



State Tax Update

Presented by Jon Wellington





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With nearly 20 years of public service under his belt, Jon is not just any attorney—he's the go-to guru for all things state and local taxation (SALT). Leading our firm's SALT practice, Jon draws on his vast experience with some of the globe's accounting giants to bring unparalleled expertise to the table.

Whether it's audit defense, income and franchise tax planning, sales and use consulting, nexus studies, or property tax minimization, Jon's got you covered.

He's exceptionally well-versed in the unique SALT needs of clients in the construction, manufacturing and distribution, and not-for-profit sectors.

DISCLOSURE

The content shared in this presentation is for informational and educational purposes only. Nothing you hear today should be taken as tax, legal, or financial advice.

Please don't use this session as the foundation for your personal or business planning decisions. Policies can change, interpretations can vary, and your situation is unique, **so always consult with a qualified advisor before making any moves.**

Agenda

- 1. Successor/Personal Liability**
- 2. Texas Franchise Tax Update**
- 3. Pass-Through Entity Taxes**
- 4. Sales Tax Topics**
- 5. Sales Tax Audit – What To Expect**
- 6. Questions?**

Sales Tax - Personal/Successor Liability

What Is Successor Liability?

- **Successor liability** – Buyer inherits debts/obligations after the purchase of another business
- Federal income tax purposes – if you just buy assets, generally avoid income tax liability of target company
- Sales tax purposes – not necessarily true
- Texas – Aggressive asserting successor liability against buyer



Also, Texas aggressively looks for potential fraud penalties and even potential criminal consequences in a transaction

Successor Liability - How to Avoid

- When a business is sold, to avoid successor liability, Buyer is supposed to withhold from the purchase price an amount sufficient to pay any liabilities until the Seller provides a receipt from the Comptroller showing that no tax is due for a given tax type
- Buyer is liable up to the amount they should have withheld **up to the purchase price**
- Since 2021, the seller and buyer jointly request a certificate of no tax due (**Form 86-114**)
 - If you ask for such a certificate, Comptroller has 90 days after the request to issue certificate (or after records are made available)
 - Essentially, the parties are asking for an audit
- If no audit needed, certificate is usually issued within **10 days**



Would you do this?

Successor Liability – Rule 3.7(d)

What constitutes a sale of the business?

Depending on the type of business, a sale could occur if:

- (1) a building, land, furniture, fixtures, inventory, and the right to use the seller's trade name;
- (2) all the capital assets of a business;
- (3) the name and goodwill of a business;
- (4) all the inventory of a business; or
- (5) fixed assets and realty necessary to operate a similar business as the seller at the same location.

- Burden of proof – on Comptroller by “clear and convincing evidence”
- Purchase of a business by a bankruptcy trustee is not a sale by the former owner and no successor liability applies



Successor Liability – How To Protect Yourself

- Worth asking for certificate of no tax due?
 - It is done jointly and only accepted if seller signs



REFUSAL WOULD BE AN ALARM!

- Asset Purchase Agreement protections
 - Escrow? Claw-back provisions? Post-acquisition review by consultant?
- Ensure preservation of documentation
- Identify original individuals responsible for tax reporting (look at returns for names)
- If possible to buy the business out of a foreclosure proceeding, you can avoid successor liability altogether

Personal Liability

- **Tax collected not remitted (TCNR)** – Trust fund tax so Comptroller very determined to get those amounts
- Personal liability – with respect to any individual who **(1) controls/supervises the collection of money or (2) controls/supervises the accounting and paying of the money, and willfully fails to pay**
- Dissolution of entity does not impact that liability

Personal Liability - Against Who?

Responsible individual – includes officers, managers, directors, or employee who is under a duty to perform an act with respect to the collection, accounting, or payment of tax

PENALTIES

- 10% underpayment penalty
- 50% penalty if failure to pay was due to fraud or intent to evade tax or individual alters, destroys, or conceals records or documents for the purpose of affecting the course or outcome of an audit or other Comptroller proceeding
- Criminal penalty – can be a felony if over \$200,000 TCNR

Personal Liability - You Might Not Even Know It



Arises when Forfeiture of Corporate Privileges

- Forfeiture occurs when the entity does not file its tax reports or **does not permit** an audit to take place.
- Many clients miss a franchise tax report and can lead to forfeiture
- If the entity has lost its corporate privileges, **(1) entity is not able to sue or defend itself in court** and **(2) each director and officer of the entity is liable for the debt of the entity.**
- Liable for each debt created or incurred after the date on which the report, tax or penalty is due and before the corporate privileges are revived.
- **Reinstatement does not retroactively remove personal liability**
- Additional issues can arise if a PIR is in error (i.e., includes former owners after sale)

Personal Liability - Fraud

- Gross underreporting, along with other factors or no plausible explanation, is sufficient to indicate intent to evade tax and warrant the fraud penalty. **25% underpayment is gross underreporting**
- “**Plausible**” – conceivably true or successful; possibly correct or even likely



Gross negligence is NOT fraud!

