ADOPTED RULES

Adopted rules include new rules, amendments to existing rules, and repeals of existing rules. A rule adopted by a state agency takes effect 20 days after the date on which it is filed with the Secretary of State unless a later date is required by statute or specified in the rule (Government Code, §2001.036). If a rule is adopted without change to the text of the proposed rule, then the *Texas Register* does not republish the rule text here. If a rule is adopted with change to the text of the proposed rule, then the final rule text is included here. The final rule text will appear in the Texas Administrative Code on the effective date.

TITLE 1. ADMINISTRATION

PART 15. TEXAS HEALTH AND HUMAN SERVICES COMMISSION

CHAPTER 383. INTERSTATE COMPACT ON MENTAL HEALTH AND MENTAL RETARDATION

1 TAC §§383.101, 383.103, 383.105, 383.107, 383.109, 383.111, 383.113, 383.115, 383.117, 383.119, 383.121, 383.123

The Texas Health and Human Services Commission (HHSC) adopts the repeal of §383.101, concerning Purpose; §383.103, concerning Application; §383.105, concerning Definitions; §383.107, concerning Prerequisite for Transfer; §383.109, concerning Legal Basis for Institutionalization; §383.111, concerning Coordinating Requests for Interstate Transfer; §383.113, concerning Requests for Persons with Mental Retardation To Be Transferred from Texas; §383.115, concerning Requests for Persons with Mental Illness To Be Transferred from Texas; §383.117, concerning Requests for Persons with Mental Retardation to Transfer to Texas; §383.119, concerning Requests for Persons with Mental Illness to Transfer to Texas; §383.121, concerning Exhibits; and §383.123, concerning References.

The repeal of the rules is adopted without changes to the proposed text as published in the October 16, 2020, issue of the *Texas Register* (45 TexReg 7356). The rules will not be republished.

BACKGROUND AND JUSTIFICATION

The rules are repealed from Texas Administrative Code (TAC) Title 1, Part 15, Chapter 383 and new rules are adopted elsewhere in this issue of the *Texas Register,* in 26 TAC Chapter 903, Interstate Compact on Mental Health and Intellectual and Developmental Disabilities. The new rules in Chapter 903 update and reorganize rules addressing the interstate compact on mental health and intellectual and developmental disabilities.

COMMENTS

The 31-day comment period ended November 16, 2020.

During this period, HHSC did not receive any comments regarding the proposed repeal of these rules.

STATUTORY AUTHORITY

The repeals are authorized by Texas Government Code §531.0055, which provides that the Executive Commissioner of HHSC shall adopt rules for the operation and provision of services by the health and human services agencies, and Texas Health and Safety Code §§533.014, 533.0356, 533A.0355, 571.006 and 612.004 which authorize creation of rules related to this topic.

The agency certifies that legal counsel has reviewed the adoption and found it to be a valid exercise of the agency's legal authority.

Filed with the Office of the Secretary of State on December 29, 2020.

TRD-202005722
Karen Ray
Chief Counsel
Health and Human Services Commission
Effective date: January 18, 2021
Proposal publication date: October 16, 2020
For further information, please call: (512) 438-3049

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TITLE 19. EDUCATION

PART 2. TEXAS EDUCATION AGENCY

CHAPTER 151. COMMISSIONER'S RULES CONCERNING PASSING STANDARDS FOR EDUCATOR CERTIFICATION EXAMINATIONS

19 TAC §151.1001

The Texas Education Agency adopts an amendment to §151.1001, concerning passing standards for educator certification examinations. The amendment is adopted without changes to the proposed text as published in the November 6, 2020 issue of the *Texas Register* (45 TexReg 7929) and will not be republished. The adopted amendment specifies the satisfactory scores for the following new educator certification examinations: Core Subjects: EC-6, Science of Teaching Reading, Early Childhood: PK-3, Educational Diagnostician, School Counselor, and Pedagogy and Professional Responsibilities for Trade and Industrial Education 6-12.

REASONED JUSTIFICATION: Texas Education Code, §21.048(a), requires the commissioner of education to establish the satisfactory levels of performance required on educator certification examinations and require a satisfactory level of performance on each core subject covered by an examination.

The amendment adopts passing standards for the new Core Subjects: EC-6, Science of Teaching Reading, Early Childhood: PK-3, Educational Diagnostician, School Counselor, and Pedagogy and Professional Responsibilities for Trade and Industrial Education 6-12 examinations.

A standard setting committee of educators developed a recommended passing standard for each subtest of the Core Subjects: EC-6 examination. The amendment to §151.1001(b)(1) implements the committee-recommended passing standard for each Core Subjects: EC-6 subtest.

The amendment also modifies §151.1001(b)(1), (b)(14), and (c) to implement an initial passing standard for the Science of Teaching Reading, Early Childhood: PK-3, Educational Diagnostician, School Counselor, and Pedagogy and Professional Responsibilities for Trade and Industrial Education 6-12 examinations. The initial passing standard includes the passing standard for selected-response and constructed-response examination sections. During the introductory period, the initial passing standards for the constructed-response section of each examination will be "complete." The adopted amendment defines "complete" as a full and complete scorable response that must address the specific requirements of the item, be of sufficient length to respond to the requirements of the item, be original work and written in the candidate's own words (however, candidates may use citations when appropriate), and conform to the standards of written English. The adopted amendment implements the initial passing standard of "complete" for each examination during an eight-month introductory period. This introductory period and the "complete" passing standard provide candidates and educator preparation programs with a transition period to adjust to more rigorous examinations without the deterrence or penalty that comes with a rigorous passing standard and allows for the collection of examination performance data to inform the development of passing standards for both the select-response and constructed-response sections after the introductory period.

Standard setting committees for each examination will develop recommendations to be used to develop passing standards after the introductory period. The initial passing standards for the Science of Teaching Reading, Early Childhood: PK-3, and Educational Diagnostician examinations will be implemented prior to September 6, 2021, and the initial passing standards for the School Counselor and Pedagogy and Professional Responsibilities for Trade and Industrial Education 6-12 examinations will be implemented prior to May 3, 2022.

SUMMARY OF COMMENTS AND AGENCY RESPONSES: The public comment period on the proposal began November 6, 2020, and ended December 7, 2020. Following is a summary of the public comment received and the corresponding agency response.

Comment: A candidate seeking School Counselor certification provided a statement requesting a change to School Counselor certification requirements to include obtaining a bachelor's degree; having a master's degree in school counseling or any child psychology; completing "certain hours" working under a counselor; and making it optional to have experience as a teacher, substitute, or any other teaching experience before applying for certification.

Agency Response: This comment is outside the scope of the current rule proposal, which addresses certification examination passing standards.

STATUTORY AUTHORITY. The amendment is adopted under Texas Education Code, §21.048(a), which requires the commissioner to determine the level of performance considered to be satisfactory on educator certification examinations and further authorizes the commissioner to require a satisfactory level of performance on each core subject covered by an examination.

CROSS REFERENCE TO STATUTE. The amendment implements Texas Education Code, §21.048(a).

The agency certifies that legal counsel has reviewed the adoption and found it to be a valid exercise of the agency's legal authority.

Filed with the Office of the Secretary of State on December 30, 2020.

TRD-202005745
Cristina De La Fuente-Valadez
Director, Rulemaking
Texas Education Agency
Effective date: January 19, 2021
Proposal publication date: November 6, 2020
For further information, please call: (512) 475-1497

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TITLE 25. HEALTH SERVICES

PART 1. DEPARTMENT OF STATE HEALTH SERVICES

CHAPTER 1. MISCELLANEOUS PROVISIONS
SUBCHAPTER V. ADULT STEM CELLS

25 TAC §1.462

The Executive Commissioner of the Texas Health and Human Services Commission (HHSC), on behalf of the Department of State Health Services (DSHS), adopts amendment to §1.462, relating to Informed Consent for Investigational Stem Cell Treatment.

The amendment to §1.462 is adopted without changes to the proposed text as published in the September 11, 2020, issue of the *Texas Register* (45 TexReg 6313); the rule will not be republished.

BACKGROUND AND JUSTIFICATION

The amendment is necessary to implement House Bill (H.B.) 3148, 86th Legislature, Regular Session, 2019, which amended Texas Health and Safety Code, §1003.054(c), to require the Executive Commissioner of HHSC, by rule, to adopt an informed consent form that must be signed by an eligible patient before receiving an investigational stem cell treatment. The Executive Commissioner delegated the development of the informed consent form and rule amendment to DSHS. H.B. 3148 requires the informed consent form to provide notice that DSHS administers Texas Health and Safety Code, Chapter 1003, Adult Stem Cells.

Before this amendment, Texas Health and Safety Code, Chapter 1003, was permissive and did not require the Executive Commissioner to adopt an informed consent form. Under the current §1.462, physicians are required to provide the written informed consent to the eligible patient. The adopted standard informed consent form helps ensure that eligible patients are informed that investigational stem cell treatments, as defined by Chapter 1003, must be part of a clinical trial and are not approved for general use by the United States Food and Drug Administration.

COMMENTS

The 31-day comment period ended October 12, 2020. During this period, DSHS received comments regarding the proposed

rule from two commenters, including the Texas Medical Association (TMA) and one individual. A summary of comments relating to §1.462 and DSHS's responses follows.

Comment: A commenter recommended including a review schedule for the DSHS informed consent form referenced in §1.462.

Response: DSHS disagrees and declines to revise the rule in response to this comment. The consent form will not be codified in rule to allow flexibility for updates, as necessary, to comply with any changes in statute or rule and with approval from the Executive Commissioner.

Comment: Two commenters indicated that §1.462(b) is unclear and suggests that additional consent, beyond the adopted informed consent form, is required.

Response: DSHS disagrees and declines to revise the rule or form in response to this comment. The intent of the informed consent form prescribed in accordance with Texas Health and Safety Code, §1003.054, is for the patient to acknowledge they have been informed that the investigational stem cell treatment is a treatment that is part of a clinical trial, but not yet approved for general use by the United States Food and Drug Administration. Additional consent forms related to the clinical trial for a specific class of investigational stem cell treatment may be required by the physician administering the investigational stem cell treatment or overseeing the clinical trial.

In addition to comments received for changes to the rule text, DSHS received comments regarding DSHS's draft Informed Consent Form as posted on the DSHS website.

Comment: TMA suggested including an acknowledgment of the physician's consultation regarding the patient's treatment options on the informed consent form.

Response: DSHS agrees and revises the informed consent form as suggested that is located on the DSHS's website at www.dshs.texas.gov/chronic/.

Comment: TMA suggested the informed consent form be clarified to avoid any potential ambiguity between the informed consent form and disclosure form.

Response: DSHS agrees and revises the informed consent form located on the DSHS website.

Comment: TMA suggested that DSHS clarify the information required for the "Treatment Information" field on the informed consent form located on DSHS's website.

Response: DSHS agrees and revises the informed consent form to clarify that treatment information refers to the investigational stem cell treatment/clinical trial information.

