

# **MARGIN TAX UPDATE**

## **Business Law & Corporate Counsel Section Program**

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Friday, June 11, 2010  
9:45 a.m. – 10:15 a.m.



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Daniel J. Micciche has extensive experience in tax and business planning for acquisitions, divestitures and specialized capital structure planning, as well as in the formation and operation of corporations, partnerships and limited liability companies. He also represents clients in federal and state tax controversy matters.

Mr. Micciche received his B.A. with highest honors from the State University of New York at Stony Brook, where he was a member of Phi Beta Kappa. He received his J.D. from the University of Chicago Law School. He is a member of the Texas and New York bars.

Mr. Micciche is chair of the Section of Taxation of the State Bar of Texas. He currently serves on the Comptroller's Tax Advisory Group under Texas Comptroller of Public Accounts Susan Combs and previously served on the Comptroller's Tax Advisory Groups under former Texas Comptrollers Carole Keeton Strayhorn and John Sharp. He was elected chair of the Tax Section of the Dallas Bar Association in 2001. Mr. Micciche is a frequent lecturer and speaker and has served on the faculty of numerous seminars.

Mr. Micciche has been recognized in The Best Lawyers in America and in Chambers USA: America's Leading Lawyers for Business. He has also been recognized in the Guide to the World's Leading Tax Advisers (Legal Media Group) and in Texas Super Lawyers. In addition, Mr. Micciche was named as one of the Top 100 Lawyers in the Dallas Fort Worth region in the "Texas Super Lawyers 2007" survey that was published in Texas Monthly. Mr. Micciche was recommended by Practical Law Company as one of the top 10 tax lawyers in Austin, Dallas and Houston.

Mr. Micciche serves as vice chair of Texas C-BAR (Community Building through Attorney Resources), a pro bono organization, and on the board of directors of the American Foundation for the Blind-Southwest Region. He previously served on the School Finance Task Force of the Greater Dallas Chamber. He is a member of the Dallas Museum of Art, the Dallas Council on World Affairs and the USA Film Festival. He was also elected in 2008 by the Council of Chairs of the State Bar of Texas to serve a three-year term as a Section Representative on the State Bar of Texas Board of Directors.

Mr. Micciche is a 1999 graduate of the Greater Dallas Chamber's Leadership Dallas Program and the Leadership Arts Program of the Dallas Business Committee for the Arts, 1998.

Mr. Micciche chairs Akin Gump's School Partnership Program with the James Fannin Elementary School in Dallas. He is the founder and chair of the Akin Gump CLE Series for In-House Counsel in Dallas. He chairs the Dallas office's associates and counsel committee and its pro bono committee, and serves on both the firmwide retirement committee and the associate and counsel compensation committee. He served as the hiring partner for the firm's Dallas office from 1995-2002, and started the Tuesday All Attorney Lunch

Program in Dallas. In 2006 he received the firm's Partner Recognition Award for his mentoring of counsel and associates. In addition, he was the recipient of the firm's Pro Bono Award.

#### **Bar Admissions**

- New York
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#### **Education**

- J.D., University of Chicago Law School, 1981
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# **TEXAS MARGIN TAX UPDATE**

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State Bar of Texas  
**7<sup>th</sup> ANNUAL ADVANCED BUSINESS LAW COURSE**  
October 22-23, 2009  
Houston

**CHAPTER 15**

## Steven D. Moore



### Biography

Steven D Moore is a tax lawyer whose practice includes compliance; planning and controversy work, with a special emphasis on sales tax; insurance premium tax; and local property tax. Mr. Moore also has substantial experience in state tax planning for multi-state business models and regularly provides tax strategy advice relating to mergers

and acquisitions.

Recognized for his depth of expertise in state tax matters, Mr. Moore is one of the state's leading attorneys for guidance on the new Texas margin tax and he frequently speaks on this topic, having made numerous presentations to Texas State Bar and University of Texas CLE programs.

In all aspects of his practice, Mr. Moore is dedicated to helping his clients fully comply with and control their tax exposure. An effective negotiator, he works to reach successful resolution of Texas sales, franchise, and insurance premium tax audits. To this end, Mr. Moore handles administrative hearings before the Texas Comptroller of Public Accounts and works with the firm's litigation group to prosecute judicial resolution of Texas tax cases.

### Publications & Speaking Engagements

Mr. Moore has made numerous speaking presentations to major CLE programs across Texas dealing with various state tax and corporate topics, including "The New Texas Margin Tax."

[On the Margin: The Impact of the Margin Tax on Landlords and Tenants](#)

[Texas Margin Tax: Planning, Strategies, and More](#)

[Margin Tax: Comptroller Expands Definition of Uncompensated Care](#)

[Planning and Choice of Entity After the New Texas Franchise \(Margin\) Tax](#)

[Choice of Entity in 2006 Effects of the New Texas Business Organizations Code and Margin Tax](#)

[The New Margin Tax: Unintended Consequences for Healthcare Providers](#)

[Texas Legislature Passes New Business Tax](#)

[New Texas Law Penalizes Failure to Render Business Personal Property](#)

[Summary and Analysis of the Jobs and Growth Tax Relief Reconciliation Act of 2003](#)

[Aircraft Taxes: Texas State and Local Tax Enforcement on the Rise](#)

[State Bar Newsletter Update - March 2002](#)

[Texas Taxation of Electronic Commerce](#)

[1999 Texas Legislative Update](#)

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#### Practice Areas

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### Memberships

Mr. Moore is a past Chair of the State Bar of Texas State and Local Tax Committee. He is a member of the American Bar Association Committee on State and Local Tax.

### Community Involvement

Mr. Moore has a passion for classical music and dedicates a large part of his time to the arts in Austin. He serves as Chairman of the Board of Trustees of KMFA Radio and is actively involved in fundraisers and other community events to help sustain this non-profit service. Mr. Moore is also a past President and Board member of Austin Community Nursery Schools and has served as an Elder and a Finance Chair with the Central Presbyterian Church.

### Admitted

Texas, 1989

### Education

B.B.A., The University of Texas at Austin

J.D., *with honors*, The University of Texas School of Law

- Order of the Coif



# Texas Margin Tax Update

Texas Bar CLE 7<sup>th</sup> Annual Advanced Business Law Course

October 23, 2009  
Houston, Texas



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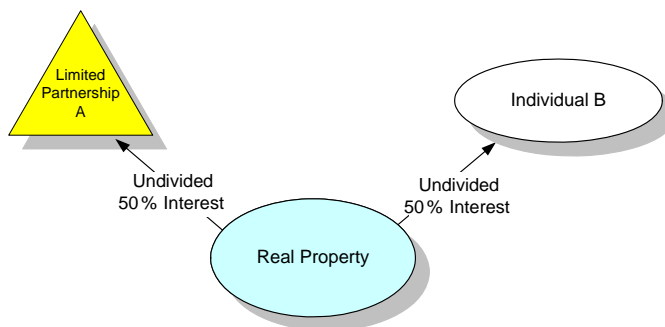


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**Arrangements Treated as Co-  
Ownerships for Federal  
Income Tax Purposes**

Co-Ownership (Limited Partnership / Individual)  
of Real Estate



**Federal Income Tax Considerations**  
**Cf. Rev. Proc. 2002-22 Ruling Guidelines**

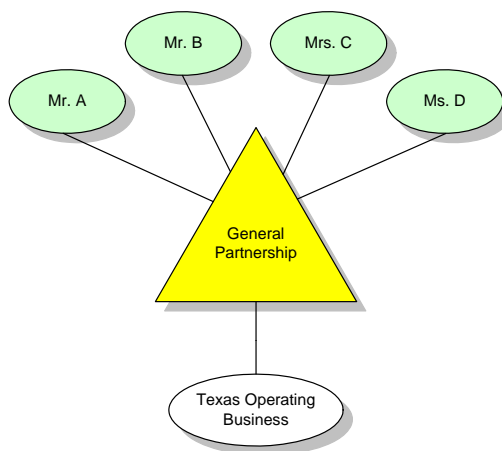
- Tenancy in common ownership
- Number of co-owners
- No treatment of co-ownership as an entity
- Co-ownership agreement
- Voting
- Restrictions on alienation
- Sharing proceeds and liabilities from sale of the property
- Proportionate sharing of profits and issues
- Proportionate sharing of debt
- Options
- No business activities
- Management and brokerage documents
- Leasing agreements
- Loan agreements
- Payments to sponsor

**Texas Margin Tax Considerations**

- §171.002(a): Taxable entity "means a partnership . . . joint venture . . . or other legal entity."
- Cf. Comp. Rule 3.581(b)(15) ("Partnership – A relationship referred to in Business Organizations Code §152.051 and Revised Partnership Act Article 6132b-2.02."), Comp. Rule 3.581(b)(6) ("General partnership – A partnership as described in Revised Partnership Act, Article 6132-1.01 et. seq., or Business Organizations Code, Title 4, Chapter 152, or an equivalent statute in another jurisdiction.").
- Cf. §171.1011(c)(3) ("Except as provided by this section and subject to Section 171.1014, for the purpose of computing its taxable margin under Section 171.101, the total revenue of a taxable entity is . . . for a taxable entity other than a taxable entity treated for federal income tax purposes as a corporation or partnership, an amount determined in a manner substantially equivalent to the amount for subdivision (1) or (2) determined by rules that the Comptroller shall adopt."); see Tex. Bus. Org. Code §152.052 (rules for determining if partnership created).

# **General Partnership Structures**

General Partnership the Direct Ownership of Which is Entirely Composed of Natural Persons – Partnership for U.S. Federal Income Tax Purposes



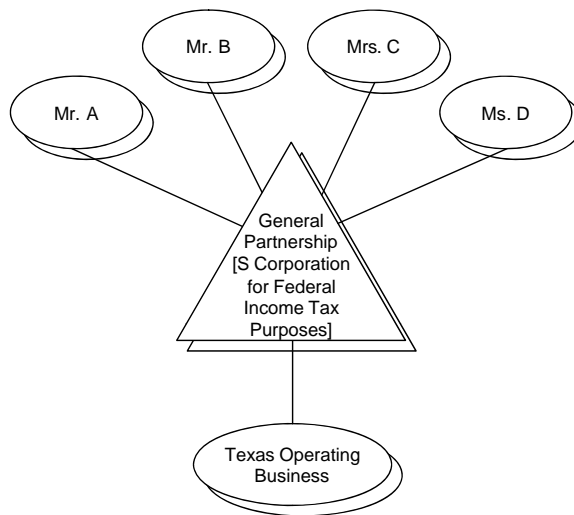
**Federal Income Tax Considerations**

- General Partnership should be treated as a partnership unless corporate treatment elected. (Treas. Reg. §301.7701-3.)

**Texas Margin Tax Considerations**

- Should not be a taxable entity. (§171.0002(b)(2).)
- See Comp. Rule 3.581(d)(2) (nontaxable entities include “general partnerships where direct ownership is composed entirely of natural persons, and the liability of those persons is not limited (e.g. by registration as a limited liability partnership) under a statute of this state or another state.”).
- See also Comp. FAQs, Rule 3.581, Q&A 2 (“The revised franchise tax does not apply to: sole proprietorships (except the tax does apply to single member LLCs filing as a sole proprietor for federal income tax purposes); general partnerships directly and solely owned by natural persons (except the tax does apply to all limited liability partnerships); entities exempt under Subchapter B of Chapter 171; and passive entities (as defined under TTC 171.0003).”); Comp. FAQs, Rule 3.581, Q&A 3 (“A general partnership directly and entirely owned by natural persons is a not a taxable entity.”).

General Partnership the Direct Ownership of Which is Entirely Composed of Natural Persons – S Corporation for U.S. Federal Income Tax Purposes



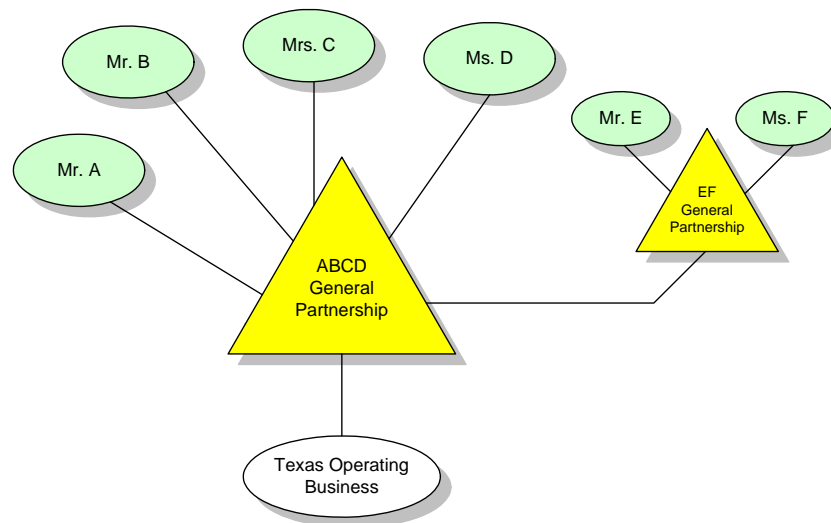
**Federal Income Tax Considerations**

- Example assumes entity is treated as an S corporation.

**Texas Margin Tax Considerations**

- Should not be a taxable entity. (§171.0002(b)(2).)

General Partnership With Natural Persons and Another General Partnership as Partners – Partnership for U.S. Federal Income Tax Purposes



**Federal Income Tax Considerations**

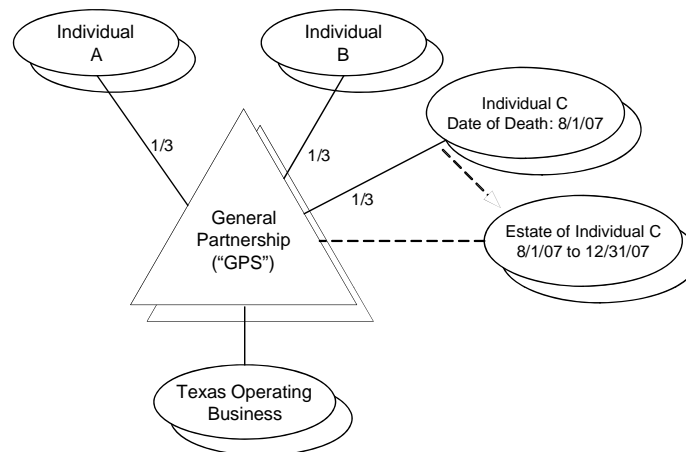
- General Partnership should be treated as a partnership unless corporate treatment elected. (Treas. Reg. §301.7701-3.)

**Texas Margin Tax Considerations**

- Comptroller's position is that the ABCD General Partnership is a taxable entity. See Comp. FAQs, Rule 3.581, Q&A 5 ("Is a general partnership whose partners consists of natural persons and one general partnership a taxable entity? Yes, a general partnership must be composed directly and entirely of natural persons to be a non- taxable entity.").



General Partnership with Estate as Partner – Partnership for U.S. Federal Income Tax Purposes



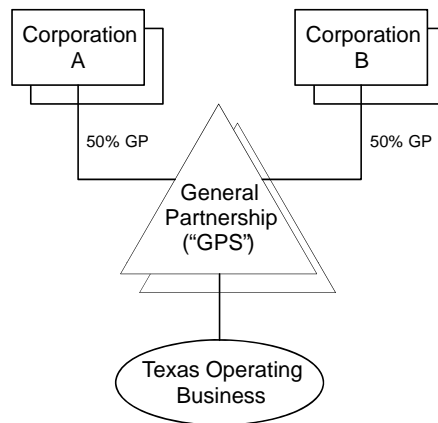
**Federal Income Tax Considerations**

- GPS should be treated as a partnership unless corporate treatment elected. (Treas. Reg. §301.7701-3.)

