

## **BILL ANALYSIS**

Senate Research Center  
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C.S.H.B. 2896  
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Finance  
5/22/2015  
Committee Report (Substituted)

### **AUTHOR'S / SPONSOR'S STATEMENT OF INTENT**

This bill clarifies existing franchise tax code provisions applicable to businesses that operate in multiple states.

Businesses that operate in multiple states across the nation are subject to tax in all of the states in which they operate. However, they are not required to pay tax to one state based upon their business activities conducted in all states. Rather, they are required to pay tax based only upon the amount of business activity they do in that particular state. This concept is called apportionment. Texas apportions a business's activity to the State of Texas based upon the business's sales, and it is expressed as a fraction: the numerator is gross receipts in Texas; the denominator is gross receipts everywhere.

This calculation can get complicated when businesses have to determine which receipts are considered "Texas" receipts and which ones are not. This is where the concept of "sourcing" comes in. Because businesses generate revenues from a myriad of activities, the state to which a receipt should be "sourced" is not always obvious. To avoid confusion for taxpayers, the specific sourcing rules applicable to most (if not all) types of business transactions are set forth in the Texas Administrative Code. (Section 3.591 (e)(21)(B), Texas Administrative Code). One such rule is that the sale of intangible property shall be sourced to the location of the payor. Thus, if the payor for intangible property is located in Texas, then the sale is considered a Texas receipt. If the payor is not located in Texas, then the sale is considered a non-Texas receipt.

This bill is applicable to the creators of entertainment content. Content creators "sell" their content to their customers by entering into non-exclusive license agreements whereby, in exchange for payment, the content creators convey a limited right to show or display the content. This type of business activity constitutes the sale of intangible property in Texas. See TGS-NOPEC Geophysical Co. v. Combs, 340 S.W.3d 432,439 (Tex. 2011). Thus, when a business sells intangible property, as discussed above, those sales shall be sourced to the location of the payor. (Section 3.591 (e)(21)(B), Texas Administrative Code). If the payor is located in Texas, then the receipt is "sourced" to Texas and added to the numerator of the sales factor shown above as a "Texas receipt." If the payor is located outside of Texas, then the sale is a non-Texas receipt and it is added only to the denominator of the sales factor (i.e., everywhere receipts).

Recently, auditors in the Office of the Comptroller of Public Accounts of the State of Texas began reinterpreting the "location of the payor" rule and requiring taxpayers (i.e., the content creators) to "look through" the payors to figure out the subscribership and/or viewership of the payors' customers. The taxpayers were then required to make a "Texas receipts" calculation based upon subscribership and/or viewership of the payors. This approach is inconsistent with TGS-NOPEC and the Administrative Code. Further, for some taxpayers, counting the payors' subscribers and/or viewers is impossible because some of their major payors—e.g., Verizon, Dish Network, and Direct TV—refuse to disclose their subscribership lists. These payors consider the locations of their customers to be trade secrets and do not want to disclose based upon their (legitimate) fear that, eventually, the content creators will seek to sell directly to their customers. Thus, the content creators cannot "look through" the payors to make a count of subscribers for these entities.

This bill clarifies that the receipts shall be sourced to the location of the payor, not to the location of the payors' customers. With this bill the state will benefit in the form of saved litigation costs and renewed certainty, predictability, and fairness for taxpayers paying the franchise tax.

C.S.H.B. 2896 amends current law relating to apportionment of certain receipts of a broadcaster under the franchise tax.

### **RULEMAKING AUTHORITY**

This bill does not expressly grant any additional rulemaking authority to a state officer, institution, or agency.

### **SECTION BY SECTION ANALYSIS**

SECTION 1. Amends Section 171.106, Tax Code, by adding Subsection (h), as follows:

(h) Requires a taxable entity that is a broadcaster to include in the numerator of the broadcaster's apportionment factor receipts arising from licensing income from broadcasting or otherwise distributing film programming by any means only if the legal domicile of the broadcaster's customer is in this state. Defines "broadcaster," "customer," "film programming," and "programming" for purposes of this subsection.

SECTION 2. Provides that this Act applies only to a report originally due on or after the effective date of this Act.

SECTION 3. Effective date: January 1, 2018.