STATUTORY AUTHORITY

The amendment is authorized by Texas Health and Safety Code §1003.054, which requires the Executive Commissioner of HHSC, by rule, to adopt an informed consent form that must be signed by an eligible patient before receiving an investigational stem cell treatment. The amendment is also authorized by Texas Government Code, §531.0055 and Texas Health and Safety Code, §1001.075, which provides that the Executive Commissioner of HHSC shall adopt rules and policies necessary for the operation and provision of services by DSHS and for the administration of Texas Health and Safety Code, Chapters 1001 and 1003.

The agency certifies that legal counsel has reviewed the adoption and found it to be a valid exercise of the agency's legal authority.

Filed with the Office of the Secretary of State on December 29, 2020.

TRD-202005721
Barbara L. Klein
General Counsel
Department of State Health Services
Effective date: January 18, 2021
Proposal publication date: September 11, 2020
For further information, please call: (512) 939-7575

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TITLE 26. HEALTH AND HUMAN SERVICES

PART 1. HEALTH AND HUMAN SERVICES COMMISSION

CHAPTER 306. BEHAVIORAL HEALTH DELIVERY SYSTEM

SUBCHAPTER D. MENTAL HEALTH SERVICES--ADMISSION, CONTINUITY, AND DISCHARGE

DIVISION 5. DISCHARGE AND ABSENCES FROM A STATE MENTAL HEALTH FACILITY OR FACILITY WITH A CONTRACTED PSYCHIATRIC BED

26 TAC §306.204

The Texas Health and Human Services Commission (HHSC) adopts an amendment to §306.204, concerning Discharge of an Individual Involuntarily Receiving Treatment. The amendment to §306.204 is adopted with changes to the proposed text as published in the September 25, 2020, issue of the *Texas Register* (45 TexReg 6665). This rule will be republished.

BACKGROUND AND JUSTIFICATION

The amendment is necessary to implement §574.081(c-2) of the Texas Health and Safety Code, as amended by Senate Bill 362, 86th Legislature, Regular Session, 2019. The amendment outlines requirements for private mental health facilities with a contracted psychiatric bed (CPB) through HHSC, or funded and operated by a local mental health authority or local behavioral health authority, to provide psychoactive medication, and any other medication prescribed to counteract adverse side effects of psychoactive medication, at the time an individual receiving court-ordered inpatient mental health services is furloughed or discharged from a facility with a CPB. The facility with a CPB is only required to provide the medication if funding is available from HHSC to cover the cost of the medications. The facility with a CPB is not required to provide or pay for more than a seven-day supply of the medication.

COMMENTS

The 31-day comment period ended October 26, 2020.

During this period, HHSC received comments regarding the proposed rule amendment from two commenters, including Disability Rights Texas and one individual. A summary of comments relating to the rule and HHSC's responses follows.

Comment: A commenter suggested that the rules ensure an individual has medications to bridge the gap between release and outpatient treatment in circumstances where there is a delay in the individual getting to their ongoing provider. It was also suggested that the rules require the facility with a CPB to verify the individual's appointment with the ongoing provider.

Response: HHSC is not authorized to provide or pay for psychoactive medication for more than seven days after furlough or discharge pursuant to Health and Safety Code §574.081(c-2). HHSC declines to modify the rule in response to this comment.

Comment: A commenter suggested that the rule language include HHSC contact information for an individual discharged from a facility with a CPB to verify availability of funding to confirm whether their psychoactive medication should be provided or paid for at furlough or discharge.

Response: HHSC agrees and revised the rule by adding new paragraph (C) at §306.204(c)(3). The new paragraph requires a facility with a CPB to inform an individual if funding is not available to provide or pay for medications upon the individual's furlough or discharge. The rule was also revised to add a cross-reference that requires an individual's designated local mental health authority or local behavioral health authority to pay for the medication, if applicable.

A minor editorial change was made to §306.204(d) replacing the word "conjunction" with "accordance" for clarity.

STATUTORY AUTHORITY

The amendment is adopted under Texas Government Code §531.0055, which provides that the Executive Commissioner of HHSC shall adopt rules for the operation and provision of services by the health and human services agencies, and Health and Safety Code §574.081(c-2), which requires HHSC to adopt rules to determine the quantity and manner of providing psychoactive medications to patients furloughed or discharged from certain hospitals pursuant to §574.081.

§306.204. Discharge of an Individual Involuntarily Receiving Treatment.

(a) Discharge from emergency detention.

(1) Except as provided by §306.178 of this subchapter (relating to Voluntary Treatment Following Involuntary Admission) and in accordance with Texas Health and Safety Code §573.021(b) and §573.023(b), an SMHF or facility with a CPB immediately discharges an individual under emergency detention if:

(A) the SMHF administrator, administrator of the facility with a CPB, or designee concludes, based on a physician's determination, the individual no longer meets the criteria in §306.176(c)(1) of this subchapter (relating to Admission Criteria for a Facility with a Contracted Psychiatric Bed Authorized by an LMHA or LBHA or for a State Mental Health Facility for Emergency Detention); or

(B) except as provided in paragraph (2) of this subsection:

(i) 48 hours has elapsed from the time the individual was presented to the SMHF or facility with a CPB; and

(ii) the SMHF or facility with a CPB has not obtained a court order for further detention of the individual.

(2) In accordance with Texas Health and Safety Code §573.021(b), if the 48-hour period described in paragraph (1)(B)(i) of this subsection ends on a Saturday, Sunday, or legal holiday, or before 4:00 p.m. on the next business day after the individual was presented to the SMHF or facility with a CPB, the SMHF or facility with a CPB detains the individual until 4:00 p.m. on such business day.

(b) Discharge under order of protective custody. Except as provided by §306.178 of this subchapter and in accordance with Texas Health and Safety Code §574.028, an SMHF or facility with a CPB immediately discharges an individual under an order of protective custody if:

(1) the SMHF administrator, facility with a CPB administrator, or designee determines that, based on a physician's determination, the individual no longer meets the criteria described in Texas Health and Safety Code §574.022(a);

(2) the SMHF administrator, facility with a CPB administrator, or designee does not receive notice that the individual's continued detention is authorized after a probable cause hearing held within the time period prescribed by Texas Health and Safety Code §574.025(b);

(3) a final order for court-ordered inpatient mental health services has not been entered within the time period prescribed by Texas Health and Safety Code §574.005; or

(4) an order to release the individual is issued in accordance with Texas Health and Safety Code §574.028(a).

(c) Discharge under court-ordered inpatient mental health services.

(1) Except as provided by §306.178 of this subchapter and in accordance with Texas Health and Safety Code §574.085 and §574.086(a), an SMHF or facility with a CPB immediately discharges an individual under a temporary or extended order for inpatient mental health services if:

(A) the order for inpatient mental health services expires; or

(B) the SMHF administrator, administrator of the facility with a CPB, or designee concludes that, based on a physician's determination, the individual no longer meets the criteria for court-ordered inpatient mental health services.

(2) In accordance with Texas Health and Safety Code §574.086(b), before discharging an individual in accordance with paragraph (1) of this subsection, the SMHF administrator, administrator of the facility with a CPB, or designee considers whether the individual should receive court-ordered outpatient mental health services in accordance with a modified order described in Texas Health and Safety Code §574.061.

(3) In accordance with Texas Health and Safety Code §574.081, at the time an individual receiving court-ordered inpatient mental health services is furloughed or discharged from a facility with a CPB, a facility with a CPB is responsible for providing or paying for psychoactive medication and any other medication prescribed to counteract adverse side effects of psychoactive medication.

(A) A facility with a CPB is only required to provide or pay for these medications if funding to cover the cost of the medications is available to be paid to the facility for this purpose from HHSC.

(B) The facility with a CPB must provide or pay for the medications in an amount sufficient to last until the individual can see a physician, or provider with prescriptive authority, but the facility with a CPB is not required to provide or pay for more than a seven-day supply.

(C) The facility with a CPB must inform an individual if funding is not available to provide or pay for the medications upon furlough or discharge. If funding is not available, the individual's designated LMHA or LBHA is responsible for providing psychoactive medications as provided in §306.207(2)(A) of this division (relating to Post Discharge or Absence for Trial Placement: Contact and Implementation of the Recovery or Treatment Plan), if applicable.

(4) Individuals committed under Texas Code of Criminal Procedure, Chapter 46B or 46C may only be discharged as provided by §306.202(f) of this division (relating to Special Considerations for Discharge Planning).

(d) Discharge packet. An SMHF administrator, administrator of a facility with a CPB, or designee forwards a discharge packet, as provided in §306.201(h) of this division (relating to Discharge Planning), of any individual committed under the Texas Code of Criminal Procedure to the jail and the LMHA or LBHA in accordance with state and federal privacy laws.

The agency certifies that legal counsel has reviewed the adoption and found it to be a valid exercise of the agency's legal authority.

Filed with the Office of the Secretary of State on December 31, 2020.

TRD-202005748
Karen Ray
Chief Counsel
Health and Human Services Commission
Effective date: January 20, 2021
Proposal publication date: September 25, 2020
For further information, please call: (512) 838-4314

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CHAPTER 903. INTERSTATE COMPACT ON MENTAL HEALTH AND INTELLECTUAL AND DEVELOPMENTAL DISABILITIES

26 TAC §§903.1 - 903.8

The Texas Health and Human Services Commission (HHSC) adopts new §903.1, concerning Purpose; §903.2, concerning Application; §903.3, concerning Definitions; §903.4, concerning Prerequisite for Transfer; §903.5, concerning Legal Basis for Institutionalization; §903.6, concerning Coordinating Requests for Interstate Transfer; §903.7, concerning Requests for a Person with Mental Illness or Intellectual and Developmental Disabilities to Transfer from Texas; and §903.8, concerning Requests for a Person with Mental Illness or Intellectual and Developmental Disabilities to Transfer to Texas.

Section 903.7 is adopted with changes to the proposed text as published in the October 16, 2020, issue of the *Texas Register* (45 TexReg 7390). The rule will be republished in the *Texas Register.* Sections 903.1 - 903.6 and 903.8 will be adopted without changes to the proposed text as published in the October 16, 2020, issue of the *Texas Register* (45 TexReg 7390). The rules will not be republished.

BACKGROUND AND JUSTIFICATION

The new chapter contains updated and reorganized rules related to the interstate compact on mental health and intellectual and developmental disabilities. These rules replace rules in 1 TAC Chapter 383. The repeal of 1 TAC Chapter 383 is located elsewhere in this issue of the *Texas Register.*

COMMENTS

The 31-day comment period ended on November 16, 2020.

During this period, HHSC Health and Specialty Care System (HSCS) received one comment from HHSC Intellectual and Developmental Disability Services (IDDS) regarding the proposed rules.

Comment: IDDS asked who is responsible for ensuring the person served or legally authorized representative is informed that an interstate transfer will not occur (§903.7(c)).

Response: HSCS agrees with the commenter's concern and revised §903.7(c) to designate who is responsible.

