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Texas New Business Margin Tax

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As you may be aware, Gov. Rick Perry signed an expanded business tax into law May 18. This new tax, named the Texas margin tax, replaces the franchise tax and is meant to partially replace the tax revenue lost by the significant cut in state property taxes that the Texas Legislature also passed during the recent special session.

Even if you didn't have to pay franchise tax before, you may now have to pay the new tax when the first returns are due in May 2008. Most legal entities that do business in Texas and enjoy some form of limited liability protection must pay the new tax. However, the law excludes "passive entities." Passive entities must meet three specific requirements.

Besides knowing what types of companies are subject to the new tax, it's important to know how the tax will be calculated. The tax is a tax on "taxable margin," which is a concept similar to taxable income. Generally, an entity's taxable margin is its revenue as reported on its federal income tax return less either its cost of goods sold or its compensation expense (limited to $300,000 per employee), but not both.

Taxable margin must then be apportioned to business done in Texas, measured by gross receipts. The tax rate is then applied to the apportioned margin. A half percent rate is used for taxable entities primarily engaged in retail or wholesale trade, and a 1 percent rate is used for all other entities.

Because of the new tax law, you may need to change the way you operate your business. For instance, companies that expect to take the compensation deduction mentioned above may want to hire workers as employees instead of contract or temporary workers so the wages and benefits paid to employees will be deductible.

One Riverway · Suite 1000 · Houston, Texas 77056-1973 · 713.622.2310 · 713.622.5613 fax
harperpearson.com