



# SALT WATCH

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## Texas Amends Margin Tax

Texas Governor Rick Perry recently signed House Bill 500 (H.B. 500)<sup>1</sup> which enacts several changes to the margin tax including a temporary margin tax rate reduction, a new minimum deduction, expanded deductions and new credits for certain taxpayers, and customer-based sourcing for Internet hosting receipts. The law goes into effect January 1, 2014.

### Tax Rates

H.B. 500 provides taxpayers with the ability to elect a reduced margin tax rate for reports due on or after January 1, 2014. Entities engaged in retail or wholesale trade can elect to reduce their margin tax rate from 0.5 percent to 0.4875 percent, and all other taxpayers can elect to reduce their rate from one percent to 0.975 percent.<sup>2</sup> Rates may again be reduced for reports due on or after January 1, 2015, if the Texas Comptroller of Public Accounts (the "Comptroller") certifies that probable revenue estimates for the state fiscal biennium ending August 31, 2015, exceed original estimates for the same period to offset revenue loss caused by the rate reduction. Taxpayers would then be able to elect to further reduce the margin tax rate to 0.475 percent for retailers and wholesalers, and to 0.95 percent for all other taxpayers.<sup>3</sup> The rates will revert to their current levels for reports due in 2015 if the Comptroller does not make this certification, and in any case, for all reports due on or after January 1,

2016, unless the Texas legislature enacts intervening legislation.<sup>4</sup>

### Credit for Rehabilitation of Certified Historic Structures

H.B. 500 also provided taxpayers with a credit of up to 25 percent of certain qualifying costs and expenses incurred for the rehabilitation of certified historic structures if the following requirements are satisfied:<sup>5</sup>

1. The rehabilitated certified historic structure is placed in service after September 1, 2013;
2. The taxpayer has an ownership interest in the certified historic structure in the year during which the structure is placed in service after the rehabilitation; and
3. The total amount of the eligible costs and expenses incurred exceeds \$5,000.

The credit may be sold or assigned to one or more taxpayers, and any unused credit may be carried forward for up to five years.<sup>6</sup>

<sup>1</sup>Acts of 83rd Legislature, Regular Session, H.B. 500.

<sup>2</sup>H.B. 500, § 2, Tex. Tax Code § 171.0022.

<sup>3</sup>H.B. 500, § 2, Tex. Tax Code § 171.0023.

<sup>4</sup>H.B. 500, § 2, Tex. Tax Code § 171.0023(d), (e).

<sup>5</sup>H.B. 500, § 14, Tex. Tax Code § 171.903.

<sup>6</sup>H.B. 500, § 14, Tex. Tax Code § 171.905 & § 171.906.

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### Deduction for Relocation Costs

H.B. 500 provides taxpayers that relocate their main office to Texas from another state on or after September 1, 2013, with a deduction from their apportioned margin for relocation costs incurred, providing that neither they nor any member in their affiliated unitary business group did business in Texas prior to the relocation.<sup>7</sup> Eligible costs include costs of relocating computers and peripheral equipment, other business supplies, furniture, and inventory, in addition to other costs related to the relocation that are allowable deductions for federal income tax purposes.<sup>8</sup>

### Expansion of Retail or Wholesale Trade Definition

H.B. 500 expanded the definition of “retail or wholesale trade” to include the following additional activities, effective for reports due on or after January 1, 2014:

- Automotive repair shops;<sup>9</sup>
- Equipment rent-to-own transactions;<sup>10</sup>
- The rental or leasing of tools, party and event supplies, or furniture;<sup>11</sup> and

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<sup>7</sup> H.B. 500, § 13, Tex. Tax Code § 171.109(b).

<sup>8</sup> H.B. 500, § 13, Tex. Tax Code § 171.109(a).

<sup>9</sup> Activities classified under Industry Group 753 of the 1987 Standard Industrial Classification (SIC) Manual H.B. 500, § 1, Tex. Tax Code § 171.0001(12)(C).

<sup>10</sup> Rental purchase agreement activities regulated by Chapter 92 of the Business and Commerce Code. H.B. 500, § 13, Tex. Tax Code § 171.0001(12)(D).

<sup>11</sup> Activities classified as Industry 7359 of the SIC Manual; H.B. 500, § 13, Tex. Tax Code § 171.0001(12)(E).

- The rental or leasing of heavy construction equipment.<sup>12</sup>

### Exclusions from Total Revenue

H.B. 500 made the following changes to the calculation of total revenue, effective for reports due on or after January 1, 2014:<sup>13</sup>

- The provision that allows pharmacies to exclude certain flow-through funds from rebates was expanded to allow pharmacy networks to exclude from total revenue certain reimbursements pursuant to contractual agreements for payments to pharmacies in the pharmacy network.
- Taxpayers primarily engaged in the business of transporting aggregates may exclude from total revenue subcontracting payments made to independent contractors for the performance of delivery services on their behalf.
- Taxpayers primarily engaged in the business of transporting barite may exclude from total revenue the subcontracting payments made to nonemployee agents for the performance of transportation services on their behalf.

