Tax Law/ Estate Planning

Recent developments in state taxes may impact small businesses

STATE TAXES

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The Texas Legislature, now meeting in Austin, is considering many proposals that would alter existing state and local taxes.

Some bills would eliminate tax reduction techniques in response to a multibillion-dollar projected state revenue shortfall in the current year and for the following years. Other bills would implement or expand exemptions from statewide and local taxes.

A few of the pending bills and amendments are important for small businesses to consider.

TEXAS FRANCHISE TAX

Modifying this state tax is probably the most important development currently under consideration.

Because Texas has no income tax applicable to individuals, it is often assumed — incorrectly — that there is also no income tax levied upon companies. In fact, the Texas franchise tax is the state's income tax on certain entities that are formed in the state of Texas or are conducting business here.

For example, a corporation (whether electing to be treated as a C corporation or an S corporation for federal tax purposes) and a limited liability company are currently subject to the Texas franchise tax. These entities that provide limited legal liability for their owners are taxed on the greater of 4.5 percent of reportable federal taxable income or .25 percent of net taxable capital.

So, for these entities whose tax is measured by reportable federal taxable income, the franchise tax is, in effect, a state income tax (which is paid in addition to any federal tax liability), and this is true regardless of whether the owners of these entities are individuals or otherwise.

On the other hand, general partnerships, limited liability partnerships, limited partnerships and certain other entities are not subject to the Texas franchise tax.

Recognizing this different tax treatment, many corporations and limited liability companies have restructured their operations using these nontaxable entities to shield income from the application of the franchise tax.

Due to perceived abuses resulting from such restructurings, the Legislature is considering a bill to expand the franchise tax to reach every limited partnership, business trust, real estate investment trust and any other entity for which any of the owners have limited liability.

This proposal, if enacted, will subject almost all entities (both business and nonbusiness) to the Texas franchise tax. This bill is being reviewed very closely by various industry groups that would be affected by the proposal, but it is fairly certain that some form of this bill will pass during the current session of the Texas Legislature.

The effective date for this bill has not yet been finalized, but it could result in the taxation of business operations of the newly-taxable entities for the 2003 tax year.

RENDITION OF TAXABLE PROPERTY

Current Texas law requires an owner of taxable property to render it for local taxation by submitting a list and a value of the property on an annual basis. However, there is no monetary penalty for failing to do so and a number of local tax officials have stated their belief that there is widespread noncompliance with the rendition requirement.

In an effort to enforce the existing law, the Harris County Appraisal District has filed several lawsuits against businesses to force these property owners to submit this rendition.

The Texas Legislature is now considering a bill that would strengthen the rendition requirement and provide significant new penalties for failure to render. Under the bill there will be a penalty of 10 percent of the total amount of taxes imposed on the taxable property for such year, plus appraisers' costs and expenses. A penalty on the taxpayer equal to 50 percent of the total amount of taxes may be imposed in the event of fraud or intent to evade the tax.

PERSONAL PROPERTY IN TRANSIT

A 2001 amendment to the Texas Constitution exempts from local property taxes tangible personal property that was purchased or brought into Texas, stored, manufactured or otherwise detained here for a relatively brief period and then sent out-of-state or to another Texas location.

However, this so-called "goods in transit" exemption cannot take effect until the Legislature passes enabling legislation. A bill to do so is under consideration and, if passed, would apply the exemption starting Jan. 1, 2004, to goods in transit held in a third party's warehouse or other facility for a period of 175 days or less.

Any business that distributes, manufactures or otherwise holds tangible property prior to re-shipment within or through Texas should keep careful records of its purchases as some may be eligible for this local property tax exemption next year.

There are several other bills being considered related to state sales tax including a proposal to impose sales tax on services currently exempt. Each business owner should consult its tax adviser regarding all pending and applicable state and local taxes and compliance requirements. ■

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