**Texas Margin Tax Considerations**

- GPS should not be a taxable entity because direct ownership of GPS is entirely composed of human beings or the estate of a human being.
- See also Comp. FAQs, Rule 3.581, Q&A 6 ("The estate of a natural person is not a taxable entity. Therefore, a general partnership composed entirely of natural persons will not become a taxable entity because of the estate of a deceased partner.").

General Partnership with Corporations  
as Partners – Partnership for U.S.  
Federal Income Tax Purposes



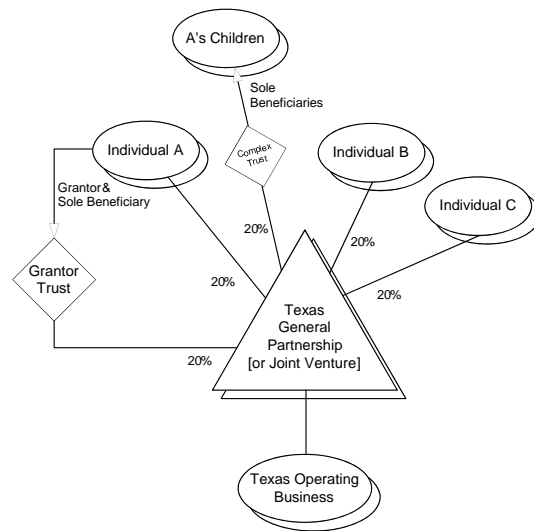
**Federal Income Tax Considerations**

- GPS should be treated as a partnership unless corporate treatment elected. (Treas. Reg. §301.7701-3.)

**Texas Margin Tax Considerations**

- GPS should be a taxable entity because the direct ownership is not entirely comprised of natural persons.

General Partnership with Trusts as Partners



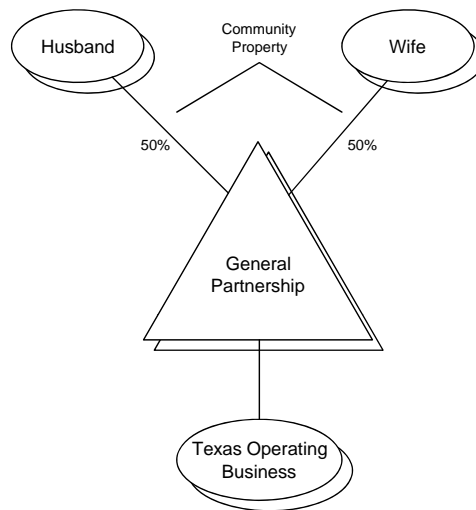
**Federal Income Tax Considerations**

- General partnership or joint venture will be treated as a partnership unless election made to treat entity as a corporation. (See Treas. Reg. § 301.7701-3.)

**Texas Margin Tax Considerations**

- Unless entity is a passive entity, it should be classified as a taxable entity for Texas margin tax purposes because the entity is not composed solely of natural persons. See §171.0002(b)(2) ("Taxable entity" does not include: (1) a sole proprietorship; (2) a general partnership: (A) the direct ownership of which is entirely composed of natural persons; and (B) the liability of which is not limited under a statute of this state or another state, including by registration as a limited liability partnership;"); §171.0001(11-a) ("Natural person" means a human being or the estate of a human being. The term does not include a purely legal entity given recognition as the possessor of rights, privileges, or responsibilities, such as a corporation, limited liability company, partnership, or trust."); Comp. Rule 3.581(b)(14) (same definition of "natural person" as in §171.0001(11-a)).

### General Partnership Owned by Husband and Wife as Community Property



#### Federal Income Tax Considerations

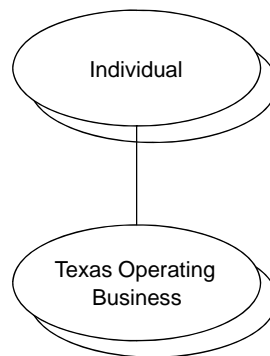
- Husband and wife can elect to treat as a disregarded entity or as a partnership for federal income tax purposes (Rev. Proc. 2002-69.)

#### Texas Margin Tax Considerations

- Should not be a taxable entity.
- See also Comp. Priv. Ltr. Rul. 200609763L (Sept. 8, 2006) ("If your small business is legally a sole proprietorship or a general partnership owned solely by you and your husband, it will not be subject to the franchise tax under HB 3.")

**Structures Treated as Sole  
Proprietorships or Divisions of a  
Corporation or Partnership for Federal  
Income Tax Purposes**

### Sole Proprietorship for Federal Income Tax and Texas Margin Tax Purposes



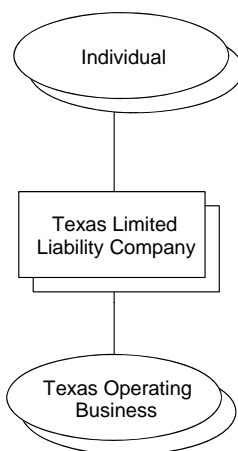
#### Federal Income Tax Considerations

- Texas operating business reported on federal income tax return of individual.

#### Texas Margin Tax Considerations

- Should not be a taxable entity. (§171.0002(b)(1).)
- See Comp. Rule 3.581(b)(23) ("Sole proprietorship – A natural person carrying on business, if the business is not formed in a manner that limits the liability of the owner. It does not include other entities treated as sole proprietorships for federal tax purposes, unless by statute the form of entity does not afford limited liability protection to the owner and it does not include single member limited liability companies.").
- See *also* Comp. FAQs, Rule 3.581, Q&A 9 ("A sole proprietorship that is not legally organized in a manner that limits its liability is not a taxable entity. A single member limited liability company filing as a sole proprietor for federal income tax purposes is a taxable entity.").

SINGLE-MEMBER (INDIVIDUAL)  
LIMITED LIABILITY COMPANY OWNING OPERATING  
BUSINESS – DISREGARDED FOR U.S. FEDERAL  
INCOME TAX PURPOSES



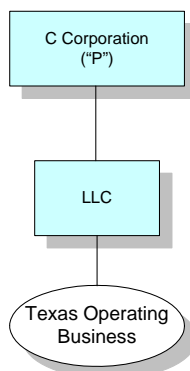
**Federal Income Tax Considerations**

- Disregarded for federal income tax purposes unless election made to treat as a corporation (Treas. Reg. § 301.7701-3(a).)

**Texas Margin Tax Considerations**

- Should be a taxable entity. (§171.0002(a))
- §171.0002(d) confirms.
- See Comp. Rule 3.581(d)(1) (nontaxable entities include "sole proprietorships (does not include single member limited liability companies)").
- See also Comp. Priv. Ltr. Rul. 200609763L (Sept. 8, 2006) ("Please keep in mind that a single member limited liability company (LLC) owned by a natural person is often treated as a sole proprietorship for federal income tax reporting purposes. This single member LLC is a taxable entity under current law and will be considered a taxable entity under HB 3.").

SINGLE-MEMBER (C CORPORATION)  
LIMITED LIABILITY COMPANY OWNING  
OPERATING BUSINESS – DISREGARDED  
FOR U.S. FEDERAL INCOME TAX PURPOSES



**Federal Income Tax Considerations**

- LLC is disregarded for federal income tax purposes unless corporate treatment elected. (Treas. Reg. § 301.7701-3.)

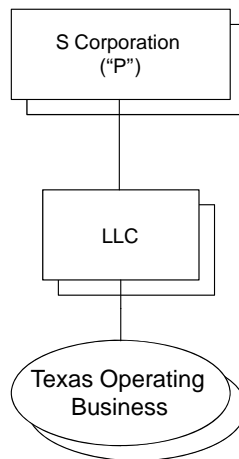
**Texas Margin Tax Considerations**

- Do LLC and P comprise a combined group?
  - a) §171.1014(a) ("Taxable entities" that are part of an affiliated group engaged in a unitary business are required to file a combined group report.); see also Comp. Rule 3.590(b)(2) ("Combined group--Taxable entities that are part of an affiliated group engaged in a unitary business and that are required to file a combined group report under Tax Code, §171.1014.")
  - b) Affiliated group: > 50% test (§§171.0001(1); 171.0001(8).); see Comp. Rule 3.590(b)(1) ("Affiliated group--Entities in which a controlling interest is owned by a common owner, either corporate or noncorporate, or by one or more of the member entities.")
  - c) Unitary business?
- See also Comp. FAQs, Rule 3.590. Q & A 2 ("What types of entities are included in a combined group? A combined group can include any taxable entity, including but not limited to, pass-through entities, LLCs, S corporations and disregarded entities.")



SINGLE-MEMBER (S CORPORATION)  
LIMITED LIABILITY COMPANY OWNING  
OPERATING BUSINESS – DISREGARDED  
FOR FEDERAL INCOME TAX PURPOSES

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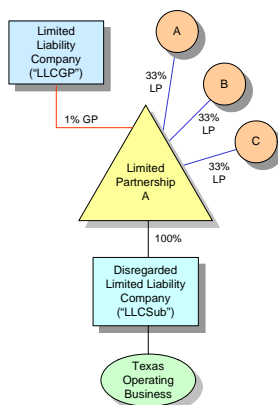
**Federal Income Tax Considerations**

- LLC is disregarded for federal income tax purposes unless corporate treatment elected. (Treas. Reg. §301.7701-3.)

**Texas Margin Tax Considerations**

- Do LLC and P comprise a combined group?
  - a) §171.1014(a) ("Taxable entities" that are part of an affiliated group engaged in a unitary business are required to file a combined group report.); see also Comp. Rule 3.590(b)(2) ("Combined group--Taxable entities that are part of an affiliated group engaged in a unitary business and that are required to file a combined group report under Tax Code, §171.1014.")
  - b) Affiliated group: > 50% test (§§171.0001(1); 171.0001(8).); see Comp. Rule 3.590(b)(1) ("Affiliated group--Entities in which a controlling interest is owned by a common owner, either corporate or noncorporate, or by one or more of the member entities.")
  - c) Unitary business?

SINGLE-MEMBER (LIMITED PARTNERSHIP) LIMITED LIABILITY COMPANY OWNING OPERATING BUSINESS – DISREGARDED FOR FEDERAL INCOME TAX PURPOSES



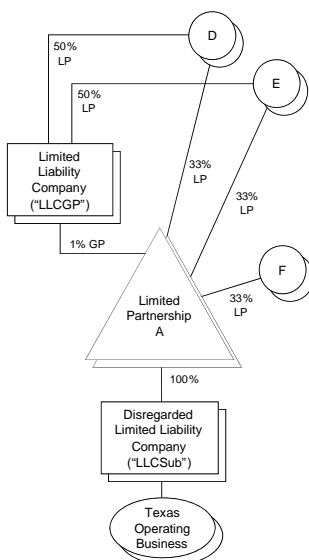
**Federal Income Tax Considerations**

- LLC should be disregarded unless corporate treatment elected. (Treas. Reg. §301.7701-3.)
- A should be treated as a partnership unless corporate treatment elected. (Treas. Reg. §301.7701-3.)
- Treatment of LLCGP depends upon number of members and whether entity classification election is made.

**Texas Margin Tax Considerations**

- Do LLCSub, Limited Partnership A, and LLCGP comprise a combined group?
  - a) §171.1014(a) ("Taxable entities" that are part of an affiliated group engaged in a unitary business are required to file a combined group report.); see also Comp. Rule 3.590(b)(2) ("Combined group--Taxable entities that are part of an affiliated group engaged in a unitary business and that are required to file a combined group report under Tax Code, §171.1014.");
  - b) Affiliated group: > 50% test (§§171.0001(1); 171.0001(8).); see Comp. Rule 3.590(b)(1) ("Affiliated group--Entities in which a controlling interest is owned by a common owner, either corporate or noncorporate, or by one or more of the member entities."); see Comp. Rule 3.590(b)(4)(E) ("Except as otherwise provided, an entity is owned when a controlling interest is directly held or the interest is constructively owned. An individual constructively owns stock that is owned by his or her spouse.")
  - c) Unitary business?
- See also Comp. FAQs, Rule 3.590, Q & A 8 ("In determining a combined group, is there attribution of ownership between family members? An individual constructively owns stock or interest that is owned by his or her spouse. There is no other attribution of ownership between family members.").

SINGLE-MEMBER (LIMITED PARTNERSHIP) LIMITED LIABILITY COMPANY  
 OWNING OPERATING BUSINESS – DISREGARDED FOR FEDERAL  
 INCOME TAX PURPOSES / AFFILIATED GROUP ILLUSTRATION



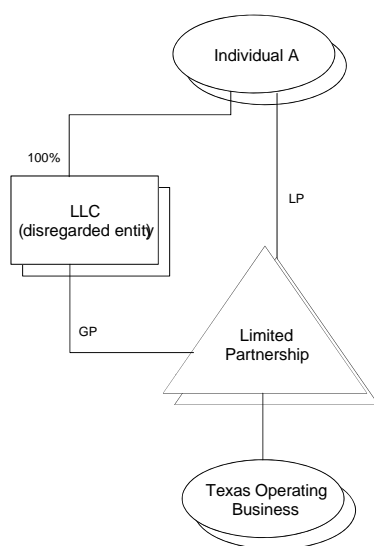
**Federal Income Tax Considerations**

- LLC should be disregarded unless corporate treatment elected. (Treas. Reg. §301.7701-3.)
- A should be treated as a partnership unless corporate treatment elected. (Treas. Reg. §301.7701-3.)
- LLCGP should be treated as a partnership unless corporate treatment elected. (Treas. Reg. §301.7701-3.)

**Texas Margin Tax Considerations**

- Do LLCSub, Limited Partnership A, and LLCGP comprise a combined group?
  - a) §171.1014(a): ("Taxable entities" that are part of an affiliated group engaged in a unitary business are required to file a combined report; see also Comp. Rule 3.590(b)(2) ("Combined group—Taxable entities that are part of an affiliated group engaged in a unitary business and that are required to file a combined group report under Tax Code, §171.1014.").
  - b) Affiliated group ("means a group of one or more entities in which a controlling interest is owned by a common owner or owners, either corporate or noncorporate, or by one or more of the member entities"). (§171.0001(1): > 50% test (§171.0001(8)); see Comp. Rule 3.590(b)(1) ("Affiliated group--Entities in which a controlling interest is owned by a common owner, either corporate or noncorporate, or by one or more of the member entities."); see also Comp. Rule 3.590(b)(4)(E) ("Except as otherwise provided, an entity is owned when a controlling interest is directly held or the interest is constructively owned. An individual constructively owns stock that is owned by his or her spouse.").
  - c) Unitary business?