Personal Liability via Successor Liability

Fraudulent Transfer

- Buyer through fraud is liable for any liability of the Seller
- Fraud or sham if the transaction was taken **(1) with intent to evade/delay or prevent the collection of tax (2) without receiving a reasonable equivalent value in exchange for the business or assets being transferred**

Factors

- Who it is sold to (former insider/employee/relative)
- If a third-party Buyer immediately sells to such a person described above
- Seller retains any control of the business or assets after the transaction
- Seller and Buyer essentially operate post-transaction as the same business at the same location
- Before transfer, Seller had pending collection actions
- Transfer was concealed
- Seller was insolvent or became insolvent shortly thereafter

Personal Liability via Successor Liability

- Does there have to be an existing assessment for there to be a fraudulent transaction?
Not always
- **Generally, there is a 4-year statute of limitations**
- Statute of limitations does not apply if **(1) fraudulent report, (2) no filed report or (3) gross errors (25% underpayment)**

Texas Franchise Tax Update

Texas Franchise Tax Update

- Texas statutes provide that the franchise tax is tied to the Internal Revenue Code as of 1/1/2007 (start of the new margin tax)
- 2026 – Comptroller new policy is to look at current version of IRC except where the tax code or regulations specifically mention the IRC, in which case you still look at 1/1/2007
- Basis of this change - “reexamination of the Tax code” as opposed to a change in statute
- As a practical matter, this impacts depreciation – TFTR will now allow for bonus depreciation for COGS



Texas Franchise Tax Update



- Until 2026, Texas did not allow bonus depreciation
 - **Going forward, taxpayers can now take advantage of bonus depreciation**
- Taxpayers now supposed to use the amount of gain reported on their federal return
 - That gain is higher than would otherwise be due for Texas due to greater (bonus) depreciation amounts for federal purposes than Texas purposes
- Equitable remedy – one-time net depreciation adjustment for the 2026 franchise tax report for qualifying assets
 - **“Qualifying asset”** – placed in service before period reflected on 2026 TFTR, provided that those assets have not previously been disposed and are associated with and necessary for the production of goods.

One-time Net Depreciation Adjustment

Comptroller Memo (12/19/2025)

The depreciation adjustment for a qualifying asset for a given year is the difference in the depreciation claimed on the federal tax return and the depreciation claimed for Texas franchise tax COGS.

A taxable entity will calculate the one-time net depreciation adjustment as follows:

- For each year asset was in service, compute difference in depreciation for Texas COGS v. federal. In theory, could be negative if Texas depreciation greater than federal. If no depreciation was claimed for TFTR for a given year, the adjustment is zero.
- Add together for each asset and include in 2026 COGS (cannot be less than zero)
- This adjustment cannot reduce taxable margin below zero.
- Any unused adjustment may be carried forward

Other Franchise Tax Planning

- Texas requires combined reporting for unitary groups
- Taxpayers may be filing separately but there are benefits to combined filing

Example: if one entity holds real property it rents to a related party, combined reporting would eliminate that income as an intercompany transaction

- COGS ???

Pass-Through Entity Taxes

Pass-Through Entity Taxes

- 2016 – TCJA limited state tax deduction on personal federal income tax returns to **\$10,000**
 - SALT – includes income taxes, property taxes, sales taxes
- Assuming 40% federal tax rate, that means for every dollar of personal income tax paid to a state, loss of deduction means it costs a taxpayer 40 cents on their federal income tax return.
- Over last 10 years, now nearly every state allows for a pass-through entity to elect to pay tax at the entity level to circumvent this issue (**SALT Cap Workaround**)
- **States vary in mechanics:** tax credit v. deduction, is a return still required, less than 100% benefit, when does election need to be made, etc.)

