

Businesses will bear brunt of shifting tax load

by [Jeff Dinerstein and Chris Wolfe](#)

Texas legislators no longer ponder if they will have to change the state tax system. Their hands have been forced. The big questions -- for a while now -- have not been whether the system will change, but how and when.

After protracted lobbying and effort spanning several legislative sessions, the shape of those changes may be coming into focus. Texas-based businesses will bear the brunt of the revisions, assuming part of the load formerly on the backs of property owners.

However, instead of fretting about new taxes, companies in Texas need to focus their efforts on preparing for this almost certain change in their environment.

House Bill 3, or "HB 3" in the vernacular of the Legislature, should capture the attention of most Texas businesses as it marches through the state political process and appears headed to Gov. Rick Perry's desk.

The bill, passed by the Texas House late in the night on April 25, out of committee on Monday and before the full Senate Tuesday morning, would transform the state's corporate franchise tax into a broad-based business tax.

This proposed business tax purports to both allow Texas to collect greater tax revenues and lower the state's reliance on property taxes as a method to fund public schools.

The new plan will also wrangle in taxes from businesses that until now were free from such duty.

Under the current franchise tax, corporations and limited liability companies chartered or doing business in Texas are subject to the franchise tax, but limited partnerships are not. This limited partnership exception results in a number of businesses chartered or doing business in Texas choosing the limited partnership form over the corporate/limited liability company form.

In effect, Texas businesses have had the ability to elect whether to pay the state's franchise tax.

HB 3 would broaden the Texas tax base by including limited partnerships chartered or doing business in Texas as taxable entities.

Sole proprietorships, general partnerships owned by natural persons, certain "passive" entities and certain tax-exempt entities are exempt under the new proposal. Essentially all other entities that provide limited liability to their owners are included within the proposed tax base.

The proposed legislation does exempt taxable entities with less than \$300,000 in total revenue from the business tax, and also lowers the tax rate from the current 4.5 percent franchise tax to 1 percent (0.5 percent for retailers and wholesalers).

The HB 3 tax is imposed on a business' taxable margin (modified net income) which is basically total gross revenue less either employee compensation or costs of goods sold, but not both.

However, taxable margin will not be higher than 70 percent of total gross revenue. Taxable margin will be apportioned between Texas and outside of Texas under the proposed business tax.

How would this proposed new tax structure affect Texas businesses? First, businesses will become Texas tax (as opposed to federal income tax) indifferent between being chartered as a corporation/limited liability company or as a limited partnership.

Second, more businesses in Texas will pay more into the State coffers. For example, service providers, such as law firms and physicians offices, which currently operate in entities not subject to the franchise tax, will be pulled into the new business tax system.

Why even bother changing Texas taxes? Well, the Texas Constitution does not allow a statewide property tax. The Texas Supreme Court found that Texas, in fact, has a statewide property tax and mandated that the Texas Legislature reform the State's property tax laws, by June 1.

Seeking a workable tax reform solution, Gov. Perry appointed a blue-ribbon commission, chaired by John Sharp, to study issues and alternatives.

The Texas Tax Reform Commission issued its report to the Governor and Legislature in March. The commission reported that "of the major taxes that support the state's general revenue fund -- the largest portion of which is spent on education -- the franchise tax had the lowest growth rate of all over the past decade." HB 3 addresses this situation.

Gov. Perry called another special session of the Legislature in April in an attempt to meet the Supreme Court's fast approaching deadline. By the end of the month, the Texas House finally passed a series of bills aimed at meeting the Supreme Court's requirement.

But even if HB 3 doesn't make it all the way to law -- it still has to clear the Senate floor -- whatever solution comes out of the state will likely shift part of the state tax burden from property owners to Texas businesses.

So instead of just passively watching this process, businesses in the state need to proactively plan for both compliance and tax efficiency.

Just as legislators' hands were forced into changing the tax system, Texas companies will be forced to live with those changes. It's just a matter of how and when.

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