

Texas – Compensation regulation invalid, benefit costs deductible for federal purposes may be included in margin tax compensation deduction

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In brief

A Texas district court found a margin tax regulation invalid to the extent that it prevents taxpayers from deducting as compensation certain benefit costs that are deductible for federal income tax purposes.

Texas taxpayers taking the compensation deduction and incurring certain benefit costs should ensure such costs are deducted prospectively and should consider the potential for filing refund claims.
[*Winstead PC v. Combs*, District Court, 201st District, No, D-1-GN-12-000141 (3/18/2013)]

In detail

Texas Tax Code Sec. 171.1013(b)(2) provides that a taxpayer electing to subtract compensation for the purpose of computing its taxable margin may subtract an amount equal to “the cost of all benefits, to the extent deductible for federal income tax purposes, the taxable entity provides to its officers, directors, owners, partners, and employees, including workers’ compensation benefits, health care, employer contributions made to employees’ health savings accounts, and retirement.”

Texas regulation 34 TAC 3.589(e) provides that “a taxable entity is allowed to subtract the

cost of all benefits to the extent deductible for federal income tax purposes that it provides to its officers, directors, owners, partners, and employees.”³⁴ TAC 3.589(e)(2)(D) provides that ‘benefits’ does not include “working condition amounts provided so employees can perform their jobs. (Examples of working condition benefits include an employee’s use of a company car for business, job-related education provided to an employee, and travel reimbursement.)”

The court did not provide a detailed analysis of its determination. It ultimately held that TAC 3.589(e)(2)(D) was invalid to the extent it disallows a deduction as

compensation for benefit expenses that are deductible for federal purposes.

The takeaway

A narrow reading of the opinion focusing only on the language in TAC 3.589(e)(2)(D) would conclude that the decision only addresses ‘working condition amounts’ that should be included in a taxpayer’s compensation deduction (to the extent deductible for federal purposes). However, the decision could also provide support for the broader conclusion that, consistent with Code Sec. 171.1013(b)(2), *all* benefits deductible federally and

provided to officers, directors, owners, partners, and employees are included within the Texas compensation deduction.

While the decision could be significant for some taxpayers, it is important to

remember that it only applies to certain benefits and only to benefits paid by taxpayers electing the compensation deduction. Generally, this includes companies that provide services where compensation is a

significant component of their business.

It is unknown at this time whether the Comptroller will appeal this decision.

Let's talk

For more on how the *Winstead* decision might affect your business, please contact one of the following professionals:

State and local tax services

Scott Fischer
Partner, *Dallas*
+1 (214) 754-7589
scott.w.fischer@us.pwc.com

Ron Rucker
Manager, *Houston*
+1 (713) 356-4389
ronald.j.rucker@us.pwc.com

William Essay
Partner, *Houston*
+1 (713) 356-6050
william.j.essay@us.pwc.com

Stephanie Stewart
Manager, *Dallas*
(214) 754-7429
stephanie.r.stewart@us.pwc.com

Paul Estrada
Principal, *Houston*
+1 (713) 356-8023
paul.estrada@us.pwc.com

Michael Santoro
Director, *Chicago*
+1 (312) 298-2917
michael.v.santoro@us.pwc.com