Pass-Through Entity Taxes

- OBBBA – raised cap to \$40,000 but phases out (married couple \$600,000 the SALT Cap is \$10,000)
- **Just because Texas does not impose personal tax, this still impacts any individual taxpayer who has investment or other income from states with a personal income tax**
- Sometimes election needs to be made during the tax year (i.e., you can't wait until 2027 when you file your 2026 return; you may need to take action during 2026).
- Other issues arise when payment is made for wrong tax type, blowing election
- Can fall through the cracks, especially when different CPA firm handles tax returns for the business and the business owner

MORAL: Make sure that you have a plan and all parties are on the same page on actions to take!

Sales Tax Topics



No More Pennies

If the sales price plus sales tax results in a total that cannot be collected without pennies, retailers may round the transaction to the next lowest or next highest nickel, as they see fit, and the Agency will not adjust the sales price or recalculate tax due.

**Comptroller will continue to accept
cash payments including pennies.**

Credit Card Processing Fees

- Vendors are allowed to pass on credit card processing fees
- Taxpayers historically argued that the charge is **not** taxable because **(1) it is not part of the sales prices**, as it is a finance, carrying or service charge or interest from extending credit to the purchaser, and **(2) it is specifically excluded from the definition of taxable data processing services**

June 27, 2024 Controller Memo

- Retailer is **not** extending credit, so it is not a finance charge
- “When a retailer chooses to pass on a credit card processing fee to its customer, it is passing on the cost of an expense incurred in connection with the sale of a taxable item”
- **Therefore separate charges for credit card processing fees are taxable**



Texas Sales Tax – Repairs v Remodeling

- Texas exempts motor vehicle repairs and maintenance labor charges
 - **But Texas taxes repair of tangible personal property**
- Dealerships owe sales tax on the consumable supplies, materials and parts used to service their customers' vehicles
- Remodeling services are taxable
 - **Remodel** – “modify the style, shape, or form of motor vehicles belonging to another.”
- ATVs and dirt bikes (not designed for highway use) are **not** motor vehicles (tangible personal property), so repair **is** taxable



Texas Sales Tax – Repairs v Remodeling Examples

Taxable Remodeling

Customizing a Van

Installing a
sunroof

Nontaxable Vehicle Repairs

Replacement of
defective component
or accessory –
nontaxable repair

Tinting – nontaxable
maintenance

Taxable Repairs

Repair of defective
equipment
attachments (tangible
personal property, not
vehicle)

Taxability of loaners

- Texas imposes a gross receipts motor vehicle rental tax
 - 1-30 days – 10% tax rate
 - 30-180 days – 6.25% tax rate
- Applies to all consideration for a rental

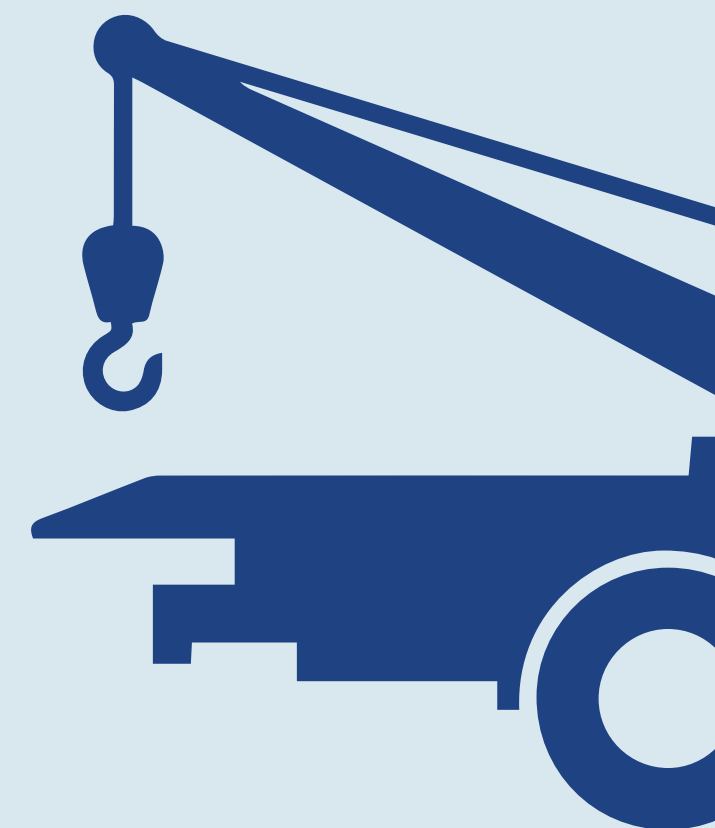
Example

- Factory program where the member provides loaner to customer while vehicle is in for warranty service
- Warranty provider (factory) pays dealership consideration for providing the loaner
- Taxable rental?
- 11/19/2013 letter to Karen Phillips, General Counsel of Texas Automobile Dealer Association (citing Hearing No. 42,119):
 - **Yes – any consideration is included as a gross rental receipt.**

