

INSTRUCTIONS FOR COMPLETING THE FINAL FRANCHISE TAX REPORT DUE JANUARY 1, 1992 OR LATER

**DO NOT SEND
IRS FORMS**

GENERAL INSTRUCTIONS

WHO MUST FILE - A corporation that becomes no longer subject to the earned surplus component of the franchise tax must file a final report. This report must be filed even if the corporation is still subject to the taxable capital component.

WHEN TO FILE - This report must be filed with the Comptroller's office within 60 days after the corporation becomes no longer subject to the earned surplus component.

In the case of a Texas corporation or a non-Texas corporation with a certificate of authority (COA) to do business in Texas, a certificate of account status may be requested at the time the final report is filed (see back of final report or form 05-359, Request for Certificate of Account Status). The certificate will be issued by the Comptroller's office and may be filed in the Texas Secretary of State's office along with the proper articles or application and filing fee. (See Pub. 98-336, Franchise Tax Quick Reference for information concerning filings with the Secretary of State.)

FOR ASSISTANCE - Call 1-800-252-1381, toll free nationwide. The local number in Austin is 512-463-4600. If you're calling from a Telecommunications Device for the Deaf (TDD) call 1-800-248-4099 toll free. The Austin TDD number is 512-463-4621.

TERMINATION OF CORPORATE EXISTENCE - Once a business has filed formal Articles of Incorporation, or an Application for Certificate of Authority with the Texas Secretary of State's office, it is recognized by the State of Texas as a legal corporate entity, whether or not it conducts business or simply exists as an inactive corporate shell. As such, the corporation **must file annual tax reports until it formally terminates its legal existence in Texas through the Secretary of State's office.**

Texas corporations must satisfy all tax liabilities before filing Articles of Dissolution. All other corporate entities must satisfy all franchise tax requirements, or state in the appropriate articles which entity will be responsible for satisfying all franchise tax requirements, before they may terminate legal existence in Texas.

All documents required by the Texas Secretary of State to terminate legal existence in Texas **must be received** in that office before 5:00 p.m. on December 31 to avoid liability for the next annual franchise tax period. If December 31 falls on a weekend, the documents must be received by 5:00 p.m. on the last working day of the year.

Postmark dates will not be accepted. You may refer to the Franchise Tax Quick Reference Guide (Pub. 98-336) for more information on filing requirements. **This section does not apply to financial institutions.**

Foreign corporations which have not obtained a certificate of authority with the Texas Secretary of State's office, but have been doing business in Texas, must satisfy all franchise tax requirements. In order to close the franchise tax account, you must notify the Comptroller's office in writing and include the date the corporation ceased doing business in Texas.

CONSOLIDATED REPORTING - Corporations are required to file based on their own financial condition. Consolidated reporting is not allowed.

SPECIFIC INSTRUCTIONS

ITEM 1 - "BEGINNING DATE" is the day after the accounting period ending date for the earned surplus component on the corporation's previous franchise tax report. "ENDING DATE" is the date the corporation becomes no longer subject to the earned surplus component of the franchise tax. (a) For a Texas or foreign corporation, the ending date is the effective date of dissolution, merger out of existence, or conversion into an entity not subject to the franchise tax. (b) For a foreign corporation continuing to exist in its state of incorporation, the ending date is the later of (i) the effective date of the withdrawal with the Secretary of State, or (ii) the date the corporation stops doing the business in Texas which made it subject to the earned surplus component of the franchise tax.

EXAMPLE: A Texas corporation filed a 1998 annual franchise tax report using a 12-31-97 accounting year ending date for the earned surplus component on Schedule B. The corporation wants to dissolve on 8-3-98. To get a certificate of account status for dissolution, the corporation must file a final report and pay tax on the earned surplus component for the accounting period from 01-01-98 through 8-3-98. If the corporation is not dissolved until 8-16-98, the corporation must file an amended final report. The amended final report is due the 60th day after 8-16-98, the date the corporation dissolves.

ACCOUNTING METHODS: A corporation must use the same accounting methods in reporting receipts (Texas and everywhere) as used in reporting federal taxable income.