SINGLE PERSON (INDIVIDUAL) LIMITED PARTNERSHIP  
 OWNING OPERATING BUSINESS- DISREGARDED  
 FOR U.S. FEDERAL INCOME TAX PURPOSES



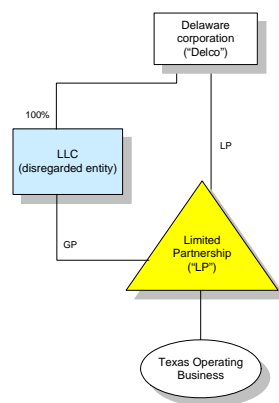
**Federal Income Tax Considerations**

- Limited partnership disregarded for federal income tax purposes unless corporate treatment elected (Rev. Rul. 2004-77)
- Operating business reported on federal income tax return of Individual A

**Texas Margin Tax Considerations**

- Under § 171.0002(a), a "taxable entity" includes a limited partnership. *Cf.* Comp. Rule 3.581(b)(23) ("Sole Proprietorship – A natural person carrying on business if the business is not formed in a manner that limits the liability of the owner. It does not include other entities treated as sole proprietorships for federal income tax purposes unless by statute the form of entity does not afford limited liability protection to the owner and it does not include single member limited liability companies.").

SINGLE PERSON (CORPORATION) LIMITED PARTNERSHIP  
OWNING OPERATING BUSINESS – DISREGARDED FOR  
U.S. FEDERAL INCOME TAX PURPOSES



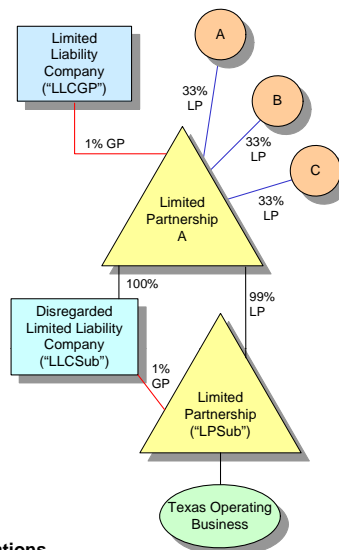
**Federal Income Tax Considerations**

- Limited partnership disregarded for federal income tax purposes unless corporate treatment elected. (Rev. Rul. 2004-77.)
- Operating business reported on corporate tax return of Delaware corporation.

**Texas Margin Tax Considerations**

- Do Delco, LLC and LP comprise a combined group?
  - a) §171.1014(a) ("Taxable entities" that are part of an affiliated group engaged in a unitary business are required to file a combined group report.); see also Comp. Rule 3.590(b)(2) ("Combined group--Taxable entities that are part of an affiliated group engaged in a unitary business and that are required to file a combined group report under Tax Code, §171.1014.")
  - b) Affiliated group: > 50% test (§§171.0001(1); 171.0001(8).); see Comp. Rule 3.590(b)(1) ("Affiliated group--Entities in which a controlling interest is owned by a common owner, either corporate or noncorporate, or by one or more of the member entities.")
  - c) Unitary business?
- See also Comp. FAQs, Rule 3.581, Q&A 13 ("The taxpayer is a disregarded entity for federal purposes. Do they have to file franchise tax if they have nexus in Texas? Yes. The determination of responsibility for Texas franchise tax is based on the legal formation of an entity. An entity's treatment for federal income tax purposes does not determine its responsibility for Texas franchise tax. Therefore, each taxable entity that is organized in Texas or doing business in Texas is subject to franchise tax, even if it is treated as a disregarded entity for federal income tax purposes. The entity is required to file a separate franchise tax report unless it is a member of a combined group. If the entity is a member of a combined group, the reporting entity may include the disregarded entity with the parent's information; in that event, both entities are presumed to have nexus.")
- See also Comp. FAQs, Rule 3.590, Q & A 9 ("Does a combined group include entities meeting the ownership and unitary criteria if the entity does not have nexus in Texas? Yes, an entity meeting the ownership and unitary criteria is included in the combined group regardless of whether the entity has nexus in Texas.")

SINGLE-PERSON (LIMITED PARTNERSHIP) LIMITED PARTNERSHIP OWNING OPERATING BUSINESS – DISREGARDED FOR U.S. FEDERAL INCOME TAX PURPOSES



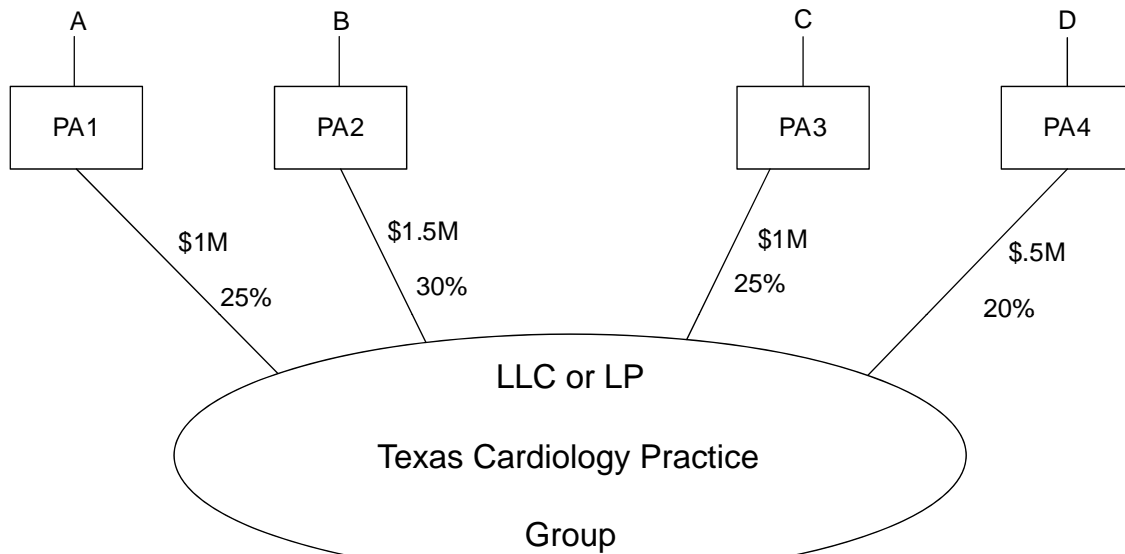
**Federal Income Tax Considerations**

- LPSub should be disregarded for federal income tax purposes unless corporate treatment elected. (Treas. Reg. §301.7701-3.)
- LLCSub should be disregarded unless corporate treatment elected. (Treas. Reg. §301.7701-3.)

**Texas Margin Tax Considerations**

- Do LPSub, LLCSub, Limited Partnership A and LLCGP comprise a combined group?
  - a) §171.1014(a) ("Taxable entities" that are part of an affiliated group engaged in a unitary business are required to file a combined group report.); see also Comp. Rule 3.590(b)(2) ("Combined group--Taxable entities that are part of an affiliated group engaged in a unitary business and that are required to file a combined group report under Tax Code, §171.1014.")
  - b) Affiliated group: > 50% test (§§171.0001(1); 171.0001(8).); see Comp. Rule 3.590(b)(1) ("Affiliated group--Entities in which a controlling interest is owned by a common owner, either corporate or noncorporate, or by one or more of the member entities.")
  - c) Unitary business?

Case Study on a Common Tiered Structure



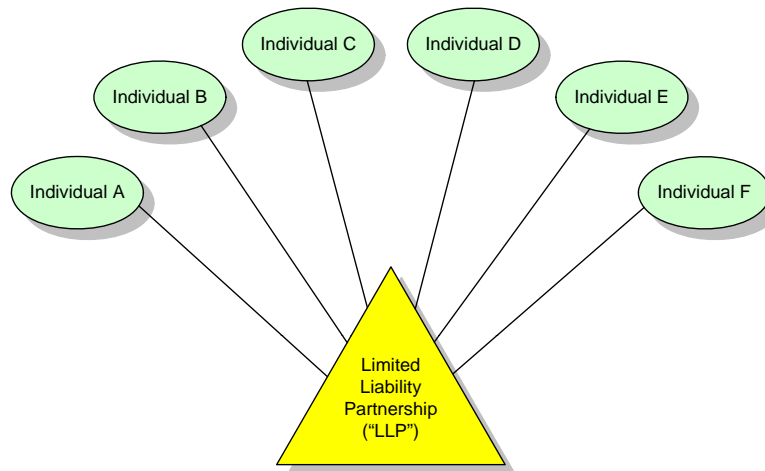
- Annual Gross receipts = \$7 million (includes \$1M medicare)
- Staff Compensation = \$2 million
- ½ of the Medicare receipts are paid through a 501(c)(3) hospital

# Limited Liability Partnership



## Limited Liability Partnership - Illustration

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**Federal Income Tax Considerations**

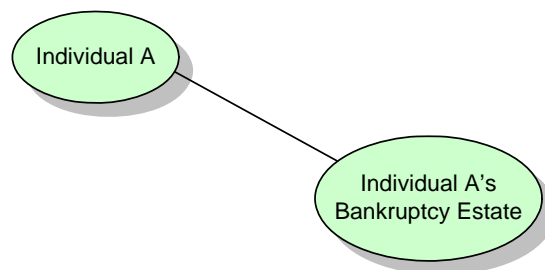
- LLP should be treated as partnership unless corporate treatment elected. (Treas. Reg. §§301.7701-3(a), 301.7701-3(b)(1).).

**Texas Margin Tax Considerations**

- Taxable entity (§171.0002(a)); see also §171.0002(b)(2).
- See also Comp. FAQs, Rule 3.581, Q&A 4 ("Is a general partnership owned directly and entirely by natural persons that elects limited liability status a taxable entity? Yes, even if a general partnership is composed entirely of natural persons, if it elects limited liability status it is a taxable entity.").
- *But cf.* Comp. FAQs, Rule 3.582, Q & A 2 ("Can a limited liability partnership qualify as a passive entity? Yes. General, limited and limited liability partnerships may qualify as a passive entity.").

**Bankruptcy Estate  
of an Individual**

### Comptroller's Position Regarding Treatment of the Bankruptcy Estate of An Individual



- See also Comp. FAQs, Rule 3.581, Q&A 16 ("Is a bankruptcy estate of an individual a taxable entity? The bankruptcy estate of an individual is a separate taxable entity for federal tax reporting. As a result, the estate will not be considered an extension of a natural person. If the estate holds an interest in a general partnership, the partnership will be a taxable entity.").

**Other Controlling Interest and  
Combined Reporting Issues**

## COMBINED GROUP ANALYSIS

Identify all entities subject to a "controlling interest"



Identify and exclude non-taxable entities (exclude passives on annual basis)



Determine scope of "unitary" business and split group if appropriate



=

COMBINED GROUP

**COMBINED REPORT MEMBERSHIP IS**

**BLIND**

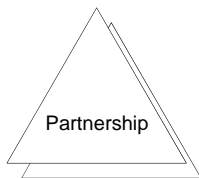
**To NEXUS**

[Except for possible impact on unitary test]

**Definition of Controlling Interest**

**Controlling Interest for Partnership**

> 50%, owned directly or indirectly, of the capital, profits, or beneficial interest in the partnership



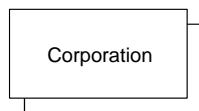
**Controlling Interest for Limited Liability Company**

> 50%, owned directly or indirectly of the total membership interest of the limited liability company  
or  
> 50%, owned directly or indirectly, of the beneficial ownership interest in the membership interest of the limited liability company



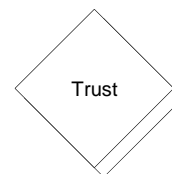
**Controlling Interest for Corporation**

> 50%, owned directly or indirectly of the total combined voting power of all classes of stock  
or  
> 50% owned directly or indirectly, of the beneficial ownership interest in the voting stock of the corporation



**Controlling Interest for Trust**

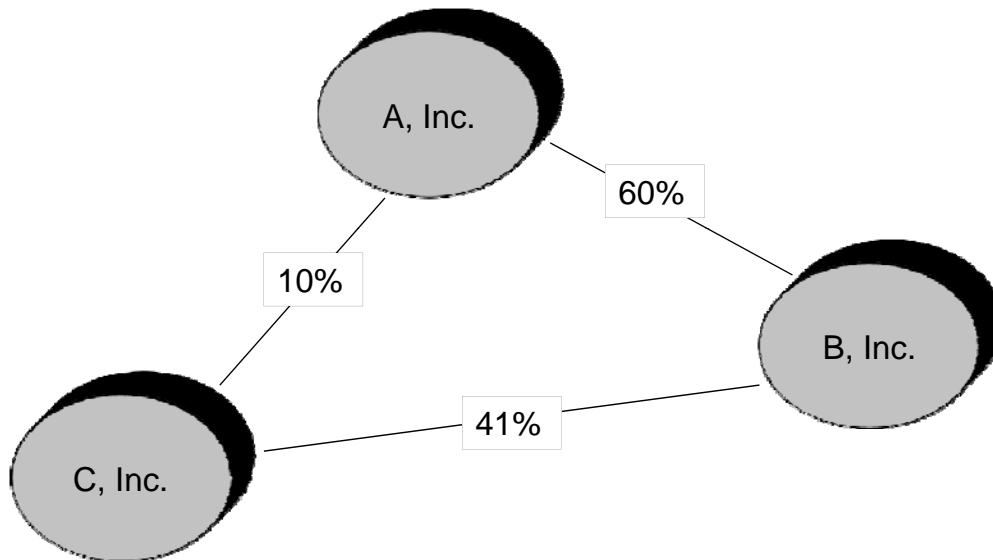
> 50%, owned directly or indirectly, of the [capital, profits, or] beneficial interest in the trust