Texas Tax Policy News, April 2017 - Towing and Debt Collection Services

- **Towing is not taxable on a standalone basis**
- If a secured party (seller-financed dealer or financial institution) hires a towing company to repossess a vehicle, the towing company is providing a taxable debt collection service and the **towing charge is taxable**.
- If a **debt collector hires a towing company** to repossess a vehicle, the towing charge is **not** taxable. **However, the debt collector must include the towing charge as part of its taxable debt collection service charge and the whole amount is taxable, even if the towing charge is separately stated.**

Debt collection services are taxable when the debt collector is doing business in Texas and the creditor's last known address is in Texas.



Sales Tax on Purchases - Beware!

Taxable Services



Services are generally not taxable unless specifically “enumerated” as a taxable service. Taxable enumerated services include:

- Janitorial Services
- Data Processing Services
- Information Services
- Tangible personal property repairs
- Nonresidential real property repairs

Taxable Data Processing Services

- Texas loves to call everything online “data processing services”
- **“service performed with a computer using the customer's data”**
- **Taxable examples:**
 - Data conversion services, Web page hosting and creation
 - Data storage, preparing W-2s, payroll tax returns, scanning documents
- **Nontaxable services:** professional services or services that otherwise use a computer to perform a nontaxable service
 - Consulting, interpreting data, preparing income tax returns, settling of electronic payments
- **Software-As-A-Service:** taxable data processing services
 - Big quirk –20% exemption for data processing and information services (80% taxable, or effective rate of 6.6% instead of 8.25%)

Data Processing Examples

Policy Letter Ruling 200101981L (01/08/2001)

- Company provides dealerships with descriptive used vehicle window stickers and Buyers Guide window stickers showing information about the used vehicle
 - VIN loaded onto computer at dealer's car lot, Computer accesses database about vehicle from manufacturer and retrieves various information. Coupled with on-site inspection to add accessories and stickers are produced.
 - Photo is taken of sticker for digital Internet advertising

EXAMPLE

Held: If all one charge, essence is taxable production and sale of sticker. If separated, web site storage of digital photograph is taxable data processing

Data Processing Examples

Private Letter Ruling No. 201806033L (06/28/2018)

- Taxpayer provides “ suite of marketing services focused on call tracking and monitoring for car dealerships...”
- Services include consulting to improve call-handling processes; setting up phone numbers to help track and monitor inbound calls; categorizing calls to evaluate sales calls and whether a lead should be pursued; and providing an online platform that logs, records, and maps calls.

EXAMPLE

Held – not taxable – “any data processing activities were performed to facilitate the consulting services”

Data Processing – Bundled Transactions

2025 – Comptroller amended Rule 3.330 on data processing to expand definition further

- **Bundled transaction** – single charge for taxable data processing and another service without a separate value and is ancillary to data processing – whole charge is taxable [and vice versa]
- Texas historically looks at “**essence-of-the-transaction**” test (i.e., what does Buyer really want) but now focuses on service provider’s behavior
 - repetitive or routine manipulation of data by the seller suggests the service is not ancillary and should be taxable
 - But the manipulation of data that depends on external knowledge and discretionary judgment suggests the activity is ancillary and should not be taxable

Clear as mud!

Data Processing – Multistate Benefit

- If you are using these services on a multistate basis, should only owe tax on Texas usage
- **“Use” means “derivation in Texas of direct or indirect benefit from the service”**
- Buyer can provide vendor an exemption certificate claiming a **“multistate benefit”**
 - Buyer then remits use tax based on Texas usage
 - Multistate purchaser may use a reasonable and consistent method supported by its business records to allocate the service between its business locations.