The Revenue Reconciliation Act of 1993 does not apply to reports originally due prior to January 1, 1996. Franchise tax reports originally due prior to January 1, 1996, should use the Internal Revenue Code in effect for the 1990 calendar year.

Therefore, a corporation should modify the federal taxable income as reported on the federal income tax return to adjust for any changes to the IRC after 12-31-90. For example, although the Revenue Reconciliation Act of 1993 increased the amount of depreciable property that can be expensed for federal

income tax purposes to \$17,500 (IRC Sec. 179), for franchise tax purposes this deduction is limited to \$10,000 as required by the 1990 IRC.

Reports Originally Due On or After January 1, 1996 and Before January 1, 1998—The Internal Revenue Code (IRC) in effect for the 1994 calendar year must be used in computing earned surplus except as indicated in the "NOTE" below.

Reports Originally Due on or After January 1, 1998—The Internal Revenue Code (IRC) in effect for the 1996 calendar year must be used in computing earned surplus except as indicated in the "NOTE" below.

NOTE: Because the franchise tax law applicable to reports due prior to January 1, 1996, required the 1990 IRC to be used in computing earned surplus (as indicated above), a corporation may have had differences between federal taxable income for federal income tax purposes and federal taxable income used in computing earned surplus on franchise tax reports due prior to 1996. If a corporation had such differences, it should continue to report the difference based on the 1990 IRC when computing earned surplus on reports due after January 1, 1996.

For example, if a corporation claimed a \$17,500 Sec. 179 deduction in reporting its federal income tax (in accordance with 1993 IRC amendments), but was limited to a \$10,000 deduction in computing earned surplus on franchise tax reports due prior to 1996 (in accordance with the 1990 IRC), the corporation should compute depreciation on the asset based on the \$10,000 Sec. 179 deduction in computing earned surplus on reports due after January 1, 1996. This treatment allows the corporation to maintain its basis in depreciating the affected assets for earned surplus computations. It will result in a greater depreciation deduction in computing earned surplus than what is reported on the federal income tax return.

ITEM 3 - Texas gross receipts should be reported for the period entered in Item 1. Gross receipts for taxable earned surplus means all revenues reportable by a

corporation on its federal tax return, without deduction for the cost of property sold, or other costs incurred, unless otherwise provided by law.

Gross receipts in Texas include:

- sales of real property located in Texas, including royalties from oil, gas, or other mineral interests;
- sales of tangible personal property when the property is delivered or shipped to a purchaser within Texas;
- sales of tangible personal property when the property is shipped from Texas to a state in which you are not subject to taxation (the "throwback rule");
- services performed within Texas;
- rentals of property situated in Texas;
- royalties from use of patents or copyrights within Texas;
- revenues from the use of trademarks, franchises, or licenses (not including the sale or license of computer software or programs) within Texas, effective for reports originally due on or after January 1, 1998;
- the net gain from the sales of investments or capital assets (See definition in Item 4.) A net loss is treated as zero receipts. If the combination of net gains and losses results in a net gain and both Texas and non-Texas sales have occurred, a separate calculation of net gains and losses on Texas sales must be made. Sales of intangible investments or capital assets (e.g., stocks, bonds, goodwill, partnership interests, etc.) to corporations incorporated in Texas are gross receipts in Texas. If the Texas net gain is greater than the total net gain, the Texas net gain to report equals the total net gain; and
- all other business receipts within Texas.

For example, interest received from a corporation incorporated in Texas is a Texas receipt.

NOTE: For reports due before January 1, 2000, dividends and interest received by a banking corporation or savings and loan association are Texas receipts if the bank corporation or savings and loan association has its commercial domicile in Texas. For reports due on or after January 1, 2000, dividends and interest received by a banking

corporation or savings and loan association are Texas receipts if they are paid by a corporation incorporated in Texas or if they are paid by an entity or person legally domiciled in Texas.

Any item of revenue which is excluded from net taxable earned surplus under Texas law or United States law is not included in Texas receipts or gross receipts everywhere.