# Controlling Interest

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## Example 1

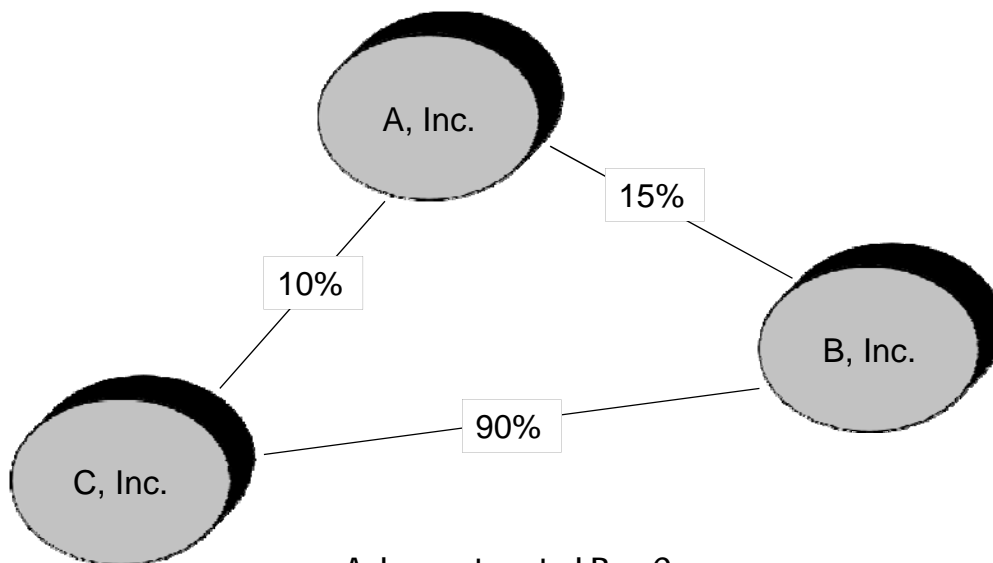


• A controls B & C



# Controlling Interest

## Example 2

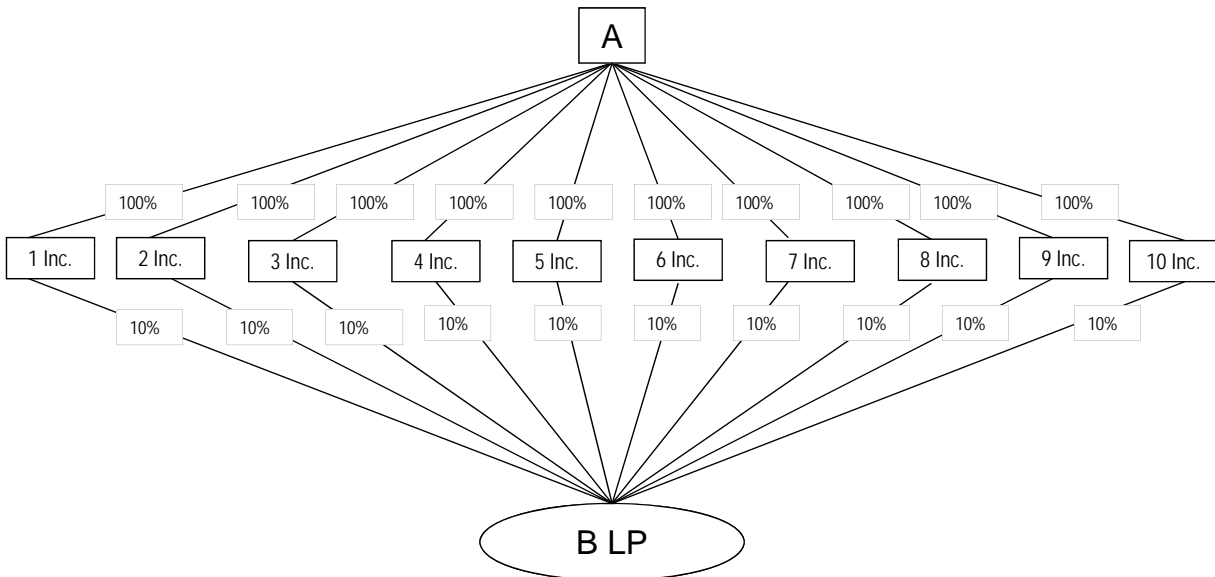


- A does not control B or C
- B controls C

# Controlling Interest

36

## Example 3

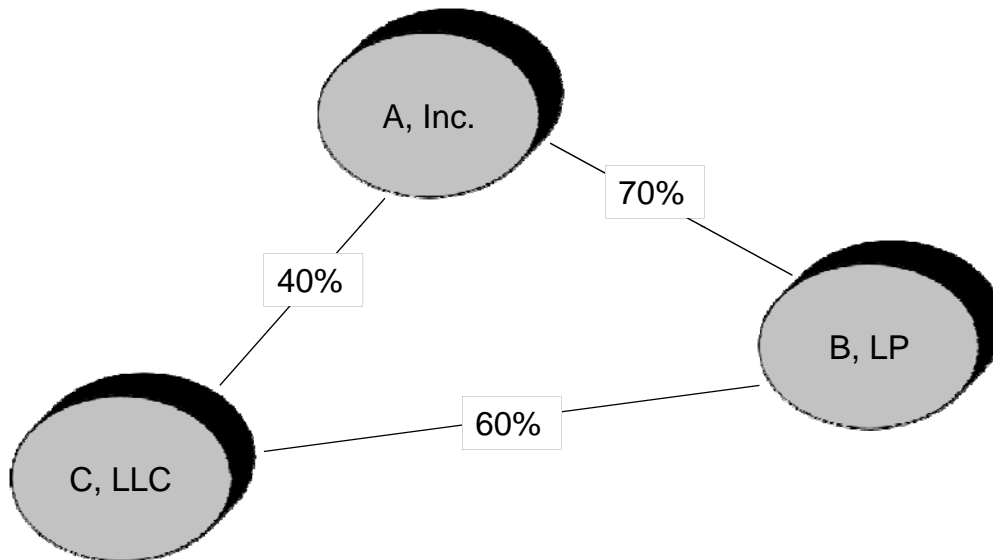


- A controls 1 Inc. through 10 Inc.
- A controls B

# Controlling Interest

## Example 4

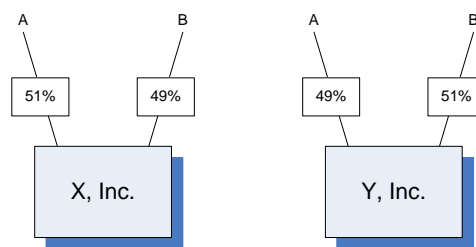
37



• A controls B & C

### Combined Reporting Issues

38

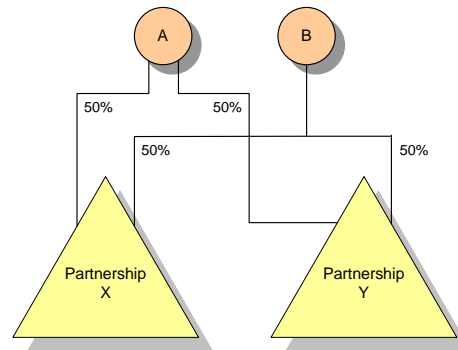


See Comp. Rule 3.590(b)(1) ("Affiliated group--Entities in which a controlling interest is owned by a common owner, either corporate or noncorporate, or by one or more of the member entities.")

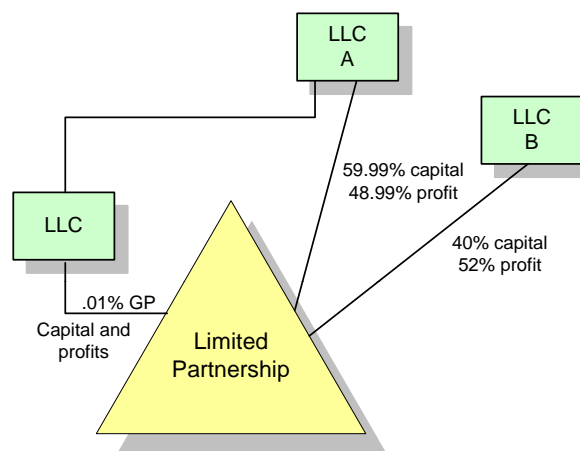
Is this "one or more entities in which" more than 50% is "owned by a common owner or owners"?

Comp. Prop. Rule 3.590(b)(4)(B)(vii)

- (vii) Individual A and Individual B each owns 50% of Partnership X. Individual A and Individual B each also owns 50% of Partnership Y. Individual A and Individual B are not husband and wife. Since neither individual owns more than 50% of each partnership, neither individual has a controlling interest in the partnerships.



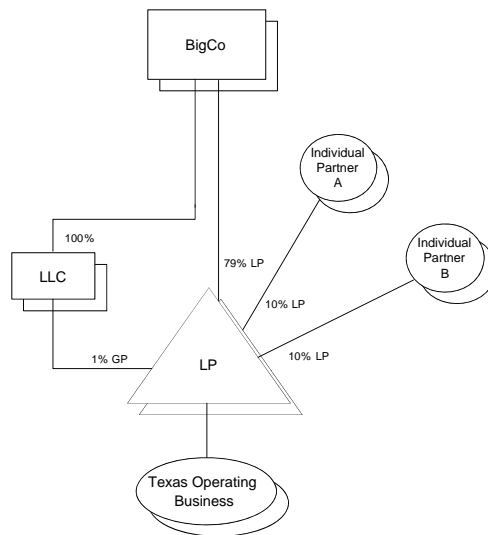
### Partnership Capital or Profits Interest



- See Comp. Rule 3.590(b)(4)(F) (" If an entity is a member of more than one affiliated group, the entity is treated as a member of the affiliated group (or part thereof) with respect to which it has a unitary relationship. If the entity has a unitary relationship with more than one of those affiliated groups, it shall elect to be treated as a member of only one group. The election shall remain in effect until the unitary business relationship between the entity and the other members ceases, or unless revoked with approval of the comptroller.").

**Selected Additional Limited  
Partnerships and Limited Liability  
Company Issues**

Minority Interest Owners and Calculation of Total Revenue for Combined Report Purposes



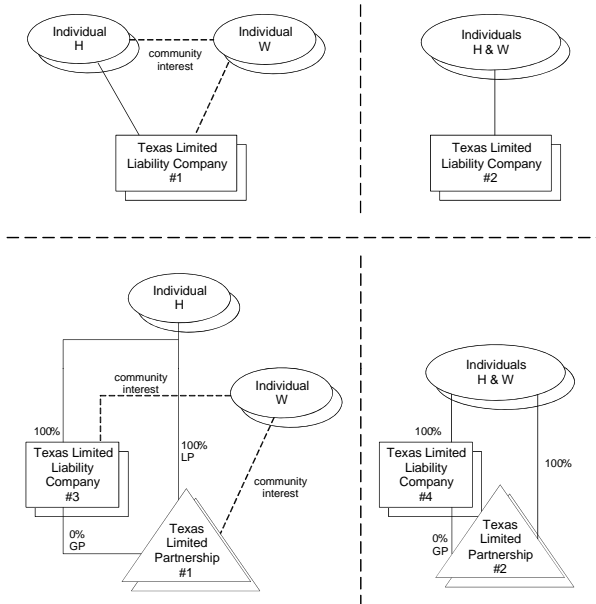
**Federal Income Tax Considerations**

- L.P. should be treated as a partnership unless corporate treatment elected. (Treas. Reg. §301.7701-3.)
- LLC should be disregarded unless corporate treatment elected. (Treas. Reg. §301.7701-3.)

**Texas Margin Tax Considerations**

- Do LP, LLC and BigCo comprise a combined group?
  - a) §171.1014(a) ("Taxable entities" that are part of an affiliated group engaged in a unitary business are required to file a combined group report.); see also Comp. Rule 3.590(b)(2) ("Combined group--Taxable entities that are part of an affiliated group engaged in a unitary business and that are required to file a combined group report under Tax Code, §171.1014.")
  - b) Affiliated group: > 50% test (§§171.0001(1); 171.0001(8)); see Comp. Rule 3.590(b)(1) ("Affiliated group--Entities in which a controlling interest is owned by a common owner, either corporate or noncorporate, or by one or more of the member entities.")
  - c) Unitary business?
  - d) If LP, LLC and BigCo comprise a combined group, how much of L.P.'s revenues are includable in the total revenues of the combined group?

SELECTED COMMUNITY PROPERTY CONSIDERATIONS  
COMPARE



**Federal Income Tax Considerations**

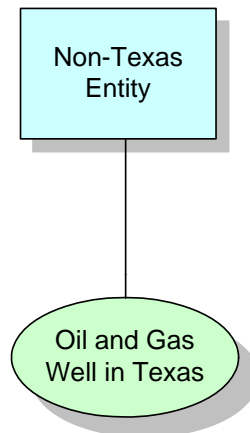
- Under Rev. Proc. 2002-69, H & W can elect to treat entities as disregarded or as partnerships for federal income tax purposes.

**Texas Margin Tax Considerations**

- Texas Limited Liability companies #1 through #4 should be "taxable entities."
- Texas Limited Partnerships #1 and #2 should be taxable entities.
- Do Texas Limited Liability Company #3 and Texas Limited Partnership #1 comprise a combined group?
- Do Texas Limited Liability Company #4 and Texas Limited Partnership #2 comprise a combined group?



### Non-Texas Entity Owning Interest in Oil and Gas Well in Texas

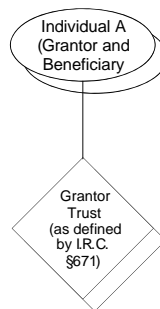


- See also Comp. FAQs, Rule 3.581, Q&A 12 ("Is a non-Texas entity that owns a royalty interest in an oil and gas well in Texas subject to the franchise tax?" Yes. A royalty interest in an oil and gas well is considered an interest in real property. Therefore a non-Texas entity that owns a royalty interest in an oil and gas well in Texas is considered to own real property in Texas and is subject to the franchise tax unless it is a non-taxable entity."); Comp. Rul. 3.582 (rules for qualifying as a passive entity).

# Trusts

Grantor Trust with Individual  
Grantor and Beneficiary

45

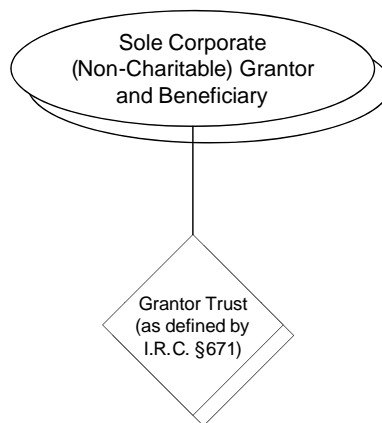
**Federal Income Tax Considerations**

- Is the trust an ordinary trust (as defined in Treas. Reg. §301.7701-4(a)) or a business trust (as defined in Treas. Reg. §301.7701-4(b))?
- Section 301.7701-4(a) of the regulations states that, in general, the term "trust" as used in the Internal Revenue Code refers to an arrangement created by will or by an inter vivos declaration whereby trustees take title to property for the purpose of protecting or conserving it for the beneficiaries under the ordinary rules applied in chancery or probate courts.
- Section 301.7701-4(b) explains that business trusts are not classified as trusts for purposes of the Code because they are not simply arrangements to protect or conserve property for the beneficiaries. Rather, business trusts generally are created by the beneficiaries simply as a device to carry on a profit-making business which normally would have been carried on through business organizations that are classified as corporations or partnerships under the Internal Revenue Code. Consequently, business trusts are classified by reference to the principles set forth in sections 301.7701-2 and 301.7701-3.
- If entity is a trust (other than a business trust) grantor treated as owner of trust and grantor includes income and deductions of trust. (I.R.C. §671; Treas. Reg. § 1.671-1, 1.671-2.)

**Texas Margin Tax Considerations**

- Entity is not a taxable entity if trust is not a business trust. (§171.0002(c)(1) ("Taxable entity" does not include an entity that is . . . A grantor trust as defined by Sections 671 and 7701(a)(30)(E), Internal Revenue Code, all of the grantors and beneficiaries of which are natural persons or charitable entities as described in Section 501(c)(3), Internal Revenue Code, excluding a trust taxable as a business entity pursuant to Treasury Regulation Section 301.7701-4(b).").

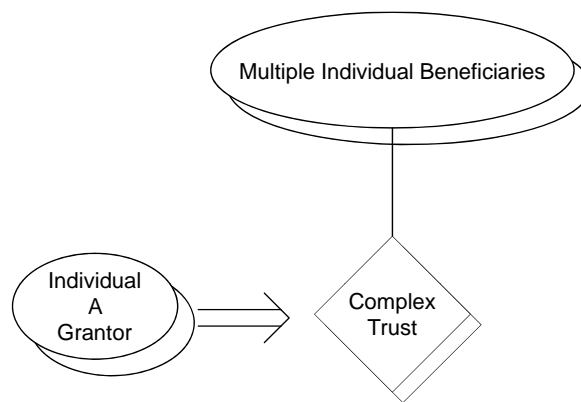
Grantor Trust with Sole Corporate  
Grantor and Beneficiary



**Texas Margin Tax Considerations**

- Should be a taxable entity because grantor and beneficiary are not natural persons.
- Is the trust a passive entity?