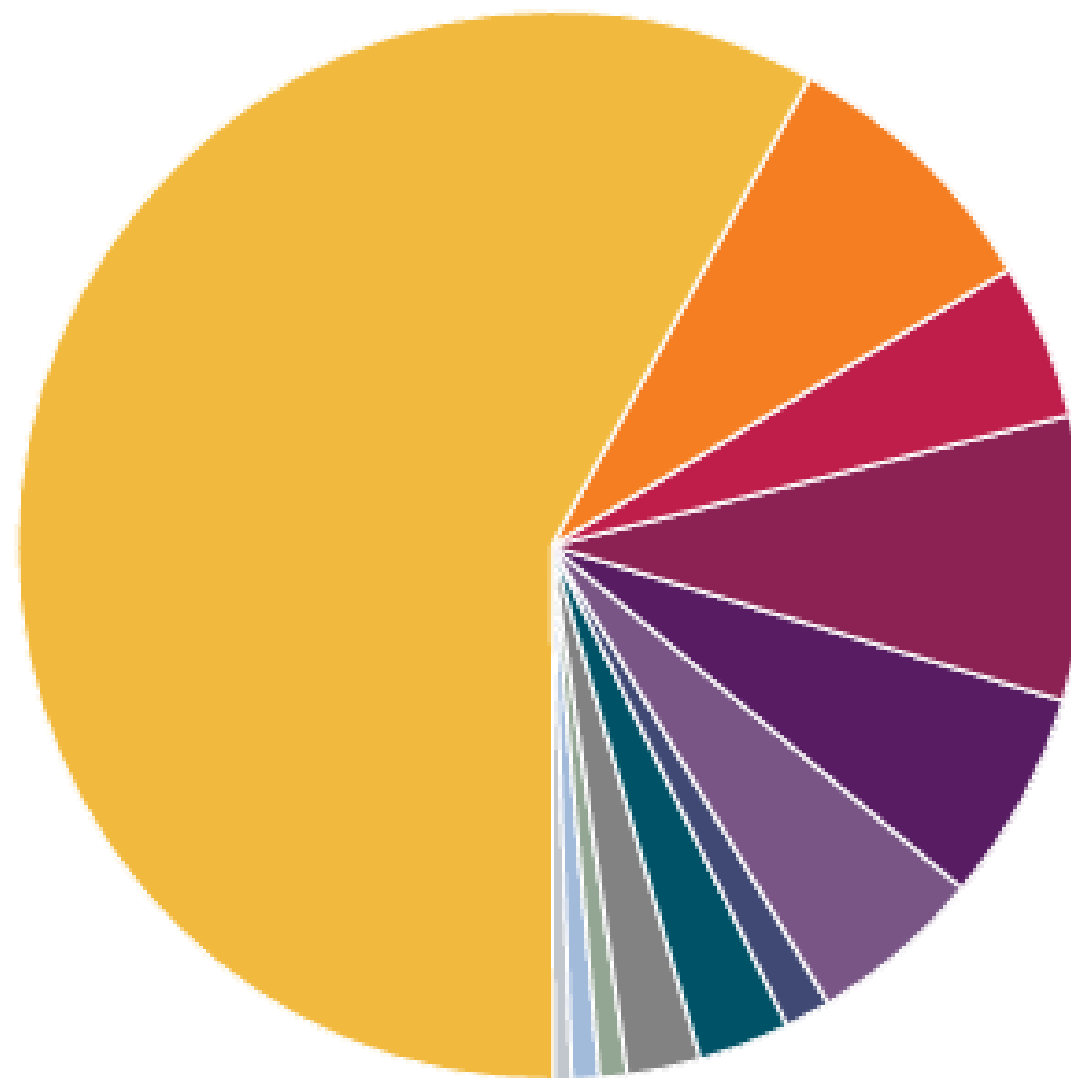
Sales Tax Audits - Walkthrough

State Tax Revenue By Source

FISCAL 2025

All Funds, Excluding Trusts

TOTAL = \$84,197,809,115



% OF TAXES	
58.3%	SALES AND USE TAXES \$49,058,906,717
8.4%	MOTOR VEHICLE SALES AND RENTAL TAXES \$7,084,998,027
4.7%	MOTOR FUEL TAXES \$3,918,009,302
8.4%	FRANCHISE TAX \$7,080,303,603
6.4%	OIL PRODUCTION TAX \$5,383,668,225
5.4%	INSURANCE TAXES \$4,508,604,938
1.3%	CIGARETTE AND TOBACCO TAXES \$1,111,056,045
2.9%	NATURAL GAS PRODUCTION TAX \$2,479,282,624
2.1%	ALCOHOLIC BEVERAGES TAXES \$1,791,055,148
0.9%	HOTEL OCCUPANCY TAX \$787,600,051
0.8%	UTILITY TAXES \$698,595,079
0.4%	OTHER TAXES \$295,729,356

Texas' total tax revenue increased by 2.8 percent in fiscal 2025, to \$84.2 billion. Most tax categories saw moderate growth over the prior year, with only oil production tax and other taxes declining from fiscal 2024.

