,000 in preceding fiscal year - Must transfer payments by means of electronic funds transfer (Effective immediately)
- Applies to sales tax, franchise tax, diesel fuel tax, and TIF
- Tax payments \geq \$50,000 in preceding fiscal year – Must file reports electronically (Effective Sept 1, 2008)

Electronic Filing

■ E-Mail Reminder

- Taxpayers electronically filing their Sales tax reports can choose to receive an email reminding them of the due date instead of the paper return
- Sent 15 days prior to the due date
- Sign up on WebFile at:
www.window.state.tx.us/webfile/

Texas Sales and Use Tax Prepayment Report

- Prepayment discount -1.25%

Timely filing discount - .50%

Total discount 1.75%

- Prepayment must be:

- at least 90% of tax that will be due for the reporting period, Or
- 100% of the total tax due and paid in the same reporting period of the preceding year

Texas Sales and Use Tax Prepayment Report

- Monthly taxable sales \$500,000
- Tax rate .0825
- Monthly tax payments \$41,250
- Prepayment discount 1.25%
- Additional annual revenue **\$6,200**
- Equivalent to an annual **Rate of Return of 15%** on your money

Texas Sales and Use Tax Prepayment Report

- Prepayment report due on the 15th of each month
 - Prepayment report and payment for July sales due July 15th
 - Regular sales tax report for July sales still due August 20th

Telecommunications Tax Grid

June 2007

SUGGESTED TAX APPLICATIONS LOCAL EXCHANGE CARRIERS

Prepared by the Accounting Committee of the Texas Statewide Telephone Cooperative, Inc.
(June 2007)

-
- 1 = State Sales Tax
 - 2 = City, County, and Other Local Taxes (See Footnote ah)
 - 3 = PUC Assessment
 - 4 = Federal Excise Tax (See Footnote aj)
 - 5 = 911 Surcharge and Poison Control Surcharge
 - 6 = Telecommunications Infrastructure Fund (TIF)(See Footnote ak)
 - 7 = Texas Universal Service Fund Assessment (TUSF) (See Footnote ai)
 - 8 = Federal Universal Service Charge (FUSC) (See Footnotes t & z)

		1	2	3	4	5	6	7	8
A. INTERSTATE									
1	Toll								
a)	Originating in Texas and billed to a telephone number or billing or service address within Texas	Y	N	N	N	N	Y	N	Nab
b)	Any other toll	N	N	N	N	N	N	N	Nab
c)	Bundled Services (See Footnote ag)	Y	N	N	N	N	Y	N	N

Telecommunications Tax Grid

June 2007 – Footnotes Page 5

- ag Per Texas Tax Code Section 151.025(d) - If any nontaxable charges are combined with and not separately stated from taxable telecommunications service charges on the customer bill or invoice of a provider of telecommunications services, the combined charge is subject to tax unless the provider can identify the portion of the charges that are nontaxable through the provider's books and records kept in the regular course of business. If the nontaxable charges cannot reasonably be identified, the charges from the sale of both nontaxable services and taxable telecommunications services are attributable to taxable telecommunications services. The provider of telecommunications services has the burden of proving nontaxable charges.

6/12/2007

Page 5

Telecommunications Tax Grid

June 2007 – Page 3

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	1	2	3	4	5	6	7	8
15 a) 9-1-1 End User Monthly Fee (See Footnote q)	N	N	N	N	N	N	N	N
b) 9-1-1 End User Surcharge	N	N	N	N	N	N	N	N
c) Poison Control Surcharge	N	N	N	N	N	N	N	N
16 Other - Separately Stated Taxes and Fees Imposed on LECs (See Footnote e)	Y	Ya	Y	Y	N	Y	Y	N

Telecommunications Tax Grid

June 2007 - Page 4

F. INTERNET SERVICES

1	Access Fees (Dial-up, ISDN, DSL, 800#, etc.)	Ym,o,p	Ym,o,p	N	N	N	N	N	N
2	Additional E-Mail Account Fees (See footnote af)	Yo,p	Yo,p	N	N	N	Y	Y	N
3	Additional Web Space Fees	Yn,o,p	Yn,o,p	N	N	N	N	N	N
4	Domain Name Registration Fees	N	N	N	N	N	N	N	N
5	Domain Name Hosting Fees	Yn,o,p	Yn,o,p	N	N	N	N	N	N
6	Website Hosting Fees	Yn,o,p	Yn,o,p	N	N	N	N	N	N
7	Webpage Design Fees	Yn,o,p	Yn,o,p	N	N	N	N	N	N
8	Sales of Software and/or Hardware	Yb,u	Yb,u	N	N	N	N	N	N
9	Repair or Installation of Software/Hardware								
	a. Lump Sum Billing	Yb	Yb	N	N	N	N	N	N
	b. Materials separately stated (Hardware only)	Yb	Yb	N	N	N	N	N	N
	c. Labor only	Yb,u	Yb,u	N	N	N	N	N	N
10	Late Fees	N	N	N	N	N	N	N	N
11	Returned Check Fees	N	N	N	N	N	N	N	N

