

Texas Margin Tax

On May 15, 2008, Texas businesses will file their first returns for the recently enacted Margin Tax. The Margin Tax replaces the existing franchise tax and applies to all business entities that enjoy liability protection under Texas law.

The Margin Tax is essentially a 1% (1/2% in the case of retailers or wholesalers) tax on all of the Texas gross receipts of businesses. However, unlike many gross receipts taxes, the Margin Tax permits businesses to take one of three available deductions.

The available deductions are: (1) a flat 30% of gross receipts, which is available to all businesses; (2) a cost of goods sold deduction, which is available to businesses that manufacture or create tangible personal property; and (3) a compensation deduction, which is available to service businesses.

Like the franchise tax it replaces, the Margin Tax is based on business activity from the preceding year. So, even though the first returns are due on May 15, 2008, the Margin Tax will be based on gross receipts and available deduction for the 2007 year. Businesses will fiscal years have slightly different timing, but in general, the first Margin Tax will be based on the 2007 fiscal year.

The 30% of gross receipts deduction that is available to all businesses means that the real tax rate for the Margin tax is a maximum 70%. However, businesses that can take advantage of the cost of goods sold deduction or the compensation deduction may be able to further reduce the tax burden.

The cost of goods sold deduction applies only to businesses that manufacture or create tangible personal property. Under the cost of goods sold deduction, a business may deduct all of its expenses associated with creating goods, but may not deduct any expenses associated with the storage or sale of finished goods. In addition, a business may also claim up to 4% of their general or administrative expenses, so long as those expenses are associated with the manufacture or creation of goods.

The compensation deduction is available to all service businesses and permits these businesses to deduct wages and cash compensation up to \$300,000 per employee. There is no limit on the amount of benefits that can be deducted.

There are many issues that will need to be addressed in the upcoming legislative session or by the recently elected Comptroller of Public Accounts. However, one of the most well known issues is that businesses that handle flow through funds for their clients are not generally able to exclude such funds from their gross receipts calculation. Consequently, businesses that broker sales or services for their clients must include the full amount received from their clients but cannot take a deduction for the amounts paid out on behalf of their clients.