STATUTORY AUTHORITY

The new sections are authorized by Texas Government Code §531.0055, which provides that the Executive Commissioner of HHSC shall adopt rules for the operation and provision of services by the health and human services agencies, and Texas Health and Safety Code §§533.014, 533.0356, 533A.0355, 571.006 and 612.004 which authorize creation of rules related to this topic.

§903.7. Requests for a person with Mental Illness or Intellectual and Developmental Disabilities to Transfer from Texas.

(a) A letter of request for interstate transfer of a person with mental illness or intellectual and developmental disabilities from a state hospital or SSLC must be sent to the Texas ICC by email (preferred) or mail.

(b) State hospital or SSLC staff must discuss the proposed transfer and the person's preference with the person, the person's LAR, and the person's family, or, if appropriate, other available sources to ascertain whether the transfer is in the person's best interest.

(c) If the transfer will not occur, the Texas ICC must provide written notification to the person or LAR and the individual who requested the transfer that the transfer will not occur and the reason for not proceeding with the transfer.

(d) The Texas ICC must contact the receiving state's ICC and make a reasonable effort to obtain authorization for the transfer if HHSC determines the transfer of a person is in the person's best interest.

(e) If the person is proposed to be transferred from a state hospital or SSLC to a facility in another state that is a party to the interstate compact, HHSC must not take final action without the approval of the committing Texas court.

(f) If the receiving state decides to accept the person for immediate transfer, then the state hospital or SSLC must:

(1) make all travel arrangements, including coordinating with the facility in the receiving state to assist with travel inside the receiving state;

(2) be responsible for all transfer expenses;

(3) ensure arrangements are made for an escort or escorts to accompany and assist the person to reach their destination;

(4) ensure the following items accompany the person upon transfer to the receiving state:

(A) all appropriate legal documents;

(B) the person's Medicaid, Medicare, or third-party insurance card or cards, if available;

(C) copies of all the person's laboratory reports and physical exams conducted within the past 30 days and any additional significant reports made within the past year;

(D) all the person's personal belongings at the state hospital or SSLC; and

(E) the supply of all prescribed medication as agreed upon by the sending and receiving facilities.

(g) The Texas ICC must ensure all authorized parties are informed of the progress made on the transfer request.

The agency certifies that legal counsel has reviewed the adoption and found it to be a valid exercise of the agency's legal authority.

Filed with the Office of the Secretary of State on December 29, 2020.

TRD-202005723
Karen Ray
Chief Counsel
Health and Human Services Commission
Effective date: January 18, 2021
Proposal publication date: October 16, 2020
For further information, please call: (512) 438-3049

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TITLE 34. PUBLIC FINANCE

PART 1. COMPTROLLER OF PUBLIC ACCOUNTS

CHAPTER 3. TAX ADMINISTRATION

SUBCHAPTER V. FRANCHISE TAX

34 TAC §3.591

The Comptroller of Public Accounts adopts amendments to §3.591, concerning margin: apportionment, with changes to the proposed text as published in the November 13, 2020, issue of the *Texas Register* (45 TexReg 8104). The rule will be republished.

The amendments implement House Bill 500, 83rd Legislature, 2013, effective January 1, 2014 and House Bill 2896, 84th Legislature, 2015, effective January 1, 2018. The amendments also update the section to reflect current guidance and improve readability.

The comptroller received comments regarding the proposed amendments from Jo Ellen Stark of Union Pacific; Celeste Embrey of Texas Bankers Association; Kim Chamberlain of Securities Industry and Financial Market Association (SIFMA); Chris Rosas of Rackspace; Angela Miele of Motion Picture Association; Patrick Reynolds of Council on State Taxation (COST); Dale Craymer of Texas Taxpayers and Research Association (TTARA); Sandi Farquharson of Ryan; and Brandon Newton of Crowe LLP.

Throughout the section, the comptroller adds titles to statutory citations; replaces the term intangibles with intangible assets; replaces the term receipts with gross receipts; replaces the term gross receipts everywhere with gross receipts from an entity's entire business; references other relevant sections; replaces the term apportioned with sourced; replaces the term legal domicile of payor with location of payor; replaces the term revenue with gross receipts; and makes minor revisions to improve readability.

The comptroller amends the definition of "capital asset" in subsection (b)(1) to remove language that makes it circular with the definition of "investment" in subsection (b)(6).

The comptroller removes former subsection (b)(2), the definition of "commercial domicile," and renumbers the subsequent paragraphs as necessary. The definition is no longer necessary as the term is no longer used in this section.

The comptroller amends renumbered subsection (b)(3) to revise the definition of "gross receipts" to reflect that certain non-receipt items excluded when calculating total revenue are not used in calculating gross receipts. Any item of revenue excluded from total revenue is not included in computing gross receipts under Tax Code, §171.1055(a). For most entities, gross receipts will equal the amount reported in total revenue unless the taxable entity has excluded non-receipt items from total revenue that must be added back when computing gross receipts, including: $500 per pro bono services case; the actual cost of uncompensated care; the direct cost of providing waterway transportation; the direct cost of providing agricultural aircraft services and the cost of a vaccine. For example, under Tax Code, §171.1011(g-3) (Determination of Total Revenue from Entire Business), an attorney may exclude $500 from total revenue for handling a pro bono case. Since the $500 is not a receipt, there is no exclusion for pro bono work when calculating gross receipts.

The comptroller adds new language to the definition of "Internal Revenue Code" in renumbered subsection (b)(4) to specify that the federal tax year beginning on January 1, 2007, is the operative federal tax year for references to the Internal Revenue Code (IRC). The new language replaces the reference to Tax Code, §171.0001 (General Definitions).

The comptroller adds new subsection (b)(5) to define "inventory." This definition is based on the discussion of inventory from IRC §1221(a)(1) and incorporates the guidance provided by STAR Accession No. 201311792L (November 21, 2013).

Sandi Farquharson of Ryan requests that following language be deleted from the definition: "Securities and loans for investment, hedging, or risk management purposes are not inventory." However, the comptroller will retain the language because it is an accurate statement that will assist auditors and taxpayers in determining what is and is not inventory.

The comptroller amends the definition of "investment" in subsection (b)(6) to make clear that inventory is not included in investments. The definition incorporates the guidance provided by STAR Accession No. 201311792L.

The comptroller amends the definition of "legal domicile" in subsection (b)(7) to remove the definition of "principal place of business" because the term will be separately defined in subsection (b)(9).

The comptroller adds new subsection (b)(9) to define "principal place of business" for all taxable entities. The definition is based on the United States Supreme Court decision, *Hertz Corp. v. Friend,* 559 U.S. 77, 92 (2010) where the court concluded that "...'principal place of business' is best read as referring to the place where a corporation's officers direct, control, and coordinate the corporation's activities."

The comptroller adds new subsection (b)(10) to define "regulated investment company." The definition is consistent with the language in Tax Code, §171.106(b) (Apportionment of Margin to this State). Subsequent paragraphs are renumbered accordingly.

Sandi Farquharson of Ryan comments that the parenthetical reference to IRC § 475(c)(2) in subsection (b)(11) should be "Security Defined" rather than "Mark to market accounting method for dealers in securities." The comptroller lists the title of the section rather than the title of the paragraph within the section. Therefore, the comptroller declines to make this change.

The comptroller adds new subsection (b)(14) to define "Texas gross receipts" pursuant to Tax Code, §171.103 (Determination of Gross Receipts from Business Done in this State for Margin).

The comptroller amends subsection (c)(1) to provide guidance from Tax Code, §171.106(b) relating to the sourcing of receipts from services provided to a regulated investment company. New subparagraphs (A) and (B) provide guidance on how to determine Texas gross receipts and gross receipts from an entity's entire business, respectively, for a regulated investment company.

The comptroller amends subsection (c)(2) to track the statutory language in Tax Code, §171.106(c) relating to the sourcing of receipts from services provided to an employee retirement plan. New subparagraphs (A) and (B) provide guidance on how to determine Texas gross receipts and gross receipts from an entity's entire business, respectively, for an employee retirement plan.

The comptroller amends subsection (d)(1) to delete the reference to §3.595 (relating to Margin: Transition) as the transition period is no longer within the statute of limitations and §3.595 has been repealed.

The comptroller amends subsection (d)(2) to add language to limit the filing of an initial report to taxable entities with a beginning date prior to October 4, 2009, pursuant to §3.584(c)(1) (relating to Margin: Reports and Payments). The comptroller also adds reporting requirements for taxable entities with a beginning date on or after October 4, 2009, consistent with §3.584(c)(2).

The comptroller amends subsection (d)(5) to explain that exclusions under §3.587 of this title (relating to Margin: Total Revenue) that are non-receipt items are not deducted from receipts.

The comptroller amends the title to subsection (e) to more accurately reflect the contents of the subsection.

The comptroller deletes the original language in subsection (e)(1) concerning bad debt recoveries. The comptroller determines the guidance unnecessary and intends no change in policy by this deletion.

The comptroller adds language to subsection (e)(1) to consolidate the sourcing rules for receipts from advertising, which are currently addressed in subsection (e)(20) for newspapers or magazines, (e)(22) for radio/television, and (e)(26) for advertising services in other media. The new language in subsection (e)(1) will provide a uniform sourcing rule across all media and will be consistent with the amendments to the general rule for sourcing receipts from services in subsection (e)(26), which states that a service is performed at the location of the receipt-producing, end-product act.

Angela Miele of MPA requests that subsection (e)(1) be applied prospectively since it changes the sourcing of receipts for radio/television advertising transmitted from a location in Texas. The comptroller amends subsection (e)(1) to retain the option to source these receipts for prior periods based on the transmitter location, as provided in former subsection (e)(22).

The comptroller restructures subsection (e)(2) concerning capital assets and investments into new subparagraphs, and revises the treatment of the sale of investments and capital assets. To be consistent with the Texas Supreme Court decision in *Hallmark Marketing Co. v. Hegar,* 488 S.W.3d 795 (Tex. 2016), net losses are no longer included in gross receipts. In addition, for reports originally due on or after January 1, 2021, net gains and losses will be determined on a sale-by-sale basis.

Under the current rule, gains and losses during an accounting period are offset to determine a "net" amount. The comptroller adopted this rule to comply with the holding in *Calvert v. Electro-Science Investors, Inc.,* 509 S.W.2d 700 (Tex. Civ. App. - Austin 1974, no writ). *See* Tex. Comp. of Pub. Accts., Rule 026.02.12.013(2)(k) (1975) (STAR Accession No. 7601R1000B02). In its *Electro-Science* opinion, the Court of Appeals held that the plain meaning of "net gain" in the apportionment statute required that "gains and losses be offset against one another in order that a net figure be obtained."

