Multistate Tax Commission
50th Annual Meeting & Conference

Texas Franchise Tax:

Pass-through Entities
&
Disregarded Entities

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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.
- IRC in effect Jan. 1, 2007.

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:
    - × 70%,
    - − $1,000,000,
    - − COGS deduction, or
    - − 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:
  - An amount determined in a manner substantially equivalent to the amount included for corporations and partnerships.
- Amount must:
  - Comply with federal income tax law; and
  - 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.