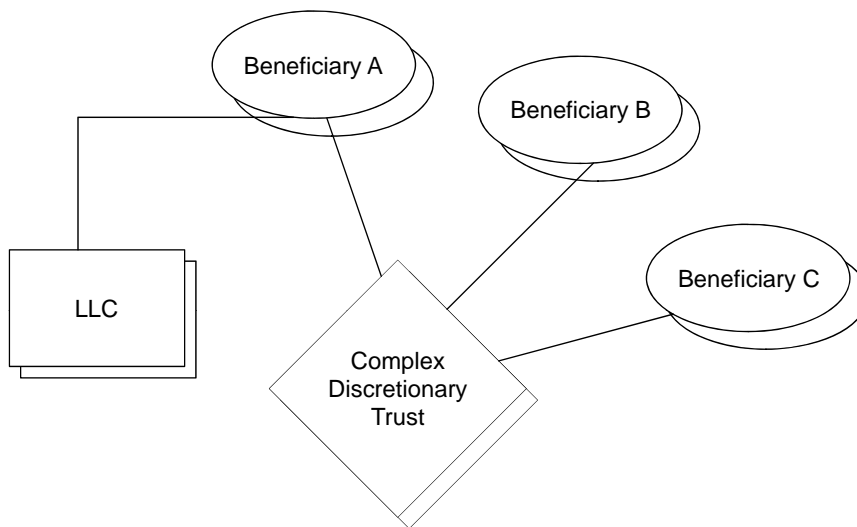
Complex Trust with Individual Grantor and  
Multiple Individual Beneficiaries



**Texas Margin Tax Considerations**

- Is the complex trust a taxable entity? See §171.0002(a) ("Except as otherwise provided by this section, 'taxable entity' means a partnership, limited liability partnership, corporation, banking corporation, savings and loan association, limited liability company, business trust, professional association, business association, joint venture, joint stock company, holding company, or other legal entity."); see also Comp. FAQs, Rule 3.581, Q&A 15 ("Are trusts subject to the franchise tax? Yes; unless the trust falls under one of the statutory exclusions in TTC 171.0002(c) as a non-taxable entity, it is a taxable entity.").
- Is the trust a passive entity? Cf. Comp. Rule 3.582(c).

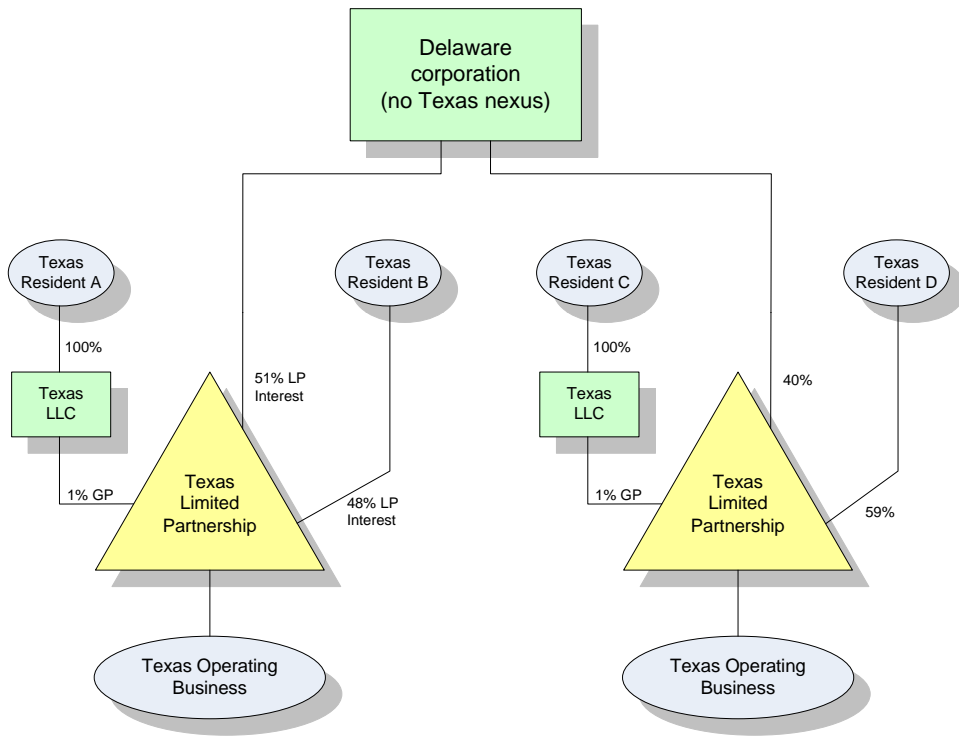
## Complex Discretionary Trust Example



- Does Beneficiary A have a "controlling interest" in the trust and in LLC? Cf. Comp. Rule 3.590(b)(4)(A)(ii) ("controlling interest means ... for a partnership, association, trust or other entity other than a limited liability company, more than 50%, owned directly or indirectly, of the capital, profits, or beneficial interest in the partnership, association, trust, or other entity"); Comp. Rule 3.590(b)(4)(A)(iii) ("controlling interest means ... for a limited liability company, either more than 50%, owned directly or indirectly, of the total membership interest of the limited liability company or more than 50%, owned directly or indirectly, of the beneficial ownership interest in the membership interest of the limited liability company").

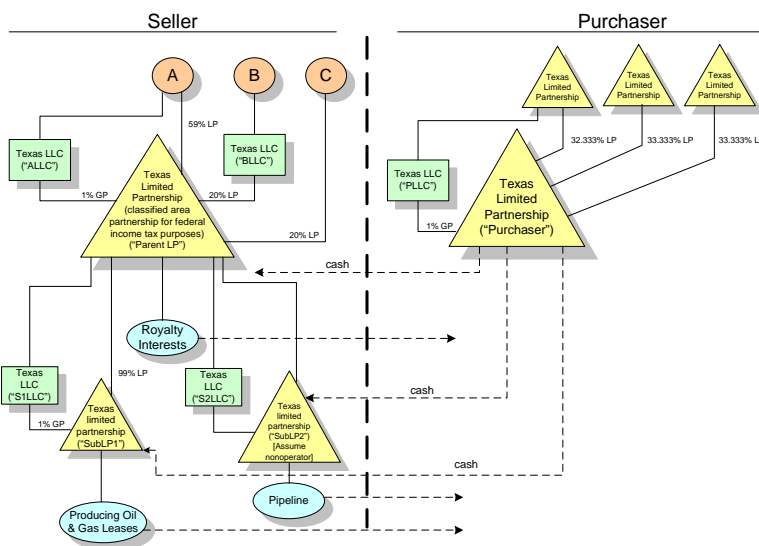
# Passive Entities

COMBINED GROUP EXAMPLE





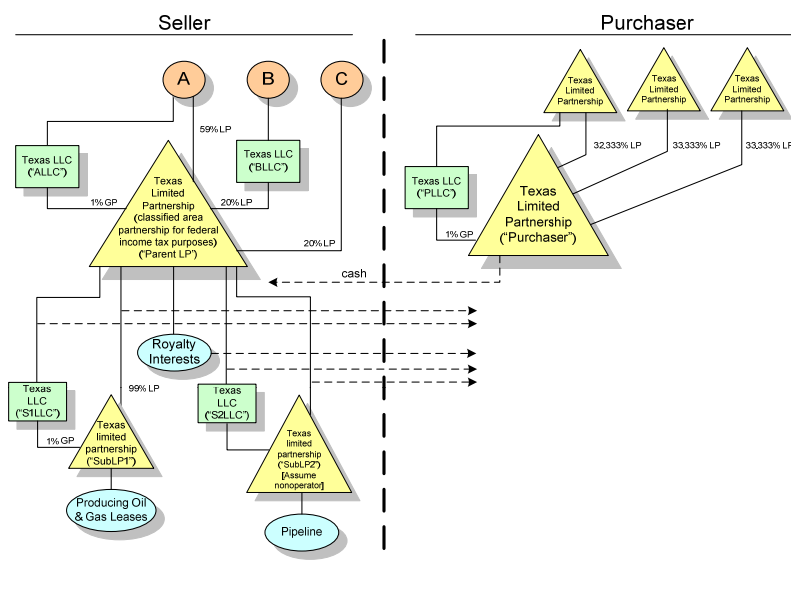
**Oil and Gas Example  
(Sale of Assets)**



- For federal income tax purposes, who is the taxpayer? See Rev. Rul. 2004-77
- For Texas margin tax purposes, is Parent LP a passive entity? See Tex. Tax Code Ann. § 171.0003(a) (“An entity is a passive entity only if: (1) the entity is a general or limited partnership or a trust, other than a business trust; (2) during the period on which margin is based, the entity’s federal gross income consists of at least 90 percent of the following income: . . . (C) capital gains from the sale of real property . . . and (3) the entity does not receive more than 10 percent of its federal gross income from conducting an active trade or business.”).

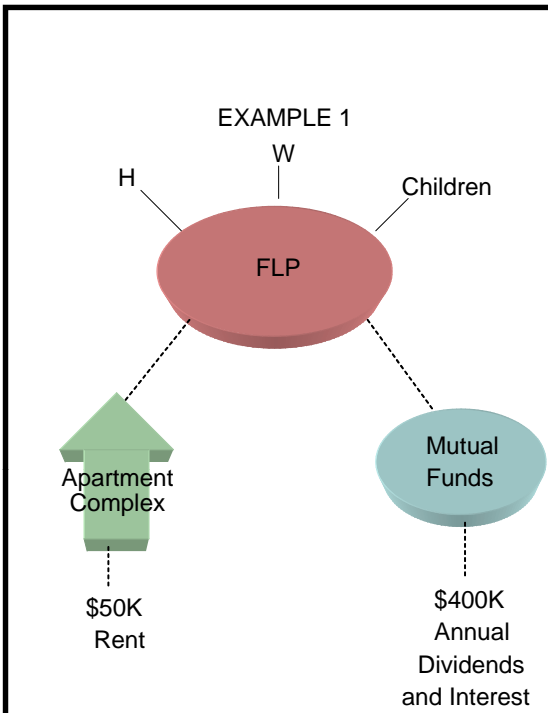
- See Comp. Rul 3.582(c)(1) (“to qualify as a passive entity, the entity must be one of the following for the entire period on which the tax is based: (A) general partnership; (B) limited partnership; (C) limited liability partnership; or (D) trust, other than a business trust;”)
- See Comp. Rule 3.582(c)(2) (“at least 90% of an entity’s federal gross income for the period on which margin is based must consist of the following sources of income: (C) net capital gains from the sale of real property. . . (D) royalties from mineral properties, bonuses from mineral properties, delay rental income from mineral properties and income from other non-operating mineral interests including non-operating working interests not described in subsection (d)(2) of this section.”)
- See Comp. Rule 3.582(f)(1) (“Activities that do not constitute an active trade or business: (1) Ownership of a royalty interest of a non-operating working interest in mineral rights.”)
- See also Comp. FAQs, Rule 3.581, Q&A 12 (“Is a non-Texas entity that owns a royalty interest in an oil and gas well in Texas subject to the franchise tax?” Yes. A royalty interest in an oil and gas well is considered an interest in real property. Therefore a non-Texas entity that owns a royalty interest in an oil and gas well in Texas is considered to own real property in Texas and is subject to the franchise tax unless it is a non-taxable entity.”); Comp. Rul. 3.582 (rules for qualifying as a passive entity).
- See also Comp. FAQs, Rule 3.590, Q & A 4 (“Can a passive entity be part of a combined group? No, a passive entity cannot be included in a combined group; however, a member of a combined group will include in total revenue the pro rata share of net income from a passive entity to the extent it was not included in the margin of another taxable entity.”).

**Oil and Gas Example  
(Sale of Interests)**



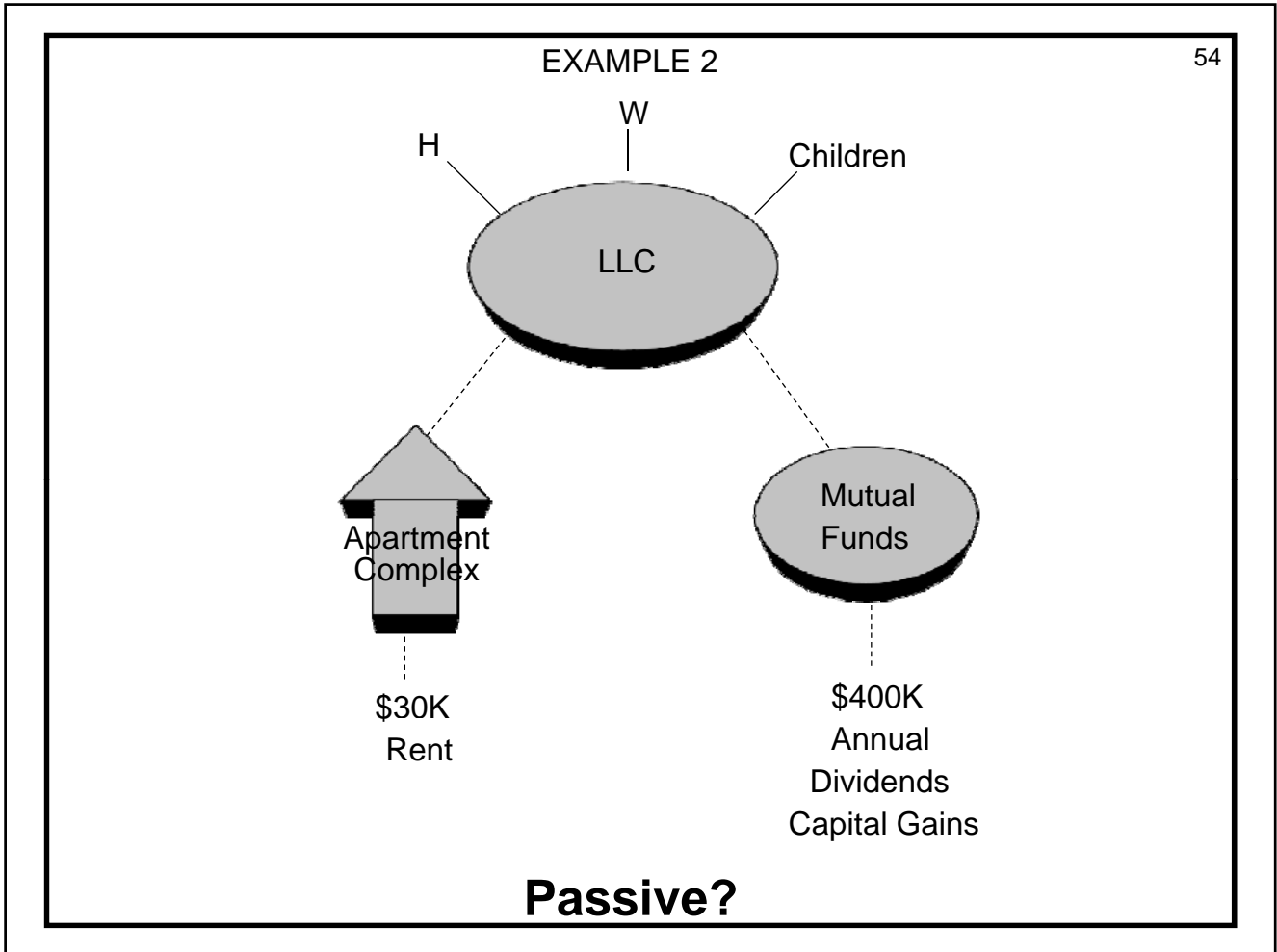
- For federal income tax purposes, who is the taxpayer? See Rev. Rul. 2004-77
- For Texas margin tax purposes, is SubLP1 a passive entity? SubLP2? ParentLP? See Tex. Tax Code Ann. § 171.0003(a) ("An entity is a passive entity only if: (1) the entity is a general or limited partnership or a trust, other than a business trust; (2) during the period on which margin is based, the entity's federal gross income consists of at least 90 percent of the following income: . . . (C) capital gains from the sale of real property . . . and (3) the entity does not receive more than 10 percent of its federal gross income from conducting an active trade or business.").