Source: Annual Cash Report 2025, Texas Comptroller of Public Accounts

Note: Percentages may not sum to 100 due to rounding.

State Tax Revenue by Source

[View full pdf here.](#)

Texas Revenue

- Total State tax revenue for fiscal 2025 - \$84,197,809,115
 - Sales tax - \$49,058,906,717 (58.3%)
 - Motor vehicle sales and rental taxes - \$7,084,998,027 (8.4%)
 - Motor fuel taxes - \$3,918,009,302 (4.7%)
 - Franchise tax - \$7,080,303,603 (8.4%)



Sales and Use Tax Audits



Audit Process

- Notification of audit with nexus questionnaire (consultants may know first – public information!)
- Schedule first visit/information request (confirmation letter)
- Audit
- Exit interview
- Assessment
- Protest Process

Sales and Use Tax Audits

Audit will address:

- Sales
- Purchases (Expenses)
- Purchases (Fixed Assets)
- Reconciliation of books to sales tax returns



Sales and Use Tax Audits

- **Sales – was all tax properly collected and timely remitted?**
 - Data requested:
 - Federal income tax returns
 - Bank statements
 - Sales journal
 - Sales invoices/
 - Exempt customers
 - Resale/Exemption Certificates

DMV shares data with the Comptroller's Office

Sales and Use Tax Audits

Expenses – was sales tax paid to vendors or use tax properly accrued?

- Accrual of use tax on out-of-state suppliers
- Service providers (taxable – janitorial services, data processing)
- Sample and projection may be required
- Data Requested:
 - G/L
 - Chart of accounts (auditor will likely select “accounts of interest”)
 - A/P invoices
 - Contracts/lease agreements/maintenance agreements

Sales and Use Tax Audits

Fixed Assets

- Auditor will review all purchases to make sure tax was paid
- Data Requested:
 - Depreciation schedule
 - A/P invoices
 - Contract



Sales and Use Tax Audits



Reconciliation

- Do your tax returns tie to your books and records?
- Do all returns and records tie to tax returns?
- Will schedule out each month of the audit
- When an error for Comptroller, you will owe tax
- When an error in taxpayer favor, you will need to prove why or get no credit

Sales and Use Tax Audits

Audit Preparation

- Obtain missing resale/exemption certificates (timing important)
- Consider using outside representative
- Consider having audit take place offsite



Sales and Use Tax Audits

If you disagree

Independent Audit Review (IAR) Conference

- Independent auditor (who works for Comptroller but not the Audit Division) will try to resolve issues
- Will issue report to Comptroller on findings and recommendations
- Typically not helpful

After (optional) IAR conference, you will receive Notification of Audit Results

- No payment due throughout entire administrative appeals process
- May choose to pay undisputed amounts to prevent interest from accruing

Sales and Use Tax Audits

Reasons why assessment may be overstated

- Misapplication of the law
- Sampling methodology flaws
- May be able to find additional invoices/documentation after audit is complete
- The other party to the transaction may already have been audited or self-assessed proper tax (need to provide proof to Comptroller)

Sales and Use Tax Audits

After Notification, if you still disagree:

- **Petition of Redetermination with Statement of Grounds**
 - 60 days to file
 - Provide all reasons for disagreement
 - You will next receive a 60-day letter for additional documentation (certificates only)
 - Opportunity to work with original auditor during this period
 - Auditor will accept your position or refer to a hearings attorney
 - Informal discussions with attorney, who will eventually file a Position Letter

Sales and Use Tax Audits

After Notification, if you still disagree:

- **If you disagree with the Position Letter, you may file a Reply Letter**
- Hearings attorney will issue response to Reply Letter
- After that, accept findings or go before an Administrative Law Judge (ALJ) with the State Office of Administrative Hearings (SOAH)
- ALJ will issue a proposed decision, which is typically accepted by the Comptroller's Office
- Agree or go to court
- Court – in Austin, generally must pay tax and file a refund suit

THANK YOU!

QUESTIONS?



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