



Texas Sales & Use Tax Update

2011

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Multistate/International Tax Issues

1. **Phone Books** – Southwestern Bell owes use tax on amounts it paid to out-of-state printers to print phone books it distributed in Texas, even though it purchased the paper for the phone books from out-of-state vendors. *Southwestern Bell Yellow Pages v. Combs*, No. 03-07-00638-CV, 2009 WL 211633 (January 30, 2009). The Third Court of Appeals found that Texas Tax Code § 151.011(a) only excludes from tax printed material that is itself a component part of a final product, not final printed products like Southwestern Bell’s phone books that were not incorporated into other property.
2. **Business Data Exchange** – Texas imposes tax on electronic data interchange services that Texas service providers perform using computers located in Texas, even when an out-of-state company purchases the services. Letter No. 201005826L (May 10, 2010). Electronic data interchange services allow businesses to transfer data between their computer systems without human intervention.
3. **Mexican Roaming Charges** – Texas does not impose sales tax on roaming charges for wireless telephone calls made in Mexico. Hearing No. 100,587 (June 4, 2010)

Taxable Services

Repairs to Tangible Personal Property

4. **Dealer Repairs** – The taxability of parts that auto dealers use to perform repairs generally depends upon who pays for the repairs. Dealers owe no sales or use tax on parts they use to perform repairs that the vehicle’s manufacturer provide free of charge. However, the dealer must collect sales tax on parts from a vehicle owner or third party who pays for repairs. Tax Policy News (May 2010):
 - a. **“Certified” Used Vehicles** – Some auto dealers sell “certified” used vehicles. The dealer pays a third party certifier to certify that the vehicle will remain in good working condition for a set period of time.

The certifier pays for any repairs to the vehicle during that period. The dealer typically performs these repairs. The dealer must collect sales tax from the certifier on the parts.

- b. **Free Maintenance Agreements** – Dealers owe no sales or use tax on parts dealers use to perform maintenance under free maintenance agreements. Manufacturers may provide a free maintenance agreement with the purchase of a vehicle that covers oil changes and replacement parts such as wiper blades. Dealers generally perform maintenance under these agreements. The Comptroller has stated that dealers owe no sales or use tax on the parts they use to perform maintenance under free maintenance agreements.
- c. **Optional Maintenance Agreements** – Dealers must collect sales and use tax from vehicle owners on parts the dealers install under optional maintenance agreements. Vehicle owners purchase optional maintenance agreements from dealers for their vehicles. The dealer must collect sales tax from the vehicle owner on any parts the dealer installs under the agreement.
- d. **Goodwill Repairs** – Dealers owe no sales or use tax on parts they use to make “goodwill repairs.” “Goodwill repairs” are free repairs dealers make within seven days of sale to vehicles they sell, when a written warranty does not cover the repair. The Comptroller treats “goodwill repairs” as repairs performed under an implied warranty, unless the dealer sold the vehicle “as-is,” and dealers owe no sales or use tax on parts they use to make “goodwill repairs.”
- e. **Promotional Items** – Dealers must pay sales tax on promotional items they provide with the sale of a vehicle, such as free oil changes. Promotional items are services that the manufacturer doesn’t provide and that a service agreement does not cover.

Real Property Services

- 5. **Oil Spill Cleanup** – The taxability of oil spill cleanup services generally turns on the location where the service is performed. Oil spill cleanup services are taxable if performed at a plant or on land not at the well site, but are not taxable if performed at the well site. Hearing No. 100,619 (October

15, 2009). The ALJ did not allow a taxpayer in the petroleum and natural gas production business a refund of taxes paid on oil spill cleanup services because the taxpayer provided no evidence showing where the service was performed.

6. **Structural Pest Control** – Structural pest control services, as defined in Texas Occupations Code § 1951.003, are a taxable real property service, even though the Texas Department of Agriculture licenses and regulates structural pest control services. Tax Policy News (March 2010). Structural pest control services include applying pesticides in and around structures, identifying or inspecting infestations of pests in structures, and identifying and inspecting infestations of pests in tree and plants in parks or near structures.
7. **Airline Terminal Maintenance** – Delta Air Lines did not qualify for the sale for resale exemption on its payments to companies that provided janitorial and maintenance services for terminal space it leased. *Delta Air Lines, Inc. v. Combs*, 318 S.W.3d 523 (Tex.App.—Austin, August 3, 2010). The Third Court of Appeals rejected Delta’s argument that it resold these services to the airports from which it leased the terminal space because Delta’s contracts with the airports required Delta, not the airports, to keep the terminal space in clean, orderly, and operable condition.