- See Comp. Rul 3.582(c)(1) ("to qualify as a passive entity, the entity must be one of the following for the entire period on which the tax is based: (A) general partnership; (B) limited partnership; (C) limited liability partnership; or (D) trust, other than a business trust;")
- See Comp. Rule 3.582(c)(2) ("at least 90% of an entity's federal gross income for the period on which margin is based must consist of the following sources of income:
  - (C) net capital gains from the sale of real property. . .
  - (D) royalties from mineral properties, bonuses from mineral properties, delay rental income from mineral properties and income from other non-operating mineral interests including non-operating working interests not described in subsection (d)(2) of this section.")
- See Comp. Rule 3.582(b)(10) (definition of "Security")
- (A) an instrument defined by Internal Revenue Code, §475(c)(2), where the holder of the instrument has a non-controlling interest in the issuer/investee;
- (B) an instrument described by Internal Revenue Code, §475(e)(2)(B), (C), (D);
- (C) an interest in a partnership where the investor has a non-controlling interest in the investee;
- (D) an interest in a limited liability company where the investor has a non-controlling interest in the investee; or
- (E) a beneficial interest in a trust where the investor has a non-controlling interest in the investee.

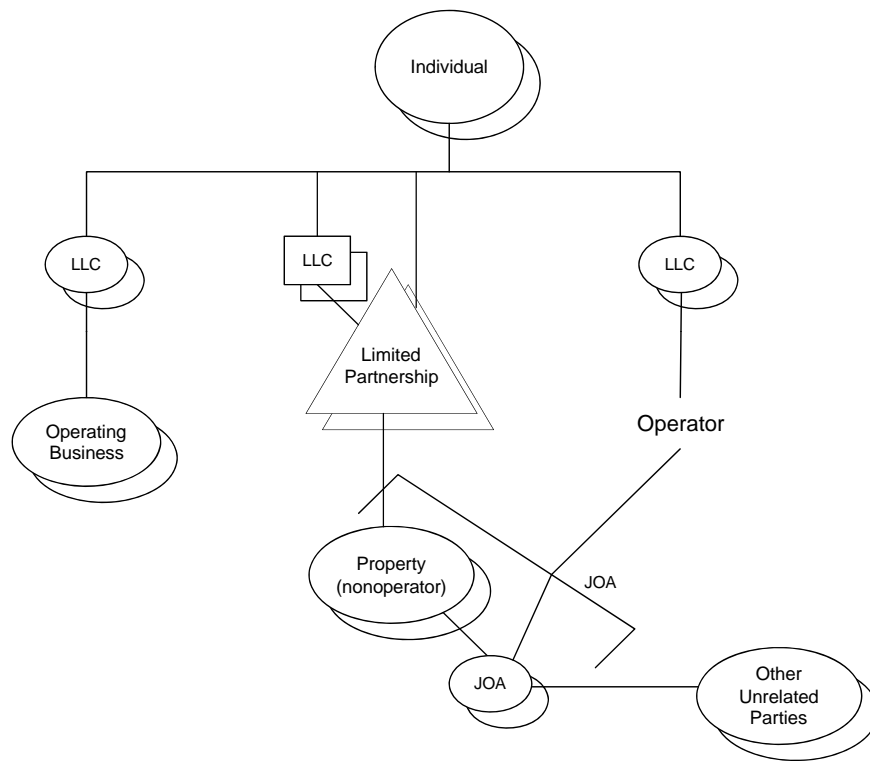


~~Passive~~ : 11% of Revenues is from rent

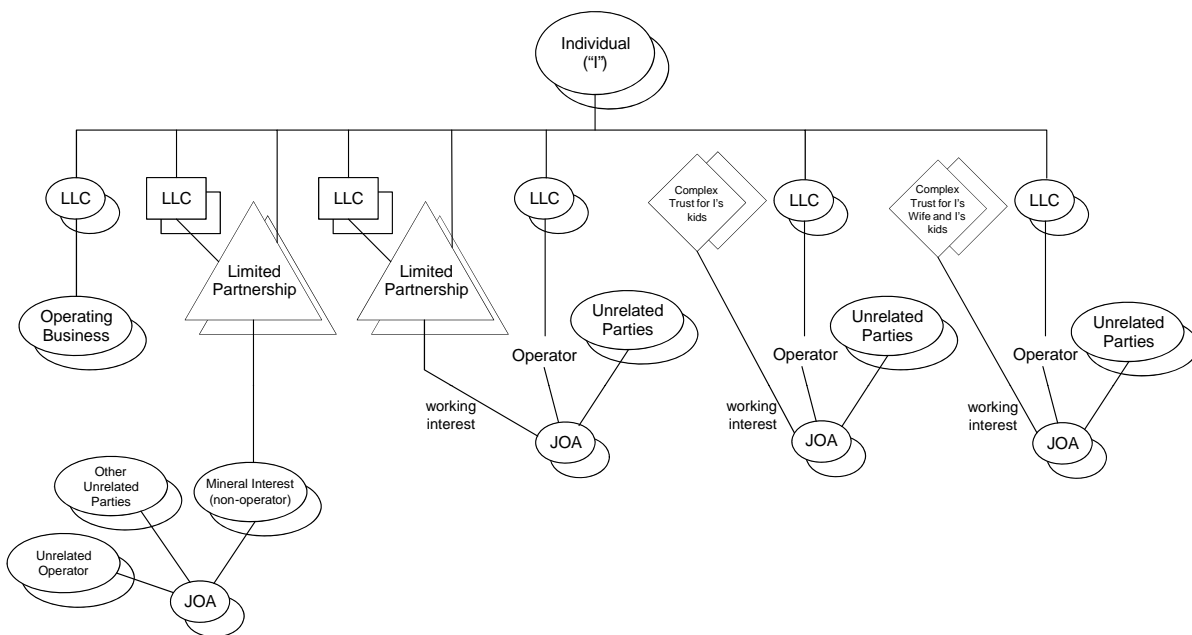
- Tex. Tax Code Ann. § 171.0003(a) (“An entity is a passive entity only if: (1) the entity is a general or limited partnership or a trust, other than a business trust; (2) during the period on which margin is based, the entity’s federal gross income consists of at least 90 percent of the following income: (A) dividends, interest, foreign currency exchange gain, periodic and nonperiodic payments with respect to notional principal contracts, option premiums, cash settlement or termination payments with respect to a financial instrument, and income from a limited liability company; (B) distributive shares of partnership income to the extent that those distributive shares of income are greater than zero; (C) capital gains from the sale of real property, gains from the sale of commodities traded on a commodities exchange, and gains from the sale of securities; and (D) royalties, bonuses, or delay rental income from mineral properties and income from other nonoperating mineral interests; and (3) the entity does not receive more than 10 percent of its federal gross income from conducting an active trade or business.”); Tex. Tax Code Ann. § 171.0003(b) (“The income described by Subsection (a)(2) does not include: (1) rent; or (2) income received by a nonoperator from mineral properties under a joint operating agreement if the nonoperator is a member of an affiliated group and another member of that group is the operator under the same joint operating agreement.”).
- Comp. Rule 3.582(c) (“Qualification as a passive entity: (1) to qualify as a passive entity, the entity must be one of the following for the entire period on which the tax is based: (A) general partnership; (B) limited partnership; (C) limited liability partnership; or (D) trust, other than a business trust; and (2) at least 90% of an entity’s federal gross income for the period on which margin is based must consist of the following sources of income: (A) dividends, interest, foreign currency exchange gain, periodic and nonperiodic payments with respect to notional principal contracts, option premiums, cash settlements or termination payments with respect to a financial instrument, and income from a limited liability company; (B) distributive shares of partnership income to the extent that those distributive shares of income are greater than zero; (C) net capital gains from the sale of real property, net gains from the sale of commodities traded on a commodities exchange, and net gains from the sale of securities; and (D) royalties from mineral properties, bonuses from mineral properties, delay rental income from mineral properties and income from other nonoperating mineral interests including nonoperating working interests not described in subsection (d)(2) of this section.”); Comp. Rule 3.582(d) (“The income described by subsection (c)(2) of this section, does not include: (1) rent; or (2) income received by a nonoperator from mineral properties under a joint operating agreement if the nonoperator is a member of an affiliated group and another member of that group is the operator under the same joint operating agreement.”);
- Comp. FAQs, Rule 3.582, Q&A 1 (“An entity is considered passive if it is a general, limited or limited liability partnership, or a non-business trust and the entity’s federal gross income during the period on which margin is based consists of at least 90% of the following income: dividends, interest, foreign currency exchange gain, periodic and nonperiodic payments with respect to notational principal contracts, option premiums, cash settlement or termination payments with respect to a financial instrument, and income from a limited liability company; distributive shares of partnership income to the extent that those distributive shares of income are greater than zero; net capital gains from the sale of real property, net gains from the sale of commodities traded on a commodities exchange, and net gains from the sale of securities; and royalties from mineral properties, bonuses from mineral properties, delay rental income from mineral properties and income from other non-operating mineral interests. \* \* \* Rent is not considered passive income for the Texas franchise tax.”).



EXAMPLE 3



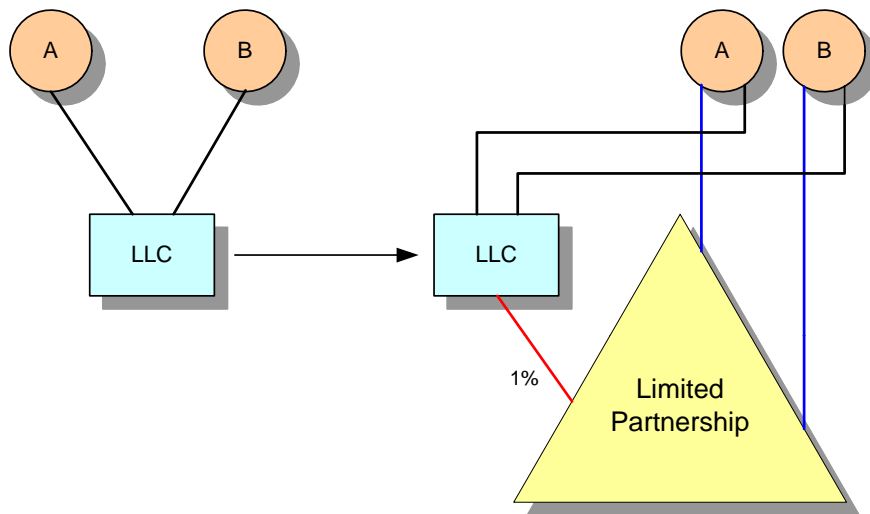
EXAMPLE 4



*Cf. Comp. Rule 3.582(d)(2)* ("passive income does not include ... income received by a nonoperator from mineral properties under a joint operating agreement if the nonoperator is a member of an affiliated group and another member of that group is the operator under the same joint operating agreement); *Comp. Rule 3.590(B)(4)(A)(ii)* ("controlling interest means ... for a partnership, association, trust or other entity other than a limited liability company, more than 50%, owned directly or indirectly, of the capital, profits, or beneficial interest in the partnership, association, trust, or other entity"); *Comp. Rule 3.590(b)(4)(C)* (In addition to the foregoing tests, the comptroller may consider any other circumstance that tends to demonstrate that the more than 50% direct or indirect common ownership test was met or was not met.)

### Planning for Conversion to a Limited Partnership

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- See also Comp. FAQs, Rule 3.582, Q & A 5 ("If an LLC converts to a limited partnership can the entity qualify for passive if it meets the 90% passive income test? To qualify as a passive entity, the entity must be a partnership or trust, other than a business trust, for the entire accounting period on which the tax is based. The entity may not qualify as passive for the accounting period during which the conversion occurs even if it meets the 90% income test. The entity may qualify as passive for subsequent reports.")

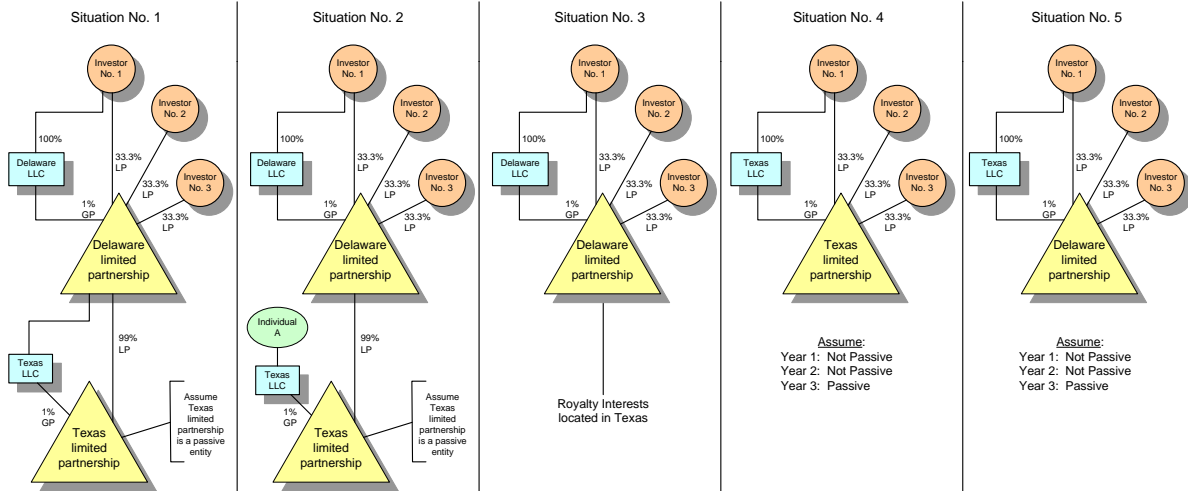
## Proposed Comp. Rule 3.581(g)

- (g) Reporting requirement for a passive entity. If an entity meets all of the qualifications of a passive entity for the reporting period, the entity will owe no tax[; however, the entity must file information to verify that the passive entity qualifications are met each year].

(1) If a passive entity has notified the comptroller or the secretary of state that it is doing business in Texas, the passive entity must file an information report to verify that the passive entity qualifications are met each year. For each report year that an entity qualifies as passive, an Ownership Information Report is not required.

(2) If a passive entity has not notified the comptroller or the secretary of state that it is doing business in Texas, the passive entity must notify the comptroller in writing only when the entity no longer qualifies as a nontaxable entity.

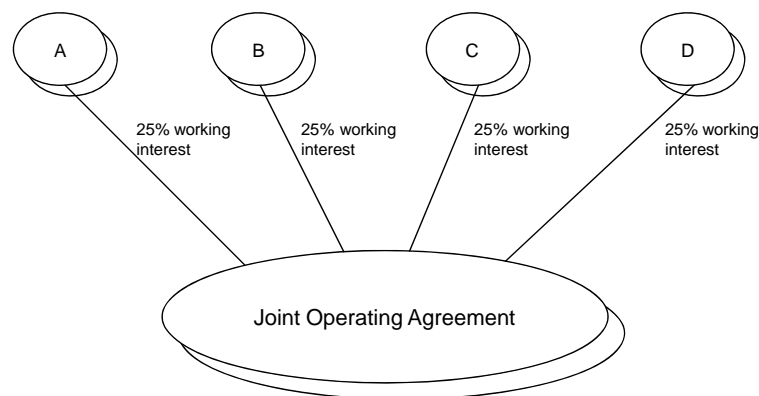
(3) If a passive entity receives notification in writing from the comptroller asking if the entity is taxable, the entity must reply to the comptroller within 30 days of the notice.