For example, a corporation should not include in Texas receipts and gross receipts everywhere the following:

- income recorded because of Sections 78 or 951-964 of the Internal Revenue Code;
- dividends received from a subsidiary, associate, or affiliated corporation that does not transact a substantial portion of its business or regularly maintain a substantial portion of its assets in the United States;
- dividends and/or interest received from federal obligations excluded from the earned surplus tax base; or
- dividends for which a "dividends received" deduction is allowed on Schedule C of Form 1120 (also reported in Item 6a of this report).

NOTE: Do not include allocated earned surplus amounts in Item 3 or 4. See Item 11.

ITEM 4 - Gross receipts everywhere include:

- all sales of tangible personal property;
- all rentals;
- all services;
- all royalties;
- all other business receipts;
- all dividends and interest not otherwise excluded by operation of law or rules; and
- the net gain from the sales of investments or capital assets. (A net loss is treated as zero receipts.)

A capital asset is any asset, other than an investment, which is held for use in the production of income, and is subject to depreciation, depletion or amortization. An investment is any non-cash asset not a capital asset and not held as inventory or proceeds from the sale of inventory.

Any item of revenue which is excluded from net taxable earned surplus under Texas law or United States law is not included in Texas receipts or receipts everywhere. For examples, see Item 3.

ITEM 5 - If Texas gross receipts are zero, enter zero. If Item 3 and Item 4 are the same and greater than zero, you should enter 1.0000. Otherwise, divide Item 3 by Item 4. You must round to 4 places past the decimal.

ITEM 6 - Except for the adjustments indicated below, 1) corporations and limited liability companies (LLCs) filing a Form 1120 for federal income tax purposes should enter the federal taxable income before net operating loss deductions and special deductions; 2) LLCs which are treated as partnerships for federal income tax purposes and S corporations should enter the amount of income reportable to the Internal Revenue Service as taxable to the members or shareholders (which includes ordinary income and certain income and expense items reflected on Schedule K of Form 1065 or Form 1120S); 3) LLCs which are treated as sole proprietorships for federal income tax purposes should report the taxable income and deductions reflected on Form 1040, including attachments and schedules that relate to the LLC.

An LLC treated as a division of a corporation for federal income tax purposes is subject to franchise tax as a separate legal entity. A consolidated franchise tax report with the corporation cannot be filed.

A Qualified Subchapter S subsidiary is subject to franchise tax as a separate legal entity. A consolidated franchise tax report with its parent cannot be filed.

Before entering these federal taxable income

amounts on Item 6, the following adjustments must be made:

- If the income includes dividends and/or interest on federal obligations, these amounts should be subtracted.
- Any amounts which must be included in allocated earned surplus on Item 11 must be subtracted.

Reports Originally Due Prior to January 1, 1996 - The Internal Revenue Code (IRC), in effect for the 1990 calendar year, must be used in computing earned surplus. See the discussion under Accounting Methods.

Reports Originally Due On or After January 1, 1996 - If the required use of the 1990 IRC in computing earned surplus on reports originally due prior to 1996 (as discussed above) caused differences between federal taxable income for federal income tax purposes and federal taxable income used in computing earned surplus, the corporation should report the difference for earned surplus purposes based on the 1990 IRC. See the discussion under Accounting Methods, for additional information about the IRC that must be used in computing earned surplus. If the amount is negative, bracket the amount as follows: <XX,XXX>.

ITEM 7 - a. Enter total deductions allowed on Schedule C, U.S. Corporation Income Tax Return, Form 1120.

b. Enter amount of income included in Item 6 which is income because of Sections 78 or 951-964 of the Internal Revenue Code.

Enter amount of dividends included in Item 6 that were received from a subsidiary, associate or affiliated corporation that does not transact a substantial portion of its business or regularly maintain a substantial portion of its assets in the United States.

ITEM 8 - Skip this item and go to Item 9 if the corporation, bank, or limited liability company is not a subsidiary and:

- 1) has 35 or fewer shareholders/members for the entire period in Item 1, or
- 2) is an S corporation for the entire period.

Also skip this item if the corporation, bank, or limited liability company is a subsidiary and the parent qualifies for the exception as described above.

