Multistate Tax Commission
50th Annual Meeting & Conference

Texas Franchise Tax:
Pass-through Entities
&
Disregarded Entities

Presented by: Tommy Hoyt

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Texas Franchise Tax

- A privilege tax imposed on each taxable entity formed in or doing business in Texas.
- It is calculated on taxable margin.
- Pass-through entities and federally disregarded entities are subject to Texas franchise tax.
Which Entities Are Taxable?

• **Taxable entities INCLUDE:**
  - Corporations and Limited Liability Companies (including SMLLCs)
  - Partnerships (Certain GPs, LPs and LLPs)
  - Trusts
  - Professional Associations

• **Taxable entities do NOT INCLUDE:**
  - Sole Proprietorships
  - General Partnerships – Owned by Natural Pers
  - Passive Entities
  - Exempt Entities
  - Certain Grantor Trusts and Other Specified Tru
Nexus

Organized in Texas or Physical presence

- People
- Property
Franchise Tax Calculation

• Margin ≤ the lesser of Total Revenue:
  o ≥ 70%,
  o － $1,000,000,
  o － COGS deduction, or
  o － Compensation deduction.

• × Gross receipts from business done in Texas ≥ Gross Receipts from Entire Business

• = Taxable Margin

• × Tax Rate (.375% wholesale or retail trade, .75% for all others)

• = Franchise Tax less Credits
Calculation: Pass-through and Disregarded Entities

- Partnerships—for total revenue, pull from specific lines of:
  - IRS Form 1065 (Return of Partnership Income);
  - Schedule K of Form 1065 (Partners’ Distributive Share),
  - IRS Form 8825 (Rental Real Estate Income/Expenses of Partnership/S-Corp.); and
  - Schedule F of Form 1040 (Profit or Loss from Farming).
Calculation: Pass-through and Disregarded Entities, cont’d

• Other pass-through entities and disregarded entities—for total revenue, pull from:
  o An amount determined in a manner substantially equivalent to the amount included for corporations and partnerships.

• Amount must:
  o Comply with federal income tax law; and
  o Includes the corresponding amount entered on a variant of the form, or a subsequent form.
Calculation: Pass-through and Disregarded Entities, cont’d

- A taxable entity may subtract, to the extent the amount is included in an entity’s income:
  - The net distributive income from a taxable entity treated as a partnership or an S Corp for federal income tax purposes; and
  - Items of income attributable to an entity that is a disregarded entity for federal income tax purposes.
Combined Reporting

• An affiliated group engaged in a unitary business.
• May include pass-through and federal disregarded entities.
• For taxable entities, including pass-through entities—total revenue, deductions, and gross receipts are calculated for each entity separately and added together.
• For disregarded entities—total revenue, deductions, and gross receipts may be included with parent and both entities will be presumed to have nexus for apportionment purposes.