However, more recently, in *Hallmark Marketing Co. v. Combs,* No. 13-14-00093-CV (Tex. App. - Corpus Christi-Edinburg 2014) (mem. op.), rev'd on other grounds, 488 S.W.3d 795 (2016), the Court of Appeals found that the statute was ambiguous:

"The ambiguity arises because it is unclear, by examining only the plain language of the statute, what the term 'net gain' means. On the one hand, 'net gain' may refer to the particular gain or loss that results from each individual sale when proceeds are offset by costs. ... On the other hand, 'net gain' may instead refer to the taxpayer's cumulative gain or loss on its various investment and capital asset sales made throughout the year."

The Texas Supreme Court reversed the Court of Appeals' *Hallmark* decision on other grounds, holding that "we do not need to relitigate the question in order to determine Hallmark did not have a net gain under any calculation." 488 S.W.3d at 799.

In the process of revising its rule to comply with the Supreme Court's determination that net losses may not be included in gross receipts, the comptroller has also evaluated its rule regarding the calculation of net gains and losses. The comptroller has concluded that the only reasonable interpretation of the statute is that "net gain" refers to the net amount resulting from proceeds of an asset sale reduced by the adjusted basis in the asset. Because the statute only permits the inclusion of net gains, the net loss from the sale of one asset cannot be used to offset the net gain from another asset.

The objective of the apportionment statute is to apportion an entity's total revenues based on the entity's business activity in Texas relative to the entity's entire business activity. The apportionment statute uses an entity's gross receipts as a proxy for business activity. Given this objective, it makes no sense to negate gains from one transaction with losses from another, resulting in one business activity essentially negating another.

Suppose a real estate investment company sold two Texas investment properties, with the loss on one sale equaling the gain on the other. If the loss offsets the gain for apportionment purposes, the company will have no Texas receipts and a zero Texas apportionment factor even though it had substantial business activity in the State. The comptroller has concluded that the Leg-

islature could not have intended that absurd result. Rather, the only reasonable interpretation of legislative intent is the opposite -- the Legislature provided that the "net gain," that is, a positive amount resulting from the proceeds from an asset sale less the asset's adjusted basis, is included in gross receipts, and the net gain should not be neutralized by net losses on other transactions.

Accordingly, new subparagraph (A) provides that only the "net gain" from the sale of an investment or capital asset should be included in gross receipts. New subparagraph (B) defines "net gain." New subparagraph (C) retains the legacy rule for legacy periods. New subparagraph (D) provides that sourcing as a Texas or non-Texas receipt is determined by the asset type. And new subparagraph (E) provides examples.

Celeste Embrey of TBA and Kim Chamberlain of SIFMA request that subsection (e)(2) still allow the netting of gains and losses. Both argue that computing the net gain or loss separately for each sale would cause undue burden and not allowing the netting of the losses could exclude a material segment of a taxpayer's business. The comptroller disagrees. The addition of only net gain involves fewer transactions than the addition of net gains and net losses, and it is the offsetting of gains with losses that could result in the exclusion of a material segment of a taxpayer's business.

Additionally, Sandi Farquharson of Ryan argues that the comptroller does not have the authority to limit the losses with respect to Texas receipts without a legislative change because Section 171.103 does not contain the same language as Section 171.105 with regards to including "only the net gain." The comptroller addressed this argument in STAR Accession 202001008L (January 22, 2020): "Although the 'net gain' language only appears in Section 171.105 for gross receipts everywhere, we will also apply the Hallmark decision to the calculation of Texas gross receipts. There must be symmetry between Texas gross receipts and gross receipts everywhere." Therefore, the comptroller declines to make this change.

Revised subsection (e)(3) replaces the sourcing rules for receipts from the sale of computer software services and programs with the sourcing rules for receipts from the sale of computer hardware and digital property and adds new subparagraphs (A) through (I). The title is changed accordingly.

New subparagraph (A) treats the sale of software installed on computer hardware as part of the sale of the computer hardware.

New subparagraph (B) treats the lease of software installed on computer hardware as part of the leasing of the computer hardware.

New subparagraph (C) treats the sale of digital property on fixed physical media (such as compact discs) as the sale of tangible personal property. This treatment is consistent with the treatment of other intellectual property that is sold in non-digital fixed physical media (such as books).

New subparagraph (D) treats the lease of digital property on fixed physical media (such as compact discs) as the lease of tangible personal property.

New subparagraph (E) treats the sale of digital property transferred by means other than fixed physical media as the sale of intangible property, which is sourced to the location of the payor. This treatment is consistent with the former paragraph (e)(3) regarding computer software.

New subparagraph (F) treats the receipts from the delivery of digital property as a service as receipts from providing services.

New subparagraph (G) treats the receipts from the delivery of digital property as part of an internet hosting service as receipts from providing internet hosting services.

New subparagraph (H) treats the receipts from the use of digital property as receipts from the use of an intangible asset.

New subparagraph (I) provides two examples of sourcing receipts from digital property. The examples illustrate that digital products lie at the intersection of multiple sourcing provisions, resulting in a complex roadmap for sourcing. Because the sourcing is dictated by statute, the complexity is unavoidable. However, many of the sourcing routes may lead to the same destination. For example, at least with regard to receipts received from individual consumers, the location where tangible personal property is delivered, the location where a service is performed, the location where the customer is located, and the location of the payor, may all be in the same state.

Brandon Newton of Crowe LLP requests a more robust definition of "digital property" and a clearer distinction between the sale of digital property and the delivery of digital property as a service. Subparagraph (C) of subsection (e)(3) identifies "digital property" as "computer programs and any content in digital format that is either protected by copyright law or no longer protected by copyright law solely due to the passage of time." Also, subparagraph (D) of subsection (e)(13) identifies factors that may be considered in distinguishing the purchase of access to computer services over the internet from the purchase or lease of digital property. The comptroller believes that these provisions, along with the examples in subparagraph (I) of subsection (e)(3), will be sufficient guides to auditors and taxpayers.

The comptroller moves former subsection (e)(7), concerning the deemed sales of assets under IRC, §338 to new subsection (e)(22). The comptroller renumbers subsequent paragraphs accordingly.

The comptroller amends renumbered subsection (e)(7), which formerly concerned both dividends and interest, to move the guidance related to interest to subsection (e)(12) and to retitle the paragraph accordingly. Subsection (e)(7) now contains guidance on dividends only.

The comptroller adds new subsection (e)(10) to provide guidance for sourcing receipts from the settlement of hedging contracts and other financial derivatives for risk management purposes. These types of investments are intangibles and the receipts are sourced to the location of the payor.

Sandi Farquharson of Ryan comments that the subsection (e)(10) is unnecessary as it does not serve any different purpose from subsection (e)(17), concerning loans and securities treated as inventory of the seller. She also restates her comments to the definition of "inventory" in subsection (b)(5). For the reasons stated in the discussion of subsection (b)(5), the comptroller declines to make changes to subsection (e)(10). Subsection (e)(10) will alert auditors and taxpayers that these types of financial derivatives are not considered to be inventory for the purpose of subsection (e)(17).

The comptroller adds new subsection (e)(12) to incorporate and reorganize the interest language moved from renumbered subsection (e)(7).

The comptroller amends renumbered subsection (e)(13) concerning internet access fees to more clearly explain the sourcing of receipts from internet hosting services to the location of the customer, pursuant to House Bill 500, 83rd Legislature, 2013, codified as Tax Code, §171.106(g), effective for reports originally due on or after January 1, 2014.

New subparagraph (A) defines "internet hosting service" using the language from Tax Code, §151.108(a), which Tax Code, §171.106(g) references.

New subparagraph (B) gives non-exhaustive examples of internet hosting services. These examples extend beyond what might be ordinarily considered as internet hosting services. However, the statutory definition extends beyond the ordinary meaning, as was noted by the analysis of the same definition that was proposed in House Bill 416 during the same legislative session. House Research Organization Analysis of House Bill 416, 83rd Legislature, 2013 ("A growing number of companies offering cloud computing services and products likely would fall under the definition of web hosting in the bill."). House Bill 500's specific exclusion of telecommunications service, which would not ordinarily be considered as an internet hosting service, indicates that the Legislature was aware of the broad sweep of the definition. The specific meaning dictated by the legislation "elevate{s} the Legislature's substituted meaning even when it departs from the term's ordinary meaning." *Entergy Gulf States, Inc. v. Summers,* 282 S.W.3d 433, 442 (2009).

New subparagraph (C) gives non-exhaustive examples that are not internet hosting services.

New subparagraph (D) lists factors for distinguishing the purchase of access to computer services over the internet from the purchase or lease of digital property over the internet. The factors are taken from the Internal Revenue Service Notice of Proposed Rulemaking regarding "Classification of Cloud Transactions and Transactions Involving Digital Content," 84 Fed. Reg. 40317 (Aug. 14, 2019).

Chris Rosas of Rackspace suggested various revisions to fine-tune the factors. The Comptroller declines these suggestions. Subparagraph (D) contains a partial list of factors, the relevance of which may vary depending upon the circumstances. If a factor described in subparagraph (D) does not fit a particular circumstance, it may be discounted.

New subparagraph (E) provides guidance for determining the physical location of the customer. The statute refers to "the customer to whom the service is provided." The comptroller has concluded from these references that the "customer" means the purchaser, or the designee of the purchaser, that consumes the service. Thus, in a resale situation, the service provider should source the revenue to the customer's customer that actually receives the service.

The statute provides no further instruction for determining the location of the customer. New subparagraph (E) enables taxpayers to determine the most reasonable sourcing method based on the available information. The method will be subject to audit review for reasonableness under the circumstances.

Chris Rosas of Rackspace requested the comptroller delete the example in subparagraph (E)(iii) regarding customer location when an intermediary purchases access to a computer service for resale to a third party. The comptroller declines the request. This is an example of the general rule that the customer location is determined by the physical location where the purchaser or the purchaser's designee consumes the service.

The comptroller amends renumbered subsection (e)(14) addressing leases and subleases to standardize the language used throughout the section. The comptroller amends subparagraphs (C) - (E) to improve readability.

The comptroller amends renumbered subsection (e)(15) to improve readability.

The comptroller amends the title of renumbered subsection (e)(16) to include all loan servicing and adds two subparagraphs. New subparagraph (A) contains the original guidance for sourcing gross receipts from servicing loans secured by real property, pursuant to Tax Code, §171.103(a)(2). New subparagraph (B) provides guidance on sourcing gross receipts from servicing other loans that are not secured by real property.

The comptroller amends the title of renumbered subsection (e)(17) to reflect that the content applies only to loans and securities treated as inventory of the seller. The comptroller amends subparagraph (A) to state that loans and securities held by a taxable entity for investment or risk management purposes are not inventory. The comptroller adds references to information on sourcing receipts from the sale of loans and securities. The comptroller amends subparagraph (B) to reflect that the guidance applies to original reports due on or after January 1, 2008, pursuant to STAR Accession No. 201005671L (May 28, 2010).

Sandi Farquharson of Ryan comments that subsection (e)(17) repeats the mistakes of subsection (b)(5), in stating that securities and loans held for investment or risk management purposes are not inventory. For the reasons stated in response to the comments under subsection (b)(5), the comptroller declines to make any changes to subsection (e)(17).