Data Processing Services

8. **Medical Transcription** – A company performs a taxable data processing services when it provides medical transcription services over the Internet using voice recognition software. The exclusion for transcription of medical dictation by a “medical transcriptionist” doesn’t apply to software that performs the same function. Letter No. 201004665L (April 29, 2010).

Telecommunications Services

9. **Cell Phones** – The Comptroller revised the telecommunications services rule to reflect the following legislative changes: (1) Texas law now sources mobile telecommunications services to the customer’s place of primary use and (2) Retailers may claim the sale for resale exemption on purchases of cell phones and similar devices when they transfer them as an integral part of a telecommunications service that a telecommunications service provider provides. Comptroller Rule § 3.344 (updated effective October 21, 2010).
10. **Pay Phones** – Texas law now excludes pay telephone calls made using coins from the definition of telecommunications services. Comptroller Rule § 3.344 (updated effective October 21, 2010).
11. **911 Emergency Services Fee** – A new Comptroller rule implements and states requirements related to the new prepaid wireless 911 emergency services fee. Comptroller Rule § 3.1271 (effective October 21, 2010).

Non-Taxable/Taxable Service Distinctions

12. **Holiday Decorating** – Charges to decorate a tree or home for the holidays are not taxable unless the decorator also sells or rents the decorations to the customer. Tax Policy News (October 2010).

Exemptions

Manufacturing

13. **Natural Gas Compressors** – A seller of natural gas could take the manufacturing exemption on lease payments for natural gas compressors it placed at its well sites because the compressors processed the gas it sold to its customers. Hearing No. 49,453 (November 18, 2009). The seller’s contracts with its customers required it to deliver the gas at “pressure quality and heat content requirements” set by the customers. The compressors pressurized the gas and pushed the gas through a dehydrator for final processing for sale. The wellhead pressure was not sufficient to

push the gas through the dehydrator and into the sales line without the compressors. The ALJ found that the seller used the compressors to process the gas, not just transport it, because the compressors allowed the sellers to deliver the gas to the sales line free of contaminants, dry, and at the pressure the customer required.

a. In contrast, a natural gas business could not take the manufacturing exemption on lease payments for compressors used to pressurize gas to facilitate transportation in transmission lines. Hearing No. 102,368 (May 5, 2010). The ALJ denied the manufacturing exemption because the taxpayer did not demonstrate any use of the compressors that facilitating processing of the gas, and the taxpayer did not show that anyone purchased the gas.

14. **Voice and Data Transmissions** – GTE could not take the manufacturing exemption on distribution frames, switches, interoffice facility cables, and similar equipment because the voice and data transmissions GTE processed with this equipment are not tangible personal property. *GTE Southwest, Inc. v. Combs*, No. 03-08-00561-CV, 2010 WL 2218662 (Tex.App.—Austin, June 3, 2010). GTE asserted that the voice and data transmissions were tangible personal property because the electronic signals, dial tones, busy signals, ring tone signals, digital addresses, and electricity that made up these transmissions were “measured,” “felt,” and “perceptible.” However, the Third Court of Appeals rejected GTE’s argument because the taxing statutes treat GTE’s product as a taxable telecommunications service rather than tangible personal property.
15. **Month-to-Month Leases** – Leased equipment does not qualify for the manufacturing exemption for equipment leased or rented for a period of one year or more if the rental contract continues indefinitely upon month-to-month payments until cancelled at will by either party upon 30 days notice, even if the contract stipulates that neither party may terminate the contract within the first 12 months. Letter No. 201006692L (June 23, 2010).
16. **Repackaging** – Home & Garden Party, Ltd. (“HGP”) could not take the manufacturing exemption on packaging materials that it used to repackage home decorating items it purchased, repackaged, and resold to independent retailers. *Combs v. Home & Garden Party, Ltd.*, No. 03-09-

00673-CV, 2010 WL 4367054 (Tex.App.—Austin, November 3, 2010). HGP purchased bulk-packaged items such as silk flowers, wire products, and figurines, and repackaged them and resold them to independent retailers. HGP packaged and sold other items it manufactured itself, such as framed prints and wood products. HGP argued that as a manufacturer, it qualified for the manufacturing exemption on all the packaging materials it purchased. The Third Court of Appeals found that repackaging the items, without making any other chemical or physical change to the items, did not constitute manufacturing. As a result, the Third Court of Appeals found the HGP did not qualify for the manufacturing exemption on packaging materials it used to repackage materials it did not manufacture.