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<sup>12</sup> Activities classified as Industry 7353 of the SIC Manual; H.B. 500, § 13, Tex. Tax Code § 171.0001(12)(F).

<sup>13</sup> H.B. 500, § 7; Tex. Tax Code § 171.1011.

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- Taxpayers primarily engaged in the business of performing landman services may exclude from total revenue subcontracting payments made to nonemployees for the performance of landman services on their behalf.
- Taxpayers may exclude from total revenue the actual cost paid for a vaccine.
- Taxpayers primarily engaged in the business of transporting goods by waterways that do not subtract cost of goods sold in computing taxable margin may exclude from total revenue the direct costs associated with transporting such goods in the same manner that a taxpayer selling the goods in the ordinary course of business would be allowed to subtract those costs under the cost of goods sold deduction.
- A taxable entity that is registered as a motor carrier may exclude from its total revenue, to the extent included in total revenue, flow-through revenue derived from taxes and fees.

crude oil, finished petroleum products, natural gas, condensate, and natural gas liquids, except for a refinery installation that manufactures finished petroleum products from crude oil.<sup>14</sup> Effective for reports due on or after January 1, 2014, such pipelines may now elect a cost of goods sold deduction in determining margin and may include depreciation, operations, and maintenance costs related to the services provided. Prior to H.B. 500, pipeline companies were not allowed such a deduction because they were viewed as service providers that did not produce goods.

H.B. 500 also amends the calculation of cost of goods sold as it applies to movie theaters. Effective September 1, 2013, a movie theater that elects to subtract cost of goods sold will subtract the costs in relation to the acquisition, production, exhibition, or use of a film or motion picture, including expenses for the right to use the film or motion picture.<sup>15</sup>

### Cost of Goods Sold Deduction

H.B. 500 amends the calculation of cost of goods sold as it applies to a pipeline company that: (1) owns or leases and operates a pipeline by which the product is transported for others and only to the portion of the product to which the taxpayer does not own title; and (2) is primarily engaged in gathering, storing, transporting, or processing

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<sup>14</sup> H.B. 500, § 9; Tex. Tax Code § 171.1012(k-2).

<sup>15</sup> H.B. 500, § 10; Tex. Tax Code § 171.1012(t).

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### \$1 Million Revenue Exclusion from Taxable Margin

Effective for reports due on or after January 1, 2014, H.B. 500 amends the computation of taxable margin to be the lesser of: (1) 70 percent of total revenue or total revenue less \$1 million; or (2) total revenue less the greater of: (a) \$1million, (b) cost of goods sold, or (c) compensation.<sup>16</sup> The above computation, in effect, makes permanent the \$1 million revenue exemption.

### Texas Combined Group – Retail or Wholesale Electric Utility Providers Excluded

H.B. 500 prohibits taxpayers that provide retail or wholesale electric utilities from being included in a combined group that includes taxable entities that do not provide retail or wholesale electric utilities if that combined group would not otherwise:<sup>17</sup>

- Qualify for the 0.5 percent tax rate but for the inclusion of the taxable entity within the combined group, and
- Have less than five percent of the combined group's total revenue derived from providing retail or wholesale electric utilities.

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16 H.B. 500, § 11; Tex. Tax Code §§ 171.1014(d) and 171.101(a)(1)(A).  
17 H.B. 500, § 11; Tex. Tax Code § 171.1014(j).

### Internet Hosting Revenue Sourcing

H.B. 500 provides a new sales sourcing rule for Internet hosting company revenue. Effective for reports due on or after January 1, 2014, receipts derived from Internet hosting are considered Texas receipts only if the customer to whom the service is provided is located in Texas.<sup>18</sup>

### Exemptions for Non-Admitted Insurance Organizations

Effective for reports due on or after January 1, 2014, H.B. 500 provides that a non-admitted insurance organization that is subject to an occupation tax, gross premiums tax, or any other tax that is imposed for the privilege of doing business in another state or foreign jurisdiction is exempt from the franchise tax. Prior to the legislation, the exemption only applied if the non-admitted insurance organization paid a Texas gross premium receipts tax in the same year.<sup>19</sup>

The legislation enacted under H.B. 500 created more changes to the margin tax than we have seen since it went into effect on January 1, 2008. Most of the changes to the tax were favorable and specific to targeted industries. However, these types of changes also make the margin tax and the cost of goods sold calculation more complex. We will likely see more legislative changes to the tax

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18 H.B. 500, § 12; Adding new Tex. Tax Code § 171.106(g).

19 H.B. 500, § 4, Tex. Tax Code § 171.052(a).



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in the future due to inequities in how the tax currently affects certain businesses.

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This article originally appeared in BDO USA, LLP's "BDO Knows: SALT" newsletter (July 2013).  
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