The comptroller removes subsection (e)(20) concerning the sourcing of receipts from newspaper and magazine advertising and incorporates the information into new subsection (e)(1) to consolidate sourcing rules for advertising.

The comptroller amends subsection (e)(21) on the sourcing of receipts from the licensing of intangibles to improve the readability of subparagraph (B) and add examples taken from *TGS-NOPEC Geophysical Co. v. Combs,* 340 S.W.3d 432 (Tex. 2011) in new subparagraph (C).

The comptroller moves the information on the sourcing of receipts from radio and television advertising from former subsection (e)(22) to new subsection (e)(1) to consolidate sourcing rules for advertising. The comptroller moves information on sourcing receipts from qualified stock purchases under IRC, §338(h)(10) from former subsection (e)(7) to subsection (e)(22). The comptroller retitles subsection (e)(22) to more accurately reflect the contents and amends the language to improve readability.

The comptroller amends subsection (e)(24) to improve readability.

The comptroller amends subsection (e)(25) to update the percentage that is applied to securities sold through an exchange when a buyer cannot be identified in order to use more current population data for Texas and the United States. The Comptroller's Revenue Estimating Division provided the current data.

Celeste Embrey of TBA and Kim Chamberlain of SIFMA comment that subsection (e)(25) should be applied prospective and request that taxpayers be given an additional option to source

securities when a buyer cannot be identified. Both request that taxpayers be able to source receipts earned in Texas from similar, comparable securities instead of 8.7%. The comptroller agrees in part and will retain the use of 7.9% of gross receipts for prior periods. The comptroller declines to amend the section to provide for the alternative method of sourcing because determining what securities would be similar, comparable securities would be too subjective.

The comptroller amends subsection (e)(26) to provide additional guidance on the sourcing of receipts from services and reorganizes the paragraph.

The statutory apportionment formula for the margin tax is based on "each service performed in this state," with a proviso that receipts from servicing loans secured by real property are apportioned based on the location of the property. Historically, the comptroller has interpreted the statute largely by ad hoc adjudications of specific cases, which were sometimes followed by rule codifications of specific outcomes for specific industries. *See, Southwestern Bell Tel. Co. v. Combs,* 270 S.W.3d 249, 266 at n. 39 (Tex. App. - Amarillo 2008, pet. denied). The former rule had special provisions for internet access fees, fees for loan servicing of real property, newspaper and magazine advertising revenue, radio and television advertising revenue, services procurement, telephone companies, and transportation companies. The adopted rule largely retains or consolidates these special provisions, and adds a new special provision for internet hosting services as a result of the 2013 legislation.

Amended subsection (e)(26), like former subsection (e)(26), remains as the generic rule for apportioning all other service receipts. Former subsection (e)(26) provided little guidance. It tracked the statutory declaration that receipts from services are apportioned to the location where the service is performed and added a second sentence: "If services are performed inside and outside Texas, then such receipts are Texas receipts on the basis of the fair value of the services rendered in Texas." Although this sentence explained the manner of apportionment *"if"* services were performed inside and outside Texas, neither the sentence nor the rest of the subsection text explained *when* services were considered to be performed inside and outside Texas.

In Comptroller's Decision No. 10,028 (1980), the comptroller added some additional meaning to the generic apportionment rule for services (emphasis added):

"To accomplish the goal of giving independent meaning and significance to the receipts factor from sales of services of a corporation, the phrase 'services performed within Texas' as used in Art. 12.02(1)(b)(ii) must be construed as 'units of service sold, the performance of which occurs within Texas, ' thereby shifting the focus geographically from every activity performed by a corporation that generates service receipts, to those *specific, end-product acts for which a customer contracts and pays to receive.* If no distinction between *receipt-producing activities versus non-receipt- producing, albeit essential, support activities* were made, no independent meaning could be given to the 'receipts from sales of services' factor, since the determination of the dollar amount of such services performed within Texas would always be ascertained by looking at other factors, such as the property and payroll located in Texas, on the theory that no activity of a corporation that generates service receipts is any more important than any other activity, since all are essential to the end-product performance of the service that is sold."

The agency has cited this decision on a number of occasions, and the courts have acknowledged that the decision represents a "longstanding interpretation" of the agency. *Westcott Communications, Inc. v. Strayhorn,* 104 S.W.3d 141, 146 (Tex. App. - Austin 2003, pet. denied); *Hegar v. Sirius XM Radio, Inc.,* No. 03-18-00573-CV (Tex. App. - Austin 2020).

Comptroller's Decision No. 10,028 distinguishes between receipts-producing activities and non-receipts producing, albeit essential support activities and focuses on the end-product acts for which a customer contracts and pays to receive. The adopted rule expounds upon these principles.

The comptroller amends subparagraph (A) or subsection (e)(26) to assist auditors and taxpayers in identifying where a service is performed. The new language reflects current guidance that a service is performed at the location where the receipts-producing, end-product act occurs, provided that there is a receipts-producing, end-product act. New clauses (i)-(ii) are added to provide examples. The comptroller amends subparagraph (B) to provide additional guidance for determining the fair value of services performed in Texas. New clauses (i)-(iii) give examples. The comptroller amends subparagraph (C) to contain information originally provided in subparagraph (A). New subparagraph (D) contains information originally provided in subparagraph (B). New subparagraph (E) contains information originally provided in subparagraph (C).

Patrick Reynolds of COST argues that the amendments to subsection (e)(26) result in market-based sourcing that is not supported by any legislative change, and that any changes should be applied prospectively. The comptroller agrees with COST that Rule 3.591 should seek to fairly apportion multistate business to Texas consistent with the statutes. The comptroller disagrees that the adopted rule is a retroactive application of market-based sourcing to service receipts. Rather, the rule recognizes that sometimes a service is performed where the taxpayer's market is located and sometimes it is not. That is the comptroller's current interpretation of the sourcing statutes, and the comptroller hopes that the rule will assist taxpayers and auditors in telling the difference.

The comptroller amends subsection (e)(27) to provide guidance on the sourcing of receipts from the sale of a membership interest in a single member limited liability company and delete the guidance regarding service procurement. Renumbered subsection (e)(13) on internet hosting and subsection (e)(26), the general rule for services, cover the sourcing of receipts from service procurement.

The comptroller amends the title of subsection (e)(30) to accurately reflect that it applies to all taxable entities providing telecommunication services.

The comptroller adds new subsection (e)(31) concerning sourcing of broadcasting receipts to implement House Bill 2896, which enacted Tax Code, §171.106(h). The language in this paragraph tracks the statutory language. Subsequent paragraphs are renumbered accordingly.

Sandi Farquharson of Ryan requests that the comptroller remove subsection (e)(32) on the ground that language regarding the sourcing receipts from transactions that occur in Texas waters is not necessary, and that these receipts should be sourced under the other types of transactions in subsection (e). She further comments that this paragraph might conflict with other sourcing paragraphs like paragraph (26) (Services). She suggests that subsection (e)(32) might be more appropriate moved

to subsection (b) as a definition regarding transactions sourced to "Texas" as including Texas waters. The comptroller declines to make these changes. Subsection (e)(32) has been in existence since the adoption of the rule, and there have not been any disputes regarding the application of this subsection.

The comptroller amends renumbered subsection (e)(33) to retitle the paragraph to accurately reflect that it applies to transportation services, and to replace the concept of "intrastate commerce" with the concept of transportation "in Texas."

The proposed rule eliminated the option to source based on the ratio of Texas mileage to everywhere mileage. Jo Ellen Stock of Union Pacific requested that the comptroller retain the option, but to clarify that the calculation should only include mileage involving the actual movement of goods and passengers. The adopted rule accepts the comment to retain the mileage option. The adopted rule also provides that only compensated mileage should be included in the calculation, to be consistent with the Legislature's overall scheme that sourcing should be based on activities that generate gross receipts.

The comptroller received comments from Celeste Embrey of TBA, Kim Chamberlain of SIFMA, and Dale Craymer of TTARA regarding the retroactive application of the additions and revisions to the rule.

When the additions or revisions are changes, the adopted rule retains the option of applying the sourcing procedures of the former rule to former periods. For example, subsection (e)(2) no longer allows the adding of net gains and net losses in calculating gross receipts from the sale of capital assets and investments. So, the subsection retains the old rule provision that allowed the addition of net gains and losses for reports originally due prior to January 1, 2021. The adopted rule retains similar options for the sourcing of receipts from the sale of securities under subsection (e)(25), which changed the percentage of Texas receipts when the payor cannot be identified, and the sourcing of receipts from radio and television advertising under subsection (e)(1), which changed the sourcing from the location of the broadcast tower to the location of the audience.

In some instances, the rule adds text to incorporate legislation adopted after the previous rule revision. New subsection (e)(31) implements the sourcing of broadcasting receipts under House Bill 2896, 84th Legislature, and new subsection (e)(13) implements the sourcing of internet hosting receipts under House Bill 500, 83rd Legislature. In those instances, the adopted rule applies the effective date of the legislation, so the additions are not retroactive applications of the law.

In other instances, the additions or revisions are expositions of existing Comptroller policy rather than changes. An example is the general rule for sourcing service receipts under subsection (e)(26). The rule is an exposition of the comptroller's current interpretation of the sourcing statute, which has been endorsed in part by the Court of Appeals opinion in the *Sirius XM Radio* litigation. TTARA suggests that it may be premature to revise the rule until the Texas Supreme Court has ruled on the pending petition for review. However, TTARA has also filed an amicus brief in the Texas Supreme Court asserting that "clarification of the sourcing rule" is needed. The amended rule clarifies how the agency applies the sourcing statute.

Finally, TTARA and others point to language in the preamble of the proposed rule that the agency might supersede some prior inconsistent rulings. However, superseding selected rulings that are inconsistent with the agency's current interpretation, as it has been broadly applied, does not constitute retroactive rulemaking. Obsolete or inconsistent rulings are routinely superseded even without rulemaking.

This amendment is adopted under Tax Code, §111.002 (Comptroller's Rules; Compliance; Forfeiture), which provides the comptroller with the authority to prescribe, adopt, and enforce rules relating to the administration and enforcement of the provisions of Tax Code, Title 2.

The amendment implements Tax Code, §171.106 (Apportionment of Margin to This State).

§3.591. Margin: Apportionment.

(a) Effective date. The provisions of this section apply to franchise tax reports originally due on or after January 1, 2008, except as otherwise noted.

(b) Definitions. The following words and terms, when used in this section, shall have the following meanings, unless the context clearly indicates otherwise.

(1) Capital asset--Any asset that is held for use in the production of income, and that is subject to depreciation, depletion or amortization.

(2) Employee retirement plan--A plan or other arrangement that qualifies under Internal Revenue Code (IRC), §401(a) (Qualified pension, profit-sharing, and stock bonus plans), or that satisfies the requirement of IRC, §403 (Taxation of employee annuities), or a government plan described in IRC, §414(d) (Definitions and special rules).