Electricity and Gas

17. **Residential Electricity and Gas** – Fire control and crime control districts may impose sales and use tax on residential use of electricity and gas if located in all or part of a municipality that imposes sales and use tax on residential use of gas and electricity. S.B. 575 (effective January 1, 2010)

Food

18. **Mobile Food Vendors** – Mobile food vendors must collect sales tax on all ready-to-eat food items, even if served on sticks or in bags instead of on plates. Mobile food vendors only need to collect sales tax on bakery items if sold on plates. However, otherwise-taxable foods, such as a Twinkie®, remain taxable even if the vendor batters and deep-fries them before selling. Traveling vendors must collect local sales tax based on the location of sale. Tax Policy News (September 2010).

Over-the-Counter Drugs

19. **Contact Lens Products** – Texas law exempts contact lens care products from sales and use tax only when purchased under a doctor's prescription. Letter No. 201004828L (April 6, 2010).

20. **Pedialyte** – Texas law exempts Pedialyte from sales and use tax only when purchased under a doctor’s prescription. Letter No. 201012906L (December 3, 2010).

Agriculture

21. **Structures** – A farmer or rancher may claim the agriculture exemption on buildings or structures and their component parts designed for a specific agricultural purpose that cannot be economically used for other purposes without major structural changes. Letter No. 201006672L (June 8, 2010). Examples of exempt structures include automated laying houses, farrowing houses, greenhouses, milking barns, and silos. A farmer or rancher may not claim the agriculture exemption on buildings used for shelter, housing, storage, or work space. Examples of non-exempt structures include bunkhouse, general storage barns, hay barns, livestock barns, pole barns, equipment storage buildings, machine shops, sheds, and shelters. A contractor constructing an exempt structure under a lump-sum contract may not purchase the incorporated materials tax-free because only the farmer or rancher may claim the agriculture exemption. However, a contractor may accept an exemption certificate from a farmer or rancher in lieu of tax on the incorporated materials if the contractor constructs the exempt structure under a separated contract.

Motion Pictures

22. **Release Prints** – Distributors of motion picture release prints must pay use tax on the original cost of the film material incorporated into the release print, but these prints are otherwise nontaxable. Letter No. 201005888L (May 11, 2010). Distributors deliver release prints to movie theaters that show films. The theaters return the release prints to the distributors immediately after use. Distributors charge movie theaters a licensing or rental fee for use of the films. The Comptroller requires the distributor of a motion picture release print to pay use tax on the original cost of film material incorporated into the print only once, when the print first enters the state for showing at a movie theater. The Comptroller treats

the cost of film material as 50 percent of the total cost of the release print unless the distributor provides an itemized invoice that specifies the cost of the film material. The movie theater operator pays no sales or use tax on the cost of the film or the portion of receipts it pays to the distributor.

Procedure

23. **Class Action** – The Comptroller only has statutory authority to consider refund claims filed by individuals, not classes. Hearing Nos. 102,508; 102,509; and 102,510 (March 23, 2010).
24. **Personal Liability** – A bankruptcy trustee was personally liable for “willfully” failing to remit sales taxes held in trust when he knew that the sales taxes were due and used the money to pay other creditors, including suppliers and staff, notwithstanding his “good intentions” of maximizing the estate’s value. *In re: Texas Pig Stands, Inc.*, 610 F.3d 937 (5th Cir., July 6, 2010).
25. **Officer and Director Liability** – The Comptroller may not need to provide notice before imposing liability on directors or officers for debts of a corporation incurred during a period of forfeiture of corporate privileges. *Greene v. State of Texas*, 324 S.W.3d 276 (Tex.App.—Austin, August 26, 2010). The Third Court of Appeals held that the statutory notice requirements under Texas Tax Code § 171.256 are not conditions precedent to imposing officer and director liability under Texas Tax Code § 171.255 for debts of a corporation incurred during a period of forfeiture of corporate privileges. As a result, the Third Court of Appeals held Greene, the sole officer and director of a bankrupt jewelry business, personally liable for the business’s unpaid Texas sales tax liability incurred during four periods when the business’s corporate privileges were forfeited for its failure to report and pay franchise taxes. The Third Court of Appeals rejected Greene’s argument that the Comptroller could not hold him personally liable for the unpaid sales taxes because the Comptroller did not provide copies of the notices it sent and the addresses to which the Comptroller sent the notices.