Telecommunications Tax Grid

June 2007 - Page 4

G. WIRELESS TELECOMMUNICATIONS

1	Access Revenue	Yac	Yac	Nv	N	N	Y	Y	Yz
2	Airtime Revenue	Yac	Yac	Nv	N	N	Y	Y	Yz
3	Basic Plan	Yac	Yac	Nv	N	N	Y	Y	Yz
4	Enhanced Services	Yac	Yac	Nv	N	N	Y	Y	N
5	Insurance	N	N	Nv	N	N	N	N	N
6	Intrastate Toll Revenue	Yac	Yac	Nv	N	Y	Y	Y	N
7	Interstate Toll Revenue	Yac	Yac	Nv	N	N	Y	Y	Yz

6/12/2007

Page 4

Telecommunications Tax Grid

June 2007 - Page 5

21	Text messaging	Yac	Yac	N	N	N	Y	Y	Yz
	Media messaging	Yac	Yac	N	N	N	Y	Y	Yz
	Ring tone downloads	Y	Y	N	N	N	N	N	N
	Music downloads	Y	Y	N	N	N	N	N	N
	Video game downloads	Y	Y	N	N	N	N	N	N
	Internet access	Ym	Ym	N	N	N	N	N	N
	Prepaid cellular calling card	Yj	Yj	N	N	N	N	N	N
	Prepaid ring tone download card	Nk	Nk	N	N	N	N	N	N
	Prepaid music download card	Nk	Nk	N	N	N	N	N	N
	Prepaid video game download card	Nk	Nk	N	N	N	N	N	N
	Prepaid internet access card	Nal	Nal	N	N	N	N	N	N

Telecommunications Tax Grid

June 2007 – Footnotes Page 2

- j Prepaid phone cards, whether landline, cellular, or rechargeable, are considered tangible personal property and are subject to Texas state and local sales and use tax at the time of purchase. "Telephone prepaid calling card" means a card or other item, including an access code, that represents the right to make one or more telephone calls for which payment is made in incremental amounts and before the call is initiated. The term does not include a card sold by mechanical means for consideration of one dollar or less.
- k Music, video games, and ring tones delivered digitally, electronically, physically, or by any other medium are tangible personal property under Texas sales and use tax law. However, the sale of a prepaid card which allows the purchaser to access and download music, ring tones, or video games is not subject to Texas sales or use tax since the card represents an intangible - the "right" to a future purchase. Instead, tax is calculated when the card is redeemed.

Telecommunications Tax Grid

June 2007 – Footnotes Page 8

al Prepaid internet access cards are treated as a nontaxable intangible at the time the card is sold. Upon redemption, a single charge for access to the internet through the use of the prepaid card is subject to Texas sales tax as an Internet access service. The first \$25 per month charged for internet access is exempt from Texas sales tax. If the seller keeps records of who purchases Internet access services, they can exempt the first \$25 per month charged for Internet access. If the seller does not keep records of who purchases Internet access services, the entire charge is subject to Texas sales and use tax.

6/12/2007

Page 8

Texas Margin Tax

Status of HB 3928 – Technical Corrections

- HB 3928 resulted in approximately 50 Changes
- First taxable period generally begins January 1, 2007
- First report due May 15, 2008

Taxable Entities

- Applies to most business entities that have statutory liability protection
 - Corporations
 - C Corporations
 - S Corporations
 - Limited Liability Companies
 - Professional Associations
 - Banks and S&Ls

Taxable Entities

○ Other Entities

- General Partnerships (consisting of partners other than natural persons)
- Limited Partnerships
- Limited Liability Partnerships
- Business Trusts
- Beneficiary Protection Trusts
- Joint Ventures
- Holding Company
- Other Legal Entity

Exempt Entities

- Entities with No Owner Protection
 - Sole Proprietorships
 - General Partnerships (all interests directly owned by natural persons)
 - Family Limited Partnerships
 - Grantor Trusts
 - Estates
- Other Exempt Entities
 - Telephone Cooperatives
 - Prior Exempt Corporations
 - Passive Entities
 - Benefit Plans

