

Texas Comptroller Proposes to Amend Franchise Tax Rule for Retail or Wholesale Trade

Overview

On June 10, 2019, the Texas Comptroller of Public Accounts ("Comptroller") filed amendments with the Office of the Secretary of State.¹ The proposed amendments to Texas Administrative Code ("TAC") § 3.584 were published in the June 21, 2019 issue of the *Texas Register* for public comments ("Proposed Rules"). The Proposed Rules include revisions and additions of definitions pertaining to a taxpayer's eligibility to utilize the reduced franchise tax rate available for certain entities, which are primarily engaged in retail or wholesale trade.² Specifically, the Comptroller has proposed to adjust the definition of "primarily engaged in retail or wholesale trade". Further, the Comptroller is seeking to add a subsection defining "produce," which appears in Texas Tax Code ("TTC"), §171.002(c), but is not currently defined in the TAC.³

The Proposed Rules also include changes to the amount of time taxpayers have to file petitions for redetermination and changes to the date a decision on a petition for redetermination becomes final⁴, as well as other changes.

This Tax Alert summarizes certain provisions of the Proposed Rules.

Modifications to the meaning of "Primarily Engaged in Retail or Wholesale Trade"

The Comptroller has proposed to amend TAC § 3.584 by adding a definition of "produce," thus altering the definition of "primarily engaged in retail or wholesale trade"⁵ as produce is used in subsection (2)(B). Further, the Comptroller explained in the introduction to the Proposed Rules that the state will be interpreting these sections consistently and "a taxable entity cannot claim the cost of goods sold deduction on goods that it "produces," while simultaneously claiming it does not "produce" the same goods for purposes of determining qualification for the reduced rate".⁶

Currently, TAC § 3.584 provides, "a taxable entity is primarily engaged in retail or wholesale trade only if:

- (A) the total revenue from the taxable entity's activities in retail and wholesale trade is greater than the total revenue from its activities in trades other than retail and wholesale trade;
- (B) less than 50% of the total revenue from the taxable entity's activities in retail or wholesale trade comes from the sale of products the taxable entity produces or products produced by an entity that is part of an affiliated group to which the taxable entity also belongs, except for those businesses under SIC Manual, Major Group 58 (Eating and Drinking Places). A product is not considered to be produced if modifications made to the acquired product do not increase its sales price by more than 10%; and
- (C) the taxable entity does not provide retail or wholesale utilities, including telecommunications services, electricity, or gas."⁷

The current version of the rule does not provide a definition of "produce," even though that term is used when referencing the 10% test in subsection (B).⁸

The proposed amendment adds a new subsection defining "produce" and removes it from the definition of "primarily engaged in retail or wholesale trade." As currently proposed, "produce" is defined as follows:

- "(3) Produce-To construct, manufacture, install during the manufacturing or construction process, develop, mine, extract, improve, create, raise, or grow either a product or a component of a product.

¹ 44 Tex. Reg. 3082 (proposed June 10, 2019) (to be codified at 34 Tex. Admin. Code § 3.584) (Tex. Comptroller of Pub. Accounts). A copy of the *Texas Register* issue is available [here](#).

² 44 Tex. Reg. 3081 (proposed June 10, 2019) (to be codified at 34 Tex. Admin. Code § 3.584) (Tex. Comptroller of Pub. Accounts).

³ *Id.*

⁴ 44 Tex. Reg. 3082 (proposed June 10, 2019) (to be codified at 34 Tex. Admin. Code § 3.584) (Tex. Comptroller of Pub. Accounts).

⁵ 44 Tex. Reg. 3081 (proposed June 10, 2019) (to be codified at 34 Tex. Admin. Code § 3.584) (Tex. Comptroller of Pub. Accounts).

⁶ *Id.*

⁷ 34 Tex. Admin. Code § 3.584(b)(2)(A)-(C).

⁸ 34 Tex. Admin. Code § 3.584(b)(2)(B).

- (A) A taxable entity produces a product that it sells if the taxable entity or an entity that is part of an affiliated group to which the taxable entity also belongs:
- (i) asserts a software copyright on the product or a component of the product;
 - (ii) asserts a patent right under Title 35 of the United States Code or comparable law of any other foreign jurisdiction with respect to the product, a component of the product, or the packaging of the product; or
 - (iii) produces a component of the product or acquires the product and makes a modification to the product, unless the taxable entity can demonstrate that the component or modification does not increase the sales price of the product by more than 10%.
- (B) Except as provided in subparagraph (A) of this paragraph, a taxable entity does not produce a product that it sells if an unrelated party manufactures the product and all components of the product to the taxable entity's specifications."⁹

The proposed definition of "produce" will likely narrow the potential eligibility for taxpayers to qualify for the reduced tax rate for taxpayers across various industries. The Proposed Rules also emphasize that taxpayers have the burden of proving that modifications to products do not increase the sales prices of products in excess of 10%.¹⁰

Updates to Periods for Filing and Finalization of Petitions for Redetermination

Under the Proposed Rules, the period for filing petitions for redetermination is lengthened from 30 to 60 days after the date the notice of determination is issued.¹¹ Additionally, the Proposed Rules specify that a decision on a petition for redetermination becomes final at the time a decision in a contested case is final under Government Code, Chapter 2001.¹² Currently, the rule requires the finalization of a decision 20 days after service on the petitioner of the notice of the decision.¹³

Considerations

Texas franchise taxpayers currently eligible, or potentially eligible, for the reduced retail or wholesale tax rate should continue to monitor the status of the proposal and review certain receipts used in the reduced rate test for potential ineligibility.

The above proposed amendments can be adopted as early as July 21, 2019. The Texas Department of Revenue, Tax Policy Division is now accepting comments on the proposed amendments until July 20, 2019, which may be submitted to Teresa G. Bostick, Director, Tax Policy Division, P.O. Box 13528, Austin, Texas 78711-3528.¹⁴

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⁹ 44 Tex. Reg. 3082 (proposed June 10, 2019) (to be codified at 34 Tex. Admin. Code § 3.584) (Tex. Comptroller of Pub. Accounts).

¹⁰ *Id.*

¹¹ 44 Tex. Reg. 3085 (proposed June 10, 2019) (to be codified at 34 Tex. Admin. Code § 3.584) (Tex. Comptroller of Pub. Accounts).

¹² *Id.*

¹³ 34 Tex. Admin. Code § 3.584(e)(3)(C).

¹⁴ 44 Tex. Reg. 3082 (proposed June 10, 2019) (to be codified at 34 Tex. Admin. Code § 3.584) (Tex. Comptroller of Pub. Accounts).

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