

# Land & Construction News Of Texas

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## Taxing the margins?

*The revised Texas franchise tax*



In an attempt to find new funding for public schools, reduce property tax rates, and close loopholes in the Texas Franchise Tax, the Texas legislature enacted a significant revision of the Franchise Tax, commonly known as the Margin Tax. As part of the "loophole" closing, the revised Franchise Tax now taxes previously exempt entities, most notably Limited Partnerships.

### Below are some of the highlights of the revised Texas Franchise Tax:

- » Effective for tax reports due on or after January 1, 2008. Most tax payers will file May 15, 2008.
- » Taxpayers with less than \$300,000 in Gross Revenue will owe no Franchise Tax.
- » All entities with limited liability protection are affected with a few exceptions - general partnerships, sole proprietorships; and certain passive entities are exempt from the tax.
- » Passive entities will be exempt from tax if they are a general or limited partnership or a trust and their federal gross income consists of at least 90% passive income.

### Passive income includes:

- Dividends, interest, income from LLCs; distributive shares of partnership income, royalties, bonuses and delay rentals.
  - Capital gains from the sale of real property.
  - Rent is not passive income.
- » The tax base will be the lesser of:
- 70% of gross revenue;
  - gross revenue minus employee compensation (including benefits); or
  - gross revenue minus the cost of goods sold.

» The tax due will be 1% of the apportioned tax base with the exception of retailers and wholesalers who are subject to a .5% tax rate.

» Unitary businesses must file a combined report and all members of a combined report are jointly and severally liable for the Franchise Tax of the unitary group. Most affiliated entities with 50% or more common ownership will be a unitary business. However, additional factors indicating that a unitary business exists are:

- activities within the same line of business;
- a vertically structured enterprise or process; or
- a functional integration with strong centralized management.

### 2007 Legislation Changes:

The law provides a discounted tax rate for taxpayers with less than \$900,000 in Gross Revenue:

- 80 percent discount for a taxable entity with total revenue greater than \$300,000 but less than \$400,000;

- 60 percent discount for an entity with total revenue equal to or greater than \$400,000 but less than \$500,000;
- 40 percent discount for an entity with total revenue equal to or greater than \$500,000 but less than \$700,000;
- 20 percent discount for a taxable entity with total revenue equal to or greater than \$700,000 but less than \$900,000.

Limited Partnerships are now required to include gross rental income instead of their net rental income in the calculation of gross revenue. Thus, under the franchise Tax, rental income reporting is now identical for corporations and partnerships.

*This summary is not intended to provide a detailed analysis of all relevant substantive and procedural obligations arising from the revised Franchise Tax. If you have questions or comments regarding this legislation or related Texas tax matters, please contact Labry Welty at [lwelty@munsch.com](mailto:lwelty@munsch.com).*

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