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Texas: Franchise tax, economic nexus rule is finalized

An amended rule adopting an economic nexus standard for Texas franchise tax purposes has been finalized, effective for federal accounting periods ending in 2019 and later.

Background

Unlike a number of states where the nexus standard was ambiguous or unknown, the Texas Comptroller has historically applied a physical presence nexus standard for franchise tax purposes. In a 2018 ruling issued post-*Wayfair*,* the Comptroller clarified that, despite the *Wayfair* decision, Texas “has not moved away from the physical presence requirement for franchise tax at this time.”

**South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080 (2018)

Economic nexus standard

The amendments to [Texas Admin. Code § 3.586](#) concerning franchise tax nexus were finalized on December 20, 2019.

As amended, the regulation provides that for each federal income tax accounting period ending in 2019 or later, a foreign (non-Texas) entity with gross receipts from doing business in Texas of \$500,000 or more is subject to Texas franchise tax, even if the entity has no physical presence in the state.

A taxable entity will be deemed to be “doing business” in Texas on the earliest of: (1) the date the entity has physical presence; (2) the date the entity obtains a use tax permit; or (3) the first day of the federal income tax accounting period in which the entity has gross receipts from doing business in Texas in excess of \$500,000.

KPMG observation

A number of states have enacted economic nexus legislation or have issued definitive economic nexus guidance for income tax purposes in the year and a half since the Supreme Court’s decision in *Wayfair*. However, there are a few considerations that may heighten the implications of the Texas change.

First, the Comptroller’s position has historically been that Pub. L. No. 86-272 does not apply for franchise tax purposes (a position reiterated in the regulation). As such, companies selling tangible

personal property will not be able to claim "86-272 protection" in Texas. Second, Texas is a "Joyce state" (meaning that only the sales of entities with Texas nexus are included in the Texas sales factor numerator). Therefore, any businesses that have employed *Joyce* planning will need to reassess their positions in light of the new standard and determine its effect on the group's apportionment factor.

For more information, contact a KPMG State and Local Tax professional:

Doug Maziur | +1 713 319 3866 | dmaziur@kpmg.com

Jeff Benson | +1 214 840 6911 | jbenson@kpmg.com

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