(3) Gross receipts--Revenue as determined under §3.587 of this title (relating to Margin: Total Revenue), except as provided in subsection (e)(2) (concerning capital assets and investments) and subsection (e)(17) (concerning loans and securities) of this section. Non-receipt items excluded from total revenue under §3.587 of this title are not included in the calculation of total revenue under that section and are not deducted from gross receipts. These non-receipt items include the exclusion for uncompensated care, the $500 exclusion per pro bono services case, the exclusion for the direct cost of providing waterway transportation, the exclusion for the direct cost of providing agricultural aircraft services, and the exclusion for the cost of a vaccine. See subsection (d)(5) of this section for gross receipts that are excluded from the apportionment calculation.

(4) Internal Revenue Code--The Internal Revenue Code of 1986 in effect for the federal tax year beginning on January 1, 2007, not including any changes made by federal law after that date, and any regulations adopted under that code applicable to that period.

(5) Inventory--Property held primarily for sale to customers in the ordinary course of a trade or business. Securities and loans held for investment, hedging, or risk management purposes are not inventory.

(6) Investment--Any non-cash asset that is not a capital asset or inventory.

(7) Legal domicile--The legal domicile of a corporation or limited liability company is its state of formation. The legal domicile of a partnership, trust, or joint venture is the principal place of business of the partnership, trust, or joint venture.

(8) Location of payor--The legal domicile of the payor.

(9) Principal place of business--The place where an entity's management directs, controls, and coordinates the entity's activities.

(10) Regulated investment company--Any domestic corporation defined under IRC, §851(a) (Definition of regulated investment company), including a taxable entity that includes trustees or sponsors of employee benefit plans that have accounts in a regulated investment company.

(11) Security--An instrument defined under IRC, §475(c)(2) (Mark to market accounting method for dealers in securities). This term includes instruments described by §475(e)(2)(B), (C), and (D) of that code.

(12) Tax reporting period--The period upon which the tax is based under Tax Code, §171.1532 (Business on Which Tax on Net Taxable Margin Is Based) or §171.0011 (Additional Tax).

(13) Taxable entity--Any entity upon which tax is imposed under Tax Code, §171.0002(a) (Definition of Taxable Entity) and not specifically excluded under Tax Code, §171.0002(b) or §171.0002(c). See also §3.581 of this title (relating to Margin: Taxable and Nontaxable Entities).

(14) Texas gross receipts--The portion of a taxable entity's gross receipts that is from business done in Texas.

(c) Apportionment formula. Except as provided in paragraphs (1) and (2) of this subsection, a taxable entity's margin is apportioned to Texas to determine the amount of franchise tax due by multiplying the taxable entity's margin by a fraction, the numerator of which is the taxable entity's Texas gross receipts and the denominator of which is the taxable entity's gross receipts from its entire business.

(1) Regulated investment company services. A taxable entity's margin derived, directly or indirectly, from the sale of management, distribution, or administration services to or on behalf of a regulated investment company, is apportioned to Texas by multiplying that portion of the taxable entity's total margin by a fraction:

(A) the numerator of which is the average of the sum of shares owned at the beginning of the year and the sum of the shares owned at the end of the year by the investment company shareholders whose principal place of business is in this state or, if the shareholders are individuals, are residents of this state; and

(B) the denominator of which is the average of the sum of shares owned at the beginning of the year and the sum of shares owned at the end of the year by all investment company shareholders.

(2) Employee retirement plan services. A taxable entity's margin derived, directly or indirectly, from the sale of management, administration, or investment services to an employee retirement plan is apportioned to Texas by multiplying that portion of the taxable entity's total margin by a fraction:

(A) the numerator of which is the average of the sum of beneficiaries domiciled in Texas at the beginning of the year and the sum of beneficiaries domiciled in Texas at the end of the year; and

(B) the denominator of which is the average of the sum of all beneficiaries at the beginning of the year and the sum of all beneficiaries at the end of the year.

(d) General rules for reporting gross receipts.

(1) A taxable entity that files an annual report must report gross receipts based on the business done by the taxable entity beginning with the day after the date upon which the previous report was based, and ending with the last accounting period ending date for federal income tax purposes ending in the calendar year before the calendar year in which the report is originally due.

(2) A taxable entity with a beginning date prior to October 4, 2009 that files an initial report must report gross receipts based on its activities commencing with the beginning date, as described in §3.584 of this title (relating to Margin: Reports and Payments), and ending on the last accounting period ending date for federal income tax purposes that is at least 60 days before the original due date of the initial report. A taxable entity with a beginning date on or after October 4, 2009 that files a first annual report must report gross receipts based on its activities commencing with the beginning date and ending on the last accounting period ending date for federal income tax purposes in the same calendar year as the beginning date.

(3) Taxable entities that are members of an affiliated group that are part of a unitary business must file a combined franchise tax report. See §3.590 of this title (relating to Margin: Combined Reporting), for determining gross receipts for a combined report.

(4) When a taxable entity computes gross receipts for apportionment, the taxable entity is deemed to have elected to use the same methods that the taxable entity used in filing its federal income tax return.

(5) Any item of revenue that is excluded from total revenue under Texas law or United States law is excluded from gross receipts from an entity's entire business and Texas gross receipts as provided by Tax Code, §171.1055(a) (Exclusion of Certain Receipts for Margin Apportionment). For example, any amount that is excluded from total revenue under the IRC, §78 (Dividends received from certain foreign corporations by domestic corporations choosing foreign tax credit) or §§951 - 964 (26 U.S. Code Subpart F - Controlled Foreign Corporations), is excluded from gross receipts. Non-receipt items that are excluded from total revenue under §3.587 of this title, such as $500 per pro bono services case; the actual cost of uncompensated care; the direct cost of providing waterway transportation; the direct cost of providing agricultural aircraft services and the cost of a vaccine, are not deducted from gross receipts under this section. See subsection (b)(3) of this section, concerning definition of gross receipts. For example, under Tax Code, §171.1011(g-3) (Determination of Total Revenue from Entire Business), an attorney may exclude $500 from total revenue for handling a pro bono case. Since the $500 is not a receipt, there is no exclusion for pro bono work when calculating gross receipts. Therefore, if a taxable entity starts with its total revenue amount to calculate its gross receipts, the taxable entity must add back the $500 per pro bono services case.

(6) A taxable entity that uses a 52 - 53 week accounting year end and that has an accounting year that ends during the first four days of January of the year in which the report is originally due may use the preceding December 31 as the date through which margin is computed.

(7) Any item of allocated revenue excluded under §3.587(c)(9) of this title is excluded from Texas gross receipts and gross receipts from an entity's entire business.

(e) Computation and sourcing of gross receipts.

(1) Advertising services. Gross receipts from the dissemination of advertising are sourced to the locations of the advertising audience. The locations of the advertising audience should be determined in good faith using the most reasonable method under the circumstances, considering the information reasonably available. The method should be consistently applied from year to year and supported by records retained by the service provider. Locations that may be reasonable include the physical locations of the advertising, advertising audience locations recorded in the books and records of the service provider, and locations listed in published rating statistics. If the locations of nationwide advertising audiences cannot otherwise be reason-

ably determined, then 8.7% of the gross receipts are sourced to Texas. For reports originally due prior to January 1, 2021, advertising receipts attributable to a radio or television station transmitter in Texas may be sourced to Texas.

(2) Capital assets and investments.

(A) Except as provided in subparagraph (C), only the net gain from the sale of a capital asset or investment is included in gross receipts. A net loss from the sale of a capital asset or investment is not included in gross receipts.

(B) The net gain or net loss from the sale of a capital asset or investment is the amount realized from the sale less the adjusted basis for federal income tax purposes.

(C) For reports originally due prior to January 1, 2021, a taxable entity may add the net gains and losses from sales of investments and capital assets to determine the total gross receipts from such transactions. If both Texas and out-of-state sales have occurred, then a separate calculation of net gains and losses on Texas sales must be made. If the combination of net gains and losses results in a loss, the taxable entity may not net the loss against other receipts.

(D) The net gain from the sale of a capital asset or investments is sourced based on the type of asset or investment sold. The net gain from the sale of an intangible asset is sourced to the location of the payor as provided in paragraph (21)(B) of this subsection, concerning gross receipts from the sale of intangible assets, and paragraph (25) of this subsection, concerning securities, of this subsection Examples of intangible assets include, but are not limited to, stocks, bonds, commodity contracts, futures contracts, patents, copyrights, licenses, trademarks, franchises, goodwill, and general receivable rights. The net gain from the sale of real property is sourced as provided in paragraph (23) of this subsection, concerning real property. The net gain from the sale of tangible personal property is sourced as provided in paragraph (29) of this subsection, concerning tangible personal property.

(E) Examples.

(i) Example 1. During a report year, a real estate investment company sells two Texas investment properties, reporting a gain on sale of one property and a loss on the sale of the other property. The company should include the net gain on the profitable sale in gross receipts from its entire business but should not include the net loss on the unprofitable sale. The company should not offset the net loss against the net gain. To determine Texas gross receipts, the asset should be sourced based on its nature. Receipts from the sale of real property are sourced to the location of the property, as provided in paragraph (23) of this subsection. The company should include only the net gain on the sale of the Texas investment property in Texas gross receipts and should not include the net loss on the sale of the other Texas investment property.

(ii) Example 2. The facts are the same as in Example 1, except the real estate investment company also had net gains and net losses from the sale of out-of-state properties. For reports originally due prior to January 1, 2021, the real estate investment company may offset all of the net losses from these sales against all of the net gains. If the result is a net gain, the net gain is included in gross receipts from its entire business. If the result is a net loss, the net loss may not be not included in gross receipts from its entire business. To determine Texas gross receipts, the company may offset the net loss from the sale of the one Texas property against the net gain from the sale of the other Texas property. If the result is a net gain, the net gain is included in Texas gross receipts. If the result is a net loss, the net loss may not be included in Texas gross receipts.

(3) Computer hardware and digital property.

(A) Gross receipts from the sale of computer hardware together with any software installed on the hardware are sourced as the sale or lease of tangible personal property under paragraph (29) of this subsection.

(B) Gross receipts from the lease of computer hardware together with any software installed on the hardware are sourced as the leasing of tangible personal property under paragraph (14)(B) of this subsection.

(C) Gross receipts from the sale of digital property (computer programs and any content in digital format that is either protected by copyright law or no longer protected by copyright law solely due to the passage of time) that is transferred by fixed physical media are sourced as the sale of tangible personal property under paragraph (29) of this subsection.

(D) Gross receipts from lease of digital property that is transferred by fixed physical media are sourced as the leasing of tangible personal property under paragraph (14)(B) of this subsection.

(E) Gross receipts from the sale or lease of digital property that is transferred by means other than by fixed physical media are sourced as the sale of intangible property under paragraph (21)(B) of this subsection.

(F) Gross receipts from the delivery of digital property as a service are sourced under paragraph (26) of this subsection, unless otherwise provided in this subsection.