Exempt Entities

- Passive Entities must meet three requirements
 - 1. Must be organized as one of the following:
 - General partnership
 - Limited partnership
 - Trust
 - 2. 90% of federal gross income must arise from specific passive sources
 - 3. No more than 10% of federal gross income can be received from conducting an active trade or business

Passive Income

- Interest & Dividends
- Gains from Selling Stocks & Bonds
- Capital Gains from Real Estate Sales
- Oil & Gas Income (excluding operating working interest)
- Flow-through Income
- Other

Tax Discount for Small Businesses

- Smaller entities are exempt if:
 - Tax due is less than \$1,000, or
 - Total revenues are \$300,000 or less
- Information Report is still required

Tax Discount for Small Businesses

If Revenue is:	Multiply Tax by:
\$0 to \$300,000	Zero (no Tax Due)
\$300,001 to \$399,999	80%
\$400,000 to \$499,999	60%
\$500,000 to \$699,999	40%
\$700,000 to \$899,999	20%

Unitary Combined Reporting

- An affiliated group of entities in a unitary business will be required to file a consolidated return including all taxable entities within the group
- Affiliated Group
 - Common Ownership
 - More than 50% Control
 - Direct or Indirect
 - Vote or Beneficial Ownership

[Unitary Combined Reporting]

■ Unitary Business

- Same General Line of Business
- Vertically Integrated
- Functionally Integrated
- Centralized Management
- Synergy & Mutual Benefit

Margin Tax Calculation

- Taxable Entity's (or Unitary Group's) Taxable Margin is the Lesser of:
 - 70% of Gross Revenues, or
 - Gross Revenues Less the Greater of :
 - Cost of Goods Sold, or
 - Compensation Expense, or
 - New E-Z Computation

Compensation Method

Revenue	\$ _____
less Compensation	_____
Taxable Margin	_____
times % of Texas business	_____
times Tax Rate (.005 or .01)	_____ .01
less Temp & Bus Credits	_____
Taxable Margin before Disc	_____
less Small Business Disc	_____
Net Margin Tax Due	\$ _____

Alternative Method

Revenue	\$ _____
less 30% of Total Revenue	_____
Taxable Margin	_____
times % of Texas business	_____
times Tax Rate (.005 or .01)	<u> .01</u>
less Temp & Bus Credits	_____
Taxable Margin before Disc	_____
less Small Business Disc	_____
Net Margin Tax Due	\$ _____

(Effective Tax Rate of .7%)

New Temporary Credit

- Only Entities Previously Taxed
- Based on Business Loss Carryforward
- Tax-Affected at Old Rate (4.5%)
- 2.25% of Loss from 2008 through 2017
- 7.75% of Loss from 2018 through 2027

New Temporary Credit Example

Carryforward from May 07	\$1,000,000
Times Old Tax Rate	4.5%
Times Loss Allocation Rate	<u>2.25%</u>
Temporary Credit for 1 st 10 yrs	\$1,013

(Temporary Credit is Non-Transferable)

New E-Z Computation

- Option for Simplicity
- \$10 Million or Less in Revenue
- Revenue Times .575%
- No Credits or Deductions

E-Z Computation

Revenue	\$ _____
times % of Texas business	_____
times E-Z Tax Rate	<u>.00575</u>
Taxable Margin before Disc	_____
less Small Business Disc	_____
Net Margin Tax Due	\$ _____

Revenues

- Gross Revenues (per federal income tax return)
 - Sales
 - Dividends
 - Interest
 - Rents and Royalties
 - Capital Gains
 - Other Income

Reductions & Exclusions

- Flow-through Income
- Dividends and Interest received from Federal Obligations
- Affiliate Transactions
- Bad Debt Expense
- Sales Commissions pd to non-employees
- Schedule C Deductions

What is Compensation?

- Form W-2 “Medicare wages and tips”
- Health care benefits
- Retirement benefits
- Fringe benefits
- Worker’s compensation benefits
- Reimbursements made to a management company for wages and compensation
- Net distributive income from partnerships, LLC’s, and S Corps if paid to natural persons

Compensation Exceptions

- \$300,000 Wage Cap per employee
(This does not apply to benefits.)
- Wages paid to undocumented workers not deductible

Financial Statement Considerations

- Accrual of Margin Tax in 2007
 - % of Texas Business
 - Times
 - .7% or
 - .575%
 - Times Gross Revenues

Organizational Structure Issues

- Limited partnerships no longer minimizes franchise tax liability - Should businesses unwind Conversion Transaction?
 - Business Considerations:
 - Simplified legal structure
 - Simplified financial accounting reporting
 - Is separate legal entity needed for operating other services

The End

Please feel free to contact us:

Presented by:

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