# **Joint Operating Arrangements**

### Joint Operating Agreement



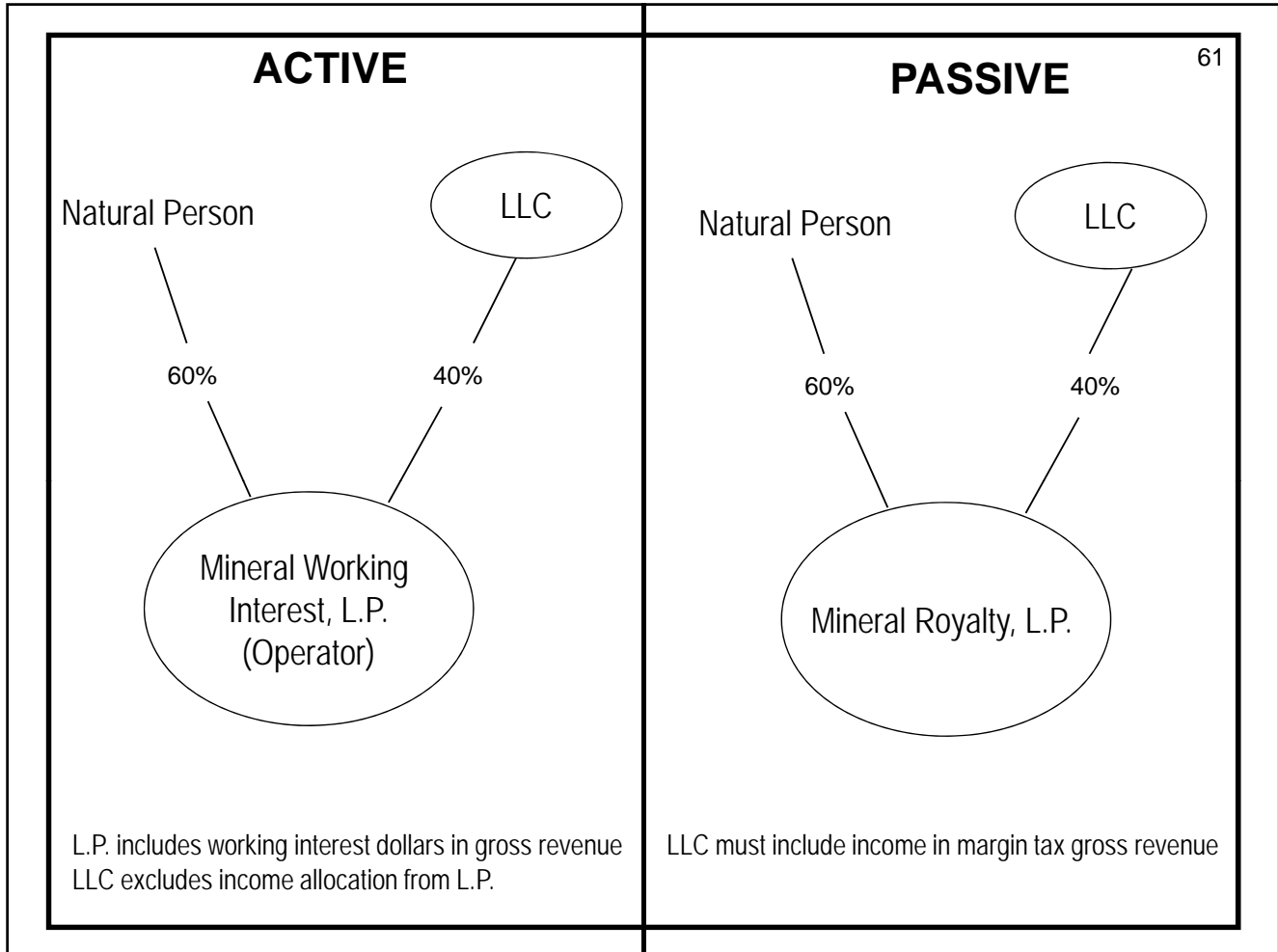
#### Federal Income Tax Considerations

- A, B, C and D can elect out of application of partnership treatment under Subchapter K if certain conditions are met, including:
  - 1) The participants are involved in the joint production, extraction, or use of property; and
  - 2) The participants own the property as co-owners, either in fee or under lease or other form of contract granting exclusive operating rights, and
  - 3) The participants reserve the right separately to take in kind or dispose of their shares of any property produced, extracted, or used, and
  - 4) The participants do not jointly sell services or the property produced or extracted, although each separate participant may delegate authority to sell his share of the property produced or extracted for the time being for his account, but not for a period of time in excess of the minimum needs of the industry, and in no event for more than one year.

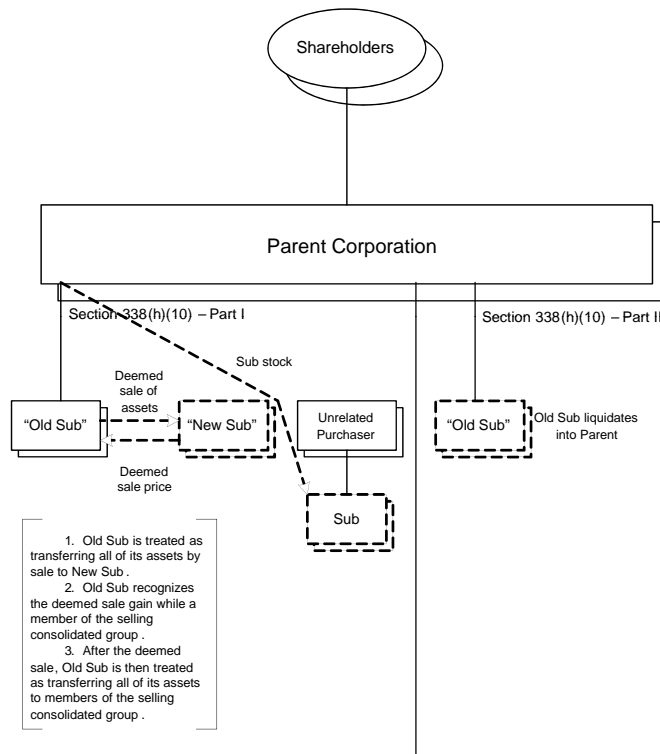
Treas. Reg. § 1.761-2(a)(3)

#### Texas Margin Tax Considerations

- §171.0002(a)(Joint venture does not include a joint operating arrangement meeting the requirements of Treas. Reg. §1.761-2(a)(3) that elects out of federal partnership treatment under I.R.C. §761(a)); Comp. Rule 3.581(c)(10) ("Taxable entities include ... joint ventures, except joint operating or co-ownership arrangements meeting the requirements of Treasury Regulation 1.761-2(a)(3) that elect out of federal partnership treatment as provided by Internal Revenue Code, §761(a).").

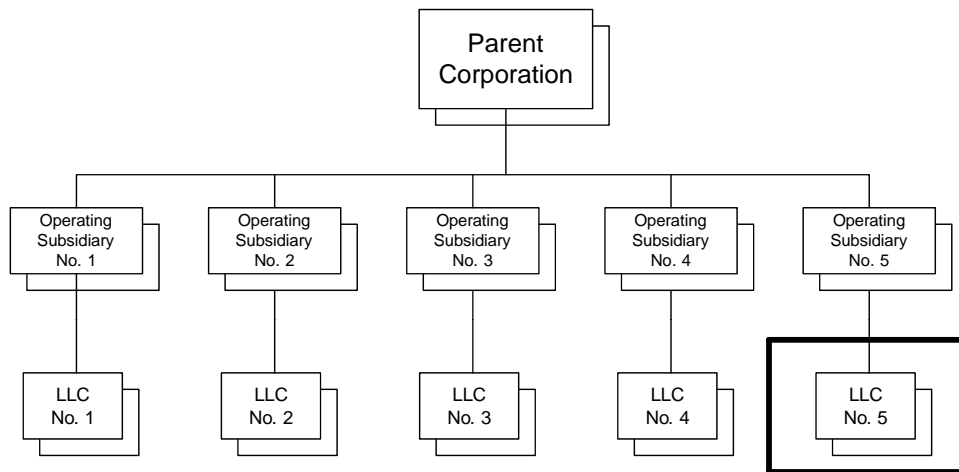


### Cash Purchase of Sub Stock With Section 338(h)(10) Election



# **Joint & Several Liability**

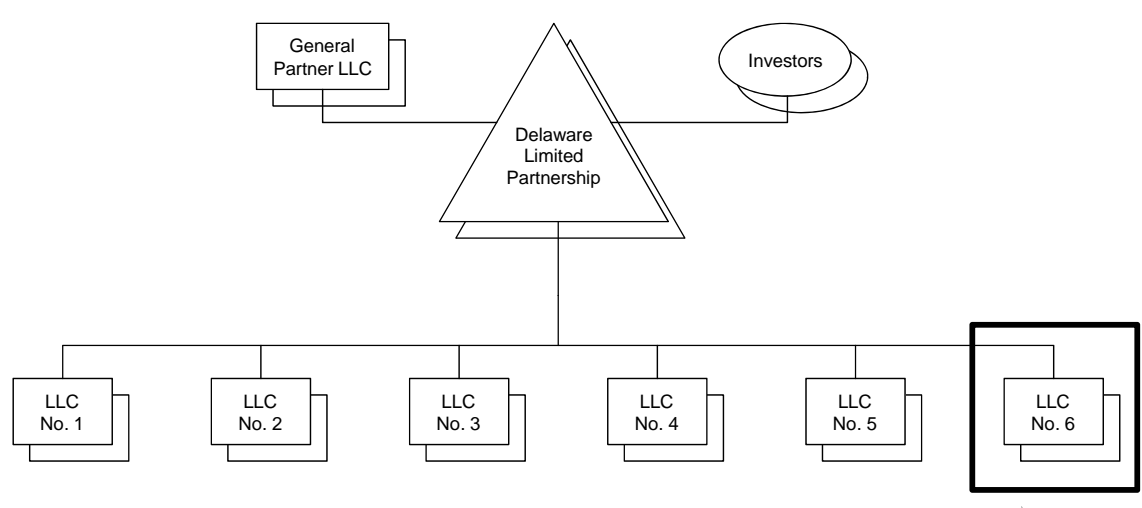
JOINT & SEVERAL LIABILITY – ILLUSTRATION NO. 1



Assume sale of 100% of interests in LLC No. 5 or all of assets in LLC No. 5

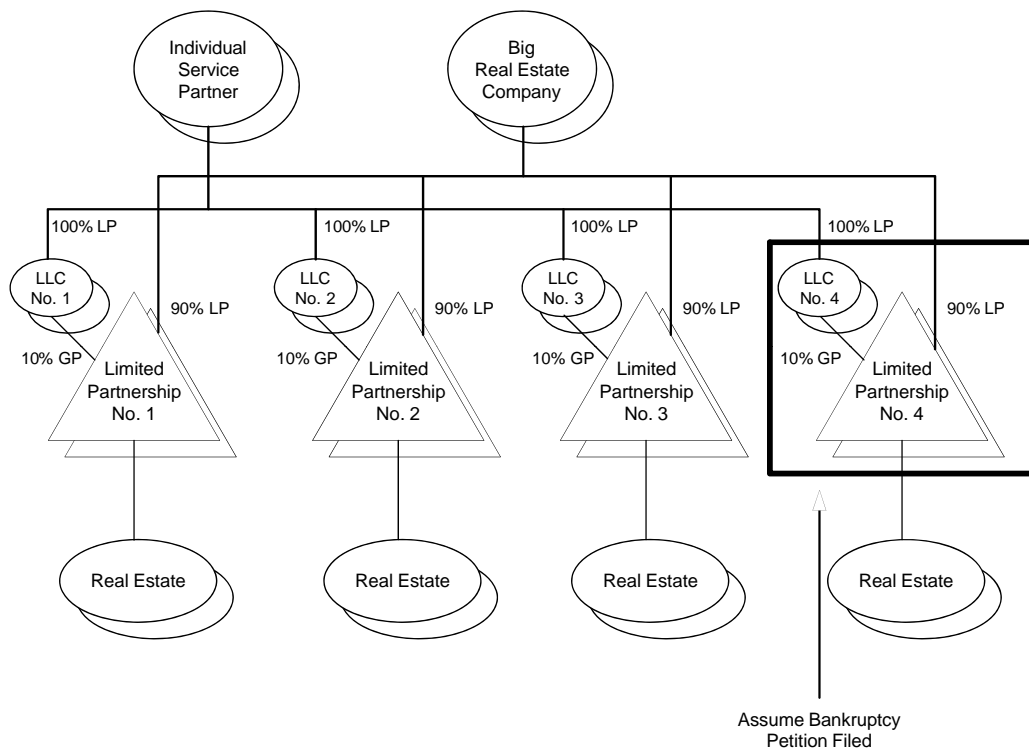
§171.1014(j): Each member of the combined group shall be jointly and severally liable for the tax of the combined group.

JOINT & SEVERAL LIABILITY – ILLUSTRATION NO. 2



Assume sale of 100% of interests in LLC No. 6 (or, alternatively, assume LLC No. 6 files for bankruptcy).

JOINT & SEVERAL LIABILITY – ILLUSTRATION NO. 3





# MAJOR APPORTIONMENT ISSUES FOR TRANSACTION ATTORNEYS

## BASIC FORMULA

COMBINED GROUP  
TAX BASE

x

TEXAS GROSS  
RECEIPTS

---

TOTAL GROSS  
RECEIPTS  
(EXCLUDING FOREIGN)

## MAJOR SOURCES OF TEXAS RECEIPTS

Services performed in Texas

Texas real estate revenue / sale or lease

Texas mineral revenue

TPP delivered in Texas to purchaser / lessee  
(Throwback rule deleted)

Dividends / interest look to location of Payor

**See 34 TAC 3.591**

## **Selected Statutory References**

### Transacting Business in Texas for Purposes of Determining Whether Foreign Entity Must Register to Transact Business in Texas

**Tex. Bus. Org. Code Ann. § 9.001(a) (Vernon 2008)** ("To transact business in this state, a foreign entity must register under this chapter if the entity: (1) is a foreign corporation, foreign limited partnership, foreign limited liability company, foreign business trust, foreign real estate investment trust, foreign cooperative, foreign public or private limited company, or another foreign entity, the formation of which, if formed in this state, would require the filing under Chapter 3 of a certificate of formation; or (2) affords limited liability under the law of its jurisdiction of formation for any owner or member.").

**Tex. Bus. Org. Code Ann § 9.001(b) (Vernon 2008)** ("A foreign entity described by Subsection (a) must maintain the entity's registration while transacting business in this state.").