(G) Gross receipts from the delivery of digital property as part of an internet hosting service are sourced as internet hosting receipts under paragraph (13) of this subsection. See paragraph (13)(D) of this subsection for factors distinguishing the purchase of access over the internet to computer services from the purchase or lease of digital property.

(H) Gross receipts from the use (as opposed to the sale or licensing) of digital property are sourced under paragraph (21)(A) of this subsection.

(I) Examples.

(i) Example 1. Movie Studio produces a copyrighted movie in digital format and successively sells the theatrical rights to Movie Theater Chain Company, the broadcast rights to Cable Company, the internet streaming rights to Internet Company A, the internet rental rights to Internet Company B, the digital versatile disc (DVD) sale rights to DVD Company, DVD rental rights to Kiosk Company, and the permanent download sale rights to Download Company. In each instance, Movie Studio's receipts are from the right to use its copyrighted digital property and sourced to where the copyright is used under paragraph (21)(A) of this subsection. Movie Theater Chain Company receipts from ticket sales are from the sale of a service and sourced to the audience location under paragraph (26)(A)(i) of this subsection. Cable Company subscription receipts from broadcasting the movie are from the sale of a service and sourced to the audience location under paragraph (26)(A)(i) of this subsection. Internet Company A's subscription receipts for its streaming service using its website are from an internet hosting service and sourced to the location of the customer under paragraph (13) of this subsection. Internet Company B's receipts from the rental (access for a limited time) of the movie using the company's website are from an internet hosting service and sourced to the location of the customer under paragraph (13) of this subsection. DVD Company's receipts from the sale of DVDs are from the sale of tangible personal property and sourced under paragraph (29) of this subsection. Kiosk Company's

receipts from the rental of DVDs are from the rental of property and sourced to the location of the property under paragraph (14) of this subsection. Download Company's receipts from the sale of permanent downloads of the movie are from the sale intangibles and sourced to the location of payor under paragraph (21)(B) of this subsection.

(ii) Example 2. Software Company designs bookkeeping software for personal use. Software Company licenses the software to Computer Company to include in the software sold with its computers. Software Company sells digital versatile discs (DVDs) of the bookkeeping software to Retail Company for resale to end users. Software Company sells downloads of its bookkeeping software directly to end users. Software Company sells an on-line version of its bookkeeping software in which end users can enter and store data on-line using the Software Company's website for a periodic fee. Software Company receipts from licensing the software to Computer Company are from the use of its digital product and sourced to the location of use under paragraph (21)(A) of this subsection. Computer Company's receipts from the sale of computers with pre-loaded software are from the sale of tangible personal property and sourced under paragraph (29) of this subsection. Software Company's receipts from the sale of DVDs to Retail Company are from the sale of tangible personal property and sourced under paragraph (29) of this subsection. Software Company's receipts from the sale of downloads to end users are from the sale of intangible property and sourced to the location of payor under paragraph (21)(B) of this subsection. Software Company's receipts from the sale of its on-line version are from the sale of an internet hosting service and sourced to the location of the customer under paragraph (13) of this subsection.

(4) Condemnation. Gross receipts from condemnation of property are sourced to the location of the property condemned.

(5) Debt forgiveness. If a creditor releases any part of a debt, then the amount that the creditor forgives is a gross receipt that is sourced to the legal domicile of the creditor.

(6) Debt retirement. Gross receipts from the retirement of a taxable entity's own indebtedness, such as through the taxable entity's purchase of its own bonds at a discount, are sourced to the taxable entity's legal domicile. The indebtedness is treated as an investment in the determination of the amount of gross receipts.

(7) Dividends.

(A) Dividends that are recognized as a reduction of the taxpayer's basis in stock of a taxable entity for federal income tax purposes are not gross receipts. Dividends that exceed the taxpayer's basis for federal income tax purposes that are recognized as a capital gain are treated as dividends for apportionment purposes.

(B) The following are excluded from Texas gross receipts and gross receipts from an entity's entire business:

(i) dividends from a subsidiary, associate, or affiliated taxable entity that does not transact a substantial portion of its business or regularly maintain a substantial portion of its assets in the United States;

(ii) Form 1120, Schedule C special deductions that are excluded from total revenue; and

(iii) dividends on federal obligations that are excluded from total revenue.

(C) Dividends that are received from a corporation or other sources are sourced to the location of the payor.

(D) Dividends received from a national bank are sourced to Texas if the bank's principal place of business is located in Texas. Dividends received from a bank that is organized under the Texas Banking Code are sourced to Texas.

(8) Exchanges of property. Exchanges of property are included in gross receipts to the extent that the exchange is recognized as a taxable transaction for federal income tax purposes. Such exchange must be included in gross receipts based on the gross exchange value, unless otherwise required under this section.

(9) Federal enclave. Gross receipts from a taxable entity's sales, services, leases, or other business activities that are transacted on a federal enclave that is located in Texas are sourced to Texas, unless otherwise excepted by this section.

(10) Financial derivatives. Gross receipts from the settlement of financial derivatives contracts, including hedges, options, swaps, futures, and forward contracts, and other risk management transactions are sourced to the location of the payor.

(11) Insurance proceeds.

(A) Business interruption insurance proceeds are gross receipts when the proceeds are intended to replace lost profits. Such receipts are Texas gross receipts when the location of the payor is in Texas.

(B) Gross receipts from fire and casualty insurance proceeds are sourced to the location of the damaged or destroyed property.

(12) Interest.

(A) Except as provided in subparagraph (B) of this paragraph, interest received is sourced to the location of the payor.

(B) Interest received from a national bank is a Texas gross receipt if the bank's principal place of business is located in Texas. Interest received from a bank that is organized under the Texas Banking Code is a Texas gross receipt.

(C) The following are excluded from Texas gross receipts and gross receipts from an entity's entire business:

(i) interest on federal obligations that is excluded from total revenue; and

(ii) interest that is exempt from federal income tax.

(D) A banking corporation may exclude from its Texas gross receipts interest that is earned on federal funds and interest that is earned on securities that are sold under an agreement to repurchase and that are held in a correspondent bank that is domiciled in Texas, but the banking corporation must include the interest in its gross receipts from an entity's entire business.

(13) Internet hosting service. For reports originally due on or after January 1, 2014, receipts from internet hosting are Texas gross receipts if the customer is located in Texas.

(A) Internet hosting service means providing to an unrelated user access over the internet to computer services using property that is owned or leased and managed by the provider and on which the user may store or process the user's own data or use software that is owned, licensed, or leased by the user or provider.

(B) Internet hosting includes real-time, nearly real-time, and on-demand access over the internet to computer services such as:

(i) data storage and retrieval;

(ii) video gaming;

(iii) database search services;

(iv) entertainment streaming services;

(v) processing of data; and

(vi) marketplace provider services.

(C) Internet hosting does not include:

(i) telecommunications service;

(ii) cable television service;

(iii) internet connectivity service;

(iv) internet advertising service; or

(v) internet access solely to download digital content for storage and use on the customer's computer or other electronic device.

(D) The purchase of access over the internet to computer services is distinguished from the purchase or lease of computer hardware or digital property (which are sourced under subsection (e)(3) of this section) by taking into account all relevant factors, the relevance of which may vary depending upon the circumstances. Some relevant factors indicating the purchase of access to a computer service rather than the purchase or lease of computer hardware or digital property include:

(i) the customer is not in physical possession of the property;

(ii) the customer does not control the property, beyond the customer's network access and use of the property;

(iii) the provider has the right to determine the specific property used in the transaction and replace such property with comparable property;

(iv) the property is a component of an integrated operation in which the provider has other responsibilities, including ensuring the property is maintained and updated;

(v) the customer does not have a significant economic or possessory interest in the property;

(vi) the provider bears any risk of substantially diminished receipts or substantially increased expenditures if there is nonperformance under the contract;

(vii) the provider uses the property concurrently to provide significant services to entities unrelated to the customer;

(viii) the provider's fee is primarily based on a measure of work performed or the level of the customer's use rather than the mere passage of time; and

(ix) the total contract price substantially exceeds the rental value of the property for the contract period.

(E) The customer location is determined by the physical location where the purchaser or the purchaser's designee consumes the service. The location should be determined in good faith using the most reasonable method under the circumstances, considering the information reasonably available. Receipts from some services may be sourced to multiple customer locations or to multiple customers. Locations that may be reasonable under the circumstances include the customer's principal place of business, the customer's business unit that is using the computer services, the delivery addresses for individual units of service provided to the customer, the primary place or places of consumption by the customer, the service address of the customer, the billing address of the customer, or a combination of methods.

(i) Example 1. An individual purchases access to a dating application. The most reasonable customer location for consumption of the service may be the billing address of the individual in the absence of information regarding the individual's physical address.

(ii) Example 2. A benefactor purchases access to a computer service for a charitable organization. The customer is the purchaser's designee for consuming the service - the charitable organization. The most reasonable customer location for consumption of the service may be the physical address of the charitable organization.

(iii) Example 3. An intermediary purchases access to a computer service for resale to a third party. The customer is purchaser's designee for consuming the service - the third party. The most reasonable customer location for consumption of the service may be the physical location of the third party, if known.

(iv) Example 4. A law firm purchases access to a database search program for attorneys in multiple offices. The customers are the purchaser's designees for consuming the service - its attorneys. The most reasonable customer locations for consumption of the service may be physical addresses of each office, with the access fee sourced proportionately based on the number of attorneys in each office.

(v) Example 5. A retailer with multiple sales outlets purchases access to point of sales software that reports to the retailer's central office. The most reasonable customer locations for consumption of the service may be the physical addresses of the central office and each designated point of sale, with the access fee sourced proportionately between the central office and each designated point of sale.

(vi) Example 6. A retailer with multiple sales outlets purchases access to federal income tax preparation software. The most reasonable customer location for consumption of the service may be the principal place of business of the retailer.

(vii) Example 7. An individual pays a fee to an internet ride-sharing service connecting the individual with a driver at a particular location. The most reasonable customer location for consumption of the service may be the physical address of rendezvous point for the ride.

(14) Leases and subleases.

(A) Gross receipts from the lease, sublease, rental, or subrental of real property are sourced to the location of the property.

(B) Gross receipts from the lease, sublease, rental, or subrental of tangible personal property are sourced to the location of the property. If the property is used both inside and outside Texas, then lease payments are sourced based on the number of days that the tangible personal property was used in Texas divided by the number of days that the tangible personal property was used everywhere. If the amount due under the lease is based on mileage, then the lease payments are sourced based on the number of miles in Texas divided by the number of miles everywhere.

(C) If a lump sum is charged for the lease, sublease, rental, or subrental of more than one item of property, and the items are located both inside and outside Texas, the lump-sum is sourced to Texas based on a ratio of the fair rental value of the items located in Texas to the fair value of the items located outside of Texas.

(D) Gross receipts from the lease, sublease, rental, or subrental of a vessel that engages in commerce are sourced to Texas based on the number of days that the vessel is engaged in commerce in Texas waters divided by the number of days that the vessel is engaged in commerce everywhere.

(E) Gross receipts from a lease, sublease, rental, or subrental of real property or tangible personal property that is treated as a sale for federal income tax purposes are sourced in the same manner as a sale. Any portion of the payments that the contracting parties designate as interest is sourced as provided in paragraph (12) of this subsection, concerning interest.

(15) Litigation awards. Litigation awards are gross receipts that are sourced to the location of the payor; however, if the litigation awards are intended to replace receipts for which another rule provided in this section applies, then the gross receipts are sourced in accordance with that rule. For example, if a taxable entity sues a Delaware corporation to recover on a sale of goods delivered to a Texas location, then a judgment for the amount of that sale would not convert the receipts from Texas gross receipts to Delaware receipts. See subsection (f) of this section, for the sourcing of receipts from judgments, compromises, or settlements that relate to natural gas production.

(16) Loan servicing.

(A) Gross receipts from servicing loans secured by real property are sourced to the location of the collateral real property that secures the loan being serviced.

(B) Gross receipts from servicing loans that are not secured by real property are sourced as provided in paragraph (26) of this subsection, concerning services.

(17) Loans and securities treated as inventory of the seller.

(A) Gross proceeds from the sale of a loan or security treated as inventory of the seller for federal income tax purposes are included in gross receipts even though the tax basis is not included in total revenue under §3.587(e)(4) of this title. Securities and loans held for investment or risk management purposes are not inventory. Gross receipts from the sale of a loan or security treated as inventory of the seller are sourced to the location of the payor as provided in paragraph (25) of this subsection, concerning securities. See paragraph (2) of this subsection, concerning capital assets and investments, or paragraph (10) of this subsection, concerning financial derivatives, for the treatment of gains and losses from sales of loans and securities not treated as inventory of the seller.

(B) If a lending institution categorizes a loan or security as "Securities Available for Sale" or "Trading Securities" under Financial Accounting Standard No. 115, the gross proceeds of the sale of that loan or security are considered gross receipts. In this subparagraph, "Financial Accounting Standard No. 115" means the Financial Accounting Standard No. 115 in effect as of January 1, 2009, not including any changes made after that date.

(18) Membership or enrollment fees paid for access to benefits. Membership or enrollment fees paid for access to benefits are gross receipts from the sale of an intangible asset and are sourced to the location of the payor.

(19) Mixed transactions. If a transaction involves elements of both a sale of tangible personal property and a service, but no documentation exists to show separate charges for the tangible personal property and service elements, then the comptroller may determine the amounts that are allocable to each element based on fair values or on any available evidence.

(20) Net distributive income. The net distributive income or loss from a passive entity that is included in total revenue is sourced to the principal place of business of the passive entity.

(21) Patents, copyrights, and other intangible assets.

(A) Gross receipts from the use of intangible assets.

(i) Revenues from a patent royalty are included in Texas receipts to the extent that the patent is utilized in production, fabrication, manufacturing, or other processing in Texas.

(ii) Revenues from a copyright royalty are included in Texas receipts to the extent that the copyright is utilized in printing or other publication in Texas.

(iii) Gross receipts that the owner of a patent, copyrighted material, trademark, franchise, or license receives from licensing the use of the patent, copyrighted material, trademark, franchise, or license are sourced to Texas to the extent the patent, copyrighted material, trademark, franchise or license is used in Texas.

(iv) Royalties from an affiliated taxable entity that does not transact a substantial portion of its business or regularly maintain a substantial portion of its assets in the United States are excluded from Texas gross receipts and gross receipts from an entity's entire business.

(B) Gross receipts from the sale of intangible assets. Except as otherwise provided in this section, gross receipts from the sale of intangible assets are sourced to the location of payor.

(C) Examples.

(i) Example 1. The owner of seismic data grants a license to an oil company to access the seismic data. Even though a license is part of this transaction, the receipts are from the use of the underlying intangible property, the seismic data (which cannot be copyrighted), not from the use of a license. Accordingly, the receipts are sourced under subparagraph (B) of this paragraph to the location of the payor.

(ii) Example 2. An inventor licenses a patent to a manufacturer. When the manufacturer licensee thereafter produces the patented item, it uses the patent, and its payments to the inventor, owner of the patent, are receipts from the use of a patent under subparagraph (A) of this paragraph. The receipts that the inventor receives are included in Texas receipts to the extent that the patent is used in production, fabrication, manufacturing, or other processing in Texas.

(iii) Example 3. The owner of copyrighted material grants a license to a publisher to publish the copyrighted material. When the publisher publishes the copyrighted material, it uses the copyright, and its payments to the owner are receipts from the use of a copyright under subparagraph (A) of this paragraph. The receipts that the copyright owner receives from the use of its copyright is included in Texas receipts to the extent the copyright is used in Texas.

(22) Qualified stock purchase under IRC, §338(h)(10) (Certain stock purchases treated as asset acquisitions). Receipts that are treated as receipts from the sale of assets by the target taxable entity under IRC, §338(h)(10) are sourced according to the rules that apply to sales of such assets. For the purposes of this paragraph, the purchaser of the target's stock is considered the purchaser of the assets.

(23) Real property. Gross receipts from the sale, lease, rental, sublease, or subrental of real property, including mineral interests, are sourced to the location of the property. Royalties from mineral interests are considered revenue from real property.

(24) Sales taxes. State or local sales taxes that are imposed on the customer, but are collected by a seller are not included in the seller's gross receipts. However, discounts that a seller is allowed to take in remittance of the collected sales tax are gross receipts to the seller.

(25) Securities. Gross receipts from the sale of securities are sourced to the location of the payor. If securities are sold through an exchange, and the payor cannot be identified, then 8.7% of the revenue is a Texas gross receipt. For reports originally due prior to January 1, 2021, a taxable entity may use 7.9% instead of 8.7%.

(26) Services. Except as otherwise provided in this section, gross receipts from a service are sourced to the location where the service is performed.

(A) Location of performance. Except as provided in other subparagraphs, a service is performed at the location of the receipts-producing, end-product act or acts. If there is a receipts-producing, end-product act, the location of other acts will not be considered even if they are essential to the performance of the receipts-producing acts. If there is not a receipts-producing, end-product act, then the locations of all essential acts may be considered.

(i) Example 1. Admission fees, subscription fees, or other charges for an audience to observe live or pre-recorded performances are sourced to the locations where the recipients observe the performance. The location where the live performance was rehearsed, the location where the pre-recorded performance was recorded, and the location where the admission fee or other charge was paid are not determinative.

(ii) Example 2. Gross receipts from the architectural design of a structure, are sourced to the location or locations where the architect performed the work. The delivery location of any tangible work product, such as a blueprint, is not determinative. However, if the tangible work product of the architect is considered to be the sale of tangible personal property rather than the sale of a service, such as the sale of house plan books, the gross receipts are sourced as provided in paragraph (29) of this subsection, concerning tangible personal property.

(B) If services are performed both inside and outside Texas for a single charge, then receipts from the services are Texas gross receipts on the basis of the fair value of the services that are performed in Texas. In determining fair value, the relative value of each service provided on a stand-alone basis may be considered. Units of service, such as hours worked, may also be considered. The cost of performing a service does not necessarily represent its value. If costs are considered, costs should be limited to costs directly related to the service and not overhead costs.

(i) Example 1. A law firm with offices in Texas and Louisiana charges a client by the hour. Hours billed for work conducted in Texas are Texas gross receipts.

(ii) Example 2. A law firm with offices in Texas and Louisiana charges a client a lump sum fee of $5,000 to draft a document. Attorneys in the Texas office recorded 20 hours on the project, and attorneys in the Louisiana office recorded 5 hours on the project at the same billing rate. Texas gross receipts are $4,000. If the law firm does not record hours worked on a project, other measures of direct cost may be considered.

(iii) Example 3. A Texas-based landscaper provides grounds maintenance services at its client's four offices in Texas, and one office in Oklahoma, for an annual fee of $50,000. The landscape services at each of the locations are substantially the same. Texas gross receipts are $40,000. Although the cost of performing the landscaping maintenance service at the Oklahoma office is higher than the cost of performing the service at the other locations because of the additional travel cost, the additional cost is not considered.

(C) Taxable entities that have margin that is derived, directly or indirectly, from the sale of services to or on behalf of a regulated investment company should refer to subsection (c)(1) of this section for information on apportionment of such margin.

(D) Taxable entities that have margin that is derived, directly or indirectly, from the sale of management, administration, or investment services to an employee retirement plan should refer to subsection (c)(2) of this section for information on apportionment of such margin.

(E) Receipts from services that a defense readjustment project performs in a defense economic readjustment zone are not Texas gross receipts.

(27) Single member limited liability company (SMLLC). For purposes of this section, the sale of a SMLLC by its sole owner is the sale of a membership interest in the SMLLC. The membership interest is an intangible asset, and receipts from the sale of a SMLLC are sourced to the location of payor.

(28) Subsidies or grants. Proceeds of subsidies or grants that a taxable entity receives from a governmental agency are gross receipts, except when the funds are required to be expended dollar-for-dollar (i.e., passed through) to third parties on behalf of the agency. Receipts from a governmental subsidy or grant are sourced in the same manner as the item to which the subsidy or grant was attributed. For example, receipts from a grant to conduct research for the government are receipts from a service and are sourced to the location where the research is performed.

(29) Tangible personal property. Examples of transactions that involve the sale of tangible personal property and result in Texas gross receipts include, but are not limited to, the following:

(A) the sale of tangible personal property that is delivered in Texas to a purchaser. Delivery is complete upon transfer of possession or control of the property to the purchaser, an employee of the purchaser, or transportation vehicles that the purchaser leases or owns. FOB point, location of title passage, and other conditions of the sale are not relevant to the determination of Texas gross receipts;

(B) the sale of tangible personal property that is delivered in Texas to an employee or transportation agent of an out-of-state purchaser. A carrier is an employee or agent of the purchaser if the carrier is under the supervision and control of the purchaser with respect to the manner in which goods are transported;

(C) the sale and delivery in Texas of tangible personal property that is loaded into a barge, truck, airplane, vessel, tanker, or any other means of conveyance that the purchaser of the property leases and controls or owns. The sale of tangible personal property that is delivered in Texas to an independent contract carrier, common carrier, or freight forwarder that a purchaser of the property hires results only in gross receipts everywhere if the carrier transports or forwards the property to the purchaser outside this state;

(D) the sale of tangible personal property with delivery to a common carrier outside Texas, and shipment by that common carrier to a purchaser in Texas;

(E) the sale of oil or gas to an interstate pipeline company, with delivery in Texas;

(F) the sale of tangible personal property that is delivered in Texas to a warehouse or other storage facility that the purchaser owns or leases;

(G) the sale of tangible personal property that is delivered to and stored in a warehouse or other storage facility in Texas at the purchaser's request, as