If you do not qualify for one of the exceptions above:

- Corporations (other than banking corporations) should enter the amount of compensation reportable to officers and directors on Forms W-2 and 1099 for the portion of the period in Item 1 during which the corporation does not qualify for an exception. LLCs which are treated as corporations for federal income tax purposes should enter the amount of compensation reportable to managers and officers on Forms W-2 and 1099 for the portion of the period in Item 1 during which the LLC does not qualify for an exception.
- Banks should enter compensation of executive officers and directors reportable on Forms W-2 and 1099 for the portion of the period in Item 1 during which the bank does not qualify for an exception.
- Limited liability companies treated as partnerships for federal income tax purposes should enter guaranteed payments or compensation to managers and officers for services for the portion of the period in Item 1 during which the limited liability company does not qualify for an exception.

NOTE: Any person designated as an officer is presumed to be an officer if the person (1) holds an office created by the board of directors or by the corporate charter or by-laws, and (2) has legal authority to bind the corporation with third parties. See Rule 3.558 for more information.

ITEM 9 - If this amount is negative, bracket the amount as follows: <XX,XXX>. If Item 6 is negative,

Item 7 will increase the negative amount and Item 8 will reduce the negative amount.

ITEM 10 - If Item 9 is negative, the percentage of the negative amount apportioned to Texas should be entered in Item 10 in brackets as follows: <XX,XXX>.

ITEM 11 - If the corporation's commercial domicile is not in Texas, Item 11 should be zero.

Corporations with a Texas commercial domicile may need to allocate certain income items to Texas. Income items that are considered non-unitary, except dividends and interest, must be allocated to Texas and reported in Item 11.

Non-unitary income must be entered in Item 11 net of related expenses. This amount must be excluded from Items 3, 4, and 6. If the amount is negative, bracket the amount as follows: <XX,XXX>.

NOTE: All income is presumed to be unitary. If all of a corporation's income is used in its operations, it will be considered unitary income. For example, investment income from stocks, bonds, etc. that is part of operating revenue is considered unitary. Such income will be apportioned and will not be subject to allocation.

ITEM 13 - Enter the amount of business loss from previous franchise tax reports that will be used to reduce apportioned and allocated earned surplus on this report. A business loss is any negative amount after apportionment and allocation.

Apportioned and allocated earned surplus may not be reduced below zero by a business loss carryover. If Item 12 is zero or less, enter zero in Item 13.

ITEM 14 - If Item 12 is zero or less, Item 14 will be zero.

ITEM 16 - Credits that may be entered in Item 16 include:

- 1) Credit amounts reported by banks for tax erroneously paid on reports originally due prior to January 1, 1992.
- 2) Credit amounts for sales tax paid on property used in manufacturing pursuant to Sec. 171.0021 of the Texas Tax Code. The credit is the sum of: A) 25 percent of the state tax paid to the state under Chapter 151 for property purchased on or after October 1, 1991, and on or before December 31, 1992; and B) 50 percent of the state tax paid to the state under Chapter 151 for property purchased on or after January 1, 1993, and on or before September 30, 1993. (The credit is not available for local taxes.)
The credit may be claimed, until completely used, on any of the first five reports which are originally due on or after January 1, 1994.
The credit claimed on a report may not exceed the tax due. A corporation may not convey, assign, or transfer the credit to another entity.

NOTE: The 1999 report is the last report for which a corporation can claim this credit.

- 3) Credits allowed to title insurance companies. See Rule 3.566 for credit qualifications and calculations.
NOTE: Credits for extension payments or prior payments should not be entered in this item. Enter extension payments or prior payments in Item 19.

Total tax credits from item 14 of Schedule D, the Texas Franchise Tax Credit Summary.

NOTE: The total amount of credit entered in Item 16 cannot be used to reduce Item 17 below zero.

ITEM 18 - If Item 17 is less than \$100, you do not owe tax. For reports due on or after January 1, 2000, if Item 4 is less than \$150,000, you do not owe tax. Enter zero in Item 18 and return the report.

ITEM 19 - Enter prior payments such as a payment made with an original final return if this is an amended final report.