**Tex. Bus. Org. Code Ann. § 9.251 (Vernon 2008)** ("Activities Not Constituting Transacting Business in This State) For purposes of this chapter, activities that do not constitute transaction of business in this state include: (1) maintaining or defending an action or suit or an administrative or arbitration proceeding, or effecting the settlement of: (A) such an action, suit, or proceeding; or (B) a claim or dispute to which the entity is a party; (2) holding a meeting of the entity's managerial officials, owners, or members or carrying on another activity concerning the entity's internal affairs; (3) maintaining a bank account; (4) maintaining an office or agency for: (A) transferring, exchanging, or registering securities the entity issues; or (B) appointing or maintaining a trustee or depository related to the entity's securities; (5) voting the interest of an entity the foreign entity has acquired; (6) effecting a sale through an independent contractor; (7) creating, as borrower or lender, or acquiring indebtedness or a mortgage or other security interest in real or personal property; (8) securing or collecting a debt due the entity or enforcing a right in property that secures a debt due the entity; (9) transacting business in interstate commerce; (10) conducting an isolated transaction that: (A) is completed within a period of 30 days; and (B) is not in the course of a number of repeated, similar transactions; (11) in a case that does not involve an activity that would constitute the transaction of business in this state if the activity were one of a foreign entity acting in its own right: (A) exercising a power of executor or administrator of the estate of a nonresident decedent under ancillary letters issued by a court of this state; or (B) exercising a power of a trustee under the will of a nonresident decedent, or under a trust created by one or more nonresidents of this state, or by one or more foreign entities; (12) regarding a debt secured by a mortgage or lien on real or personal property in this state: (A) acquiring the debt in a transaction outside this state or in interstate commerce; (B) collecting or adjusting a principal or interest payment on the debt; (C) enforcing or adjusting a right or property securing the debt; (D) taking an action necessary to preserve and protect the interest of the mortgagee in the security; or (E) engaging in any combination of transactions described by this subdivision; (13) investing in or acquiring, in a transaction outside of this state, a royalty or other nonoperating mineral interest; or (14) the execution of a division order, contract of sale, or other instrument incidental to ownership of a nonoperating mineral interest.").

**Tex. Bus. Org. Code Ann. § 9.252 (Vernon 2008)** ("Other Activities The list provided by Section [9.251](#) is not exclusive of activities that do not constitute transacting business in this state for the purposes of this code.").

**Cf. Tex. Bus. Org. Code § 9.054(a) (Vernon 2008)** ("The secretary of state may collect from a foreign filing entity a late filing fee if the entity has transacted business in this state for more than 90 days without registering under this chapter. The secretary may condition the effectiveness of a registration after the 90-day period on the payment of the late filing fee.").

**Cf. Tex. Bus. Org. Code § 9.054(b) (Vernon 2008)** ("The amount of the late filing fee is an amount equal to the product of the amount of the registration fee for the foreign filing entity multiplied by the number of calendar years that the entity transacted business in this state without being registered. For purposes of computing the fee, a partial calendar year is counted as a full calendar year.").

**Nexus for Texas Franchise Tax Purposes**

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**Tex. Tax Code Ann. § 171.001 (Vernon 2008).** ("Tax Imposed (a) A franchise tax is imposed on each taxable entity that does business in this state or that is chartered or organized in this state. (b) The tax imposed under this chapter extends to the limits of the United States Constitution and the federal law adopted under the United States Constitution. (c) The tax imposed under this section or Section 171.0011 is not imposed on an entity if, during the period on which the report is based, the entity qualifies as a passive entity as defined by Section 171.0003.").

**Unitary Business**

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**Tex. Tax Code Ann. § 171.0001(17) (Vernon 2008)** ("Unitary business" means a single economic enterprise that is made up of separate parts of a single entity or of a commonly controlled group of entities that are sufficiently interdependent, integrated, and interrelated through their activities so as to provide a synergy and mutual benefit that produces a sharing or exchange of value among them and a significant flow of value to the separate parts. In determining whether a unitary business exists, the comptroller shall consider any relevant factor, including whether: (A) the activities of the group members are in the same general line, such as manufacturing, wholesaling, retailing of tangible personal property, insurance, transportation, or finance; (B) the activities of the group members are steps in a vertically structured enterprise or process, such as the steps involved in the production of natural resources, including exploration, mining, refining, and marketing; or (C) the members are functionally integrated through the exercise of strong centralized management, such as authority over purchasing, financing, product line, personnel, and marketing.").

# **Selected Texas Administrative Code References**

**Nexus for Texas Franchise Tax Purposes**

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**34 Tex. Admin. Code § 3.586:**

- (a) Effective date. The provisions of this section apply to franchise tax reports originally due on or after January 1, 2008.
- (b) A taxable entity is subject to franchise tax in this state when it has sufficient contact with this state to be taxed without violating the United States Constitution.
- (c) Some specific activities which subject a taxable entity to Texas franchise tax include, but are not limited to, the following:
  - (1) advertising: entering Texas to purchase, place, or display advertising when the advertising is for the benefit of another and in the ordinary course of business (e.g., the foreign taxable entity makes signs and brings them into Texas, sets them up, and maintains them);
  - (2) consignments: having consigned goods in Texas;
  - (3) contracting: performance of a contract in Texas regardless of whether the taxable entity brings its own employees into the state, hires local labor, or subcontracts with another;
  - (4) delivering: delivering into Texas items it has sold;
  - (5) employees or representatives: having employees or representatives in Texas doing the business of the taxable entity;
  - (6) federal enclaves: doing business in any area within Texas, even if the area is leased by, owned by, ceded to, or under the control of the federal government;
  - (7) franchisors: entering into one or more contracts with persons, corporations, or other business entities located in Texas, by which:
    - (A) the franchisee is granted the right to engage in the business of offering, selling, or distributing goods or services under a marketing plan or system prescribed in substantial part by the franchisor; and
    - (B) the operation of a franchisee's business pursuant to such plan is substantially associated with the franchisor's trademark, service mark, trade name, logotype, advertising, or other commercial symbol designating the franchisor or its affiliate.
  - (8) holding companies: maintaining a place of business in Texas or managing, directing, and/or performing services in Texas for subsidiaries or investee entities;
  - (9) inventory: having an inventory in Texas or having spot inventory for the convenient delivery to customers, even if the bulk of orders are filled from out of state;
  - (10) leasing: leasing tangible personal property which is used in Texas;
  - (11) loan production activities: soliciting sales contracts or loans, gathering financial data, making credit checks, collecting accounts, repossessing property or performing other financial activities in Texas through employees, independent contractors, or agents, regardless of whether they reside in Texas;



**Nexus for Texas Franchise Tax Purposes, cont.**

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(12) partners:

- (A) acting as a general partner in a general partnership which is doing business in Texas;
- (B) acting as a general partner in a limited partnership which is doing business in Texas (a foreign taxable entity which is a limited partner in a limited partnership is not doing business in Texas, if that is the limited partner's only connection with Texas);

(13) place of business: maintaining a place of business in Texas;

(14) processing: assembling, processing, manufacturing, or storing goods in Texas;

(15) real estate: holding, acquiring, leasing, or disposing of any property located in Texas;

(16) services, including, but not limited to the following:

- (A) providing any service in Texas, regardless of whether the employees, independent contractors, agents, or other representatives performing the services reside in Texas;
- (B) maintaining or repairing property located in Texas whether under warranty or by separate contract;
- (C) installing, erecting, or modifying property in Texas;
- (D) conducting training classes, seminars or lectures in Texas;
- (E) providing any kind of technical assistance in Texas, including, but not limited to, engineering services; or
- (F) investigating, handling or otherwise assisting in resolving customer complaints in Texas.

(17) shipment: sending materials to Texas to be stored awaiting orders for their shipment;

(18) shows and performances: the staging of or participating in shows, theatrical performances, sporting events, or other events within Texas;

(19) solicitation: having employees, independent contractors, agents, or other representatives in Texas, regardless of whether they reside in Texas, to promote or induce sales of the foreign taxable entity's goods or services;

(20) telephone listing: having a telephone number that is answered in Texas; or

(21) transportation:

- (A) carrying passengers or freight (any personal property including oil and gas transmitted by pipeline) from one point in Texas to another point within the state, if pickup and delivery, regardless of origination or ultimate destination, occurs within Texas; or
- (B) having facilities and/or employees, independent contractors, agents, or other representatives in Texas, regardless of whether they reside in Texas;

**Nexus for Texas Franchise Tax Purposes, cont.**

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- (i) for storage, delivery, or shipment of goods;
  - (ii) for servicing, maintaining, or repair of vehicles, trailers, containers, and other equipment;
  - (iii) for coordinating and directing the transportation of passengers or freight; or
  - (iv) for doing any other business of the taxable entity.
- (d) See §3.583 of this title (relating to Margin: Exemptions) for information concerning exemption for certain trade show participants under Tax Code, §171.084.
- (e) Public Law 86-272 (15 United States Code §§381 - 384) does not apply to the franchise tax.

**Unitary Business**

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**34 Tex. Admin. Code § 3.590(b)(6):**

"Unitary business--A single economic enterprise that is made up of separate parts of a single entity or of a commonly controlled group of entities that are sufficiently interdependent, integrated, and interrelated through their activities so as to provide a synergy and mutual benefit that produces a sharing or exchange of value among them and a significant flow of value to the separate parts. In determining whether a unitary business exists, the comptroller shall consider any relevant factor, including:

(A) whether:

- (i) activities of the group members are in the same general line, such as manufacturing, wholesaling, retailing of tangible personal property, transportation, or finance;
- (ii) the activities of the group members are steps in a vertically structured enterprise or process, such as the steps involved in the production of natural resources, including exploration, mining, refining, and marketing; or
- (iii) the members are functionally integrated through the exercise of strong centralized management, such as authority over purchasing, financing, product line, personnel, and marketing.

(B) Other factors. In addition, the comptroller may consider other factors that may be applicable, including guidelines in Supreme Court decisions that presume activities are unitary. All affiliated entities are presumed to be engaged in a unitary business.

(C) New entities. When a taxable entity acquires another entity, a presumption exists for finding a unitary relationship during the first reporting period. Any party may rebut such presumption by proving that the taxable entities were not unitary. If such presumption is rebutted, then the taxable entities shall not be considered unitary as of the date of acquisition. When a taxable entity forms another taxable entity, a unitary relationship exists as of the date of formation unless the business is not unitary on a longer term basis. An acquired entity is required to file a report for the period prior to acquisition.

(D) Non-arm's-length prices. Goods or services or both are supplied at non-arm's length prices between or among entities. Existence of arm's-length pricing between entities, however, does not indicate lack of unity.

(E) Existence of benefits from joint, shared or common activity. A discount, cost-saving or other benefit can be shown to result from joint purchases, leaseholds, or other forms of joint, shared or common activities between or among entities.

(F) Relationships of joint, shared or common activity to income-producing operations. In determining whether a joint, shared, or common activity is indicative of a unitary relationship, consideration shall be given to the nature and character of the basic operations of each entity. Such consideration shall include, but not be limited to, the entity's sources of supply, its goods or services produced or sold, its labor force, and market to determine whether the joint, shared, or common activity is directly beneficial to, related to, or reasonably necessary to the income-producing activities of the unitary business.

(G) Holding entities. The tests for a unitary business established by this section apply in determining whether a holding entity is included or excluded from a unitary business."

**Selected Comptroller's  
Frequently Asked Questions**

**Unitary Business**

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**Comp. FAQs, Rule 3.590, Q&A 6** (“What does unitary business mean? A unitary business means a single economic enterprise that is made up of separate parts of a single entity or of a commonly controlled group of entities that are sufficiently interdependent, integrated, and interrelated through their activities so as to provide a synergy and mutual benefit that produces a sharing or exchange of value among them and a significant flow of value to the separate parts.”).

**Comp. FAQs, Rule 3.590, Q&A 7** (“What factors are considered in determining a unitary business? Factors to be considered in determining a unitary business include whether the activities of the members are: in the same general line of business, or steps in a vertically structured enterprise or process, or functionally integrated through the exercise of strong centralized management.”).

## **Selected Other References**

**Transacting Business in Texas for Purposes of Determining Whether Foreign Entity Must Register to Transact Business in Texas**

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**Cf. 2008 Letter from Texas Secretary of State Advising Foreign-Filing Entity of Certificate of Registration Requirement for Transacting Business in Texas** ("Our records indicate that XXXX has not registered with this office and may be transacting business in Texas. A foreign-filing entity must file an Application for Registration if it 'transacts business' in Texas. Texas statutes do not specifically define 'transacting business'; however, the Texas Business Organizations Code Sec. 9.251 lists 14 activities that do not constitute 'transacting business.' Generally, a foreign entity is transacting business in Texas if it has an office or an employee in Texas or is otherwise pursuing one of its purposes in Texas. In addition, the Texas Attorney General has held that a foreign corporate general partner of a Limited Partnership or a foreign corporate manager of a Limited Liability Company must register to transact business in Texas.").

## Combined Reporting for Texas Franchise Tax Purposes

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*DRAFT: November 4, 2008*

General Partner's Authority to File Combined Report. If, for any tax period, the Partnership (1) is part of a combined group for Texas franchise tax purposes (the "Combined Group"), and (2) is required to join in the filing of a combined report for Texas franchise tax purposes for such period, or is permitted to do so and the General Partner, in its sole discretion, determines that such a filing is desirable, the General Partner is authorized to file on behalf of the Partnership any consents, elections, and other documents and take such other action as may be necessary or appropriate to file such a combined report. (For purposes of this Section 0, any period for which the Partnership is included in a combined report for Texas franchise tax purposes is hereinafter referred to in this Agreement as a "Combined Report Year.")

Liability to Other Combined Group Members for Partnership Combined Report Years. If the Partnership is included in a Combined Group for a Combined Report Year, the Partnership shall be responsible for paying and shall indemnify any other members of the Combined Group for any Texas franchise taxes for which the Partnership would have been liable for that year, computed as though the Partnership had filed a separate franchise tax return for such Partnership Combined Report Year (such amount, the "Separate Return Tax"). To the extent another member of the Combined Group pays the Partnership's Separate Return Tax for any Combined Report Year (such member, the "Paying Member"), the General Partner is authorized to reimburse the Paying Member for such tax.

Interim Estimated Payments. If the Combined Group is required to make estimated franchise tax payments during a Combined Report Year, the Partnership shall reimburse the Paying Member, if any, for the portion of the estimated tax payments that are attributable to the inclusion of the Partnership in the Combined Group (calculated in accordance with the principles set forth in Section 0). Any such reimbursed amounts so paid by in any year shall operate to reduce the Separate Return Tax obligation of the Partnership pursuant to Section 0. The General Partner shall request a refund from the Paying Member in the event the total estimated tax payments for a Combined Report Year exceed the Separate Return Tax for such year.



Tax Adjustments. In the event of any adjustment to the tax returns of the members of the Combined Group as filed (by reason of an amended return, claim for refund, or an audit by the Office of the Texas Comptroller (the “Comptroller”)), the liability of the members of the Combined Group under Sections 2 and 5 shall be redetermined to give effect to any such adjustment as if it has been made as part of the original computation of tax liability, and members of the Combined Group shall satisfy any underpayments or overpayments within the Combined Group within 30 days after any deficiency payments are made to the Comptroller or refunds are received from the Comptroller, or, in the case of contested proceedings, within 30 days after a final determination of the contest.

Partnership Subsidiaries. All taxable entities owned by the Partnership that are includable as members of the Combined Group shall be subject to this Agreement. If at any time the Partnership acquires or creates one or more taxable entities that are includable as members of the Combined Group, they shall be subject to this Agreement and all references to the Partnership herein shall thereafter be interpreted to refer to the Partnership and such entities as a group.

Intent and Interpretation. The intent of this Section is that the Partnership should make the Paying Member whole, without more, by reimbursing the Paying Member only to the extent of the Partnership’s Separate Return Tax. Any ambiguity in the interpretation hereof shall be resolved, with a view to effectuating such intent, in favor of the Paying Member.

- Doc #5532587
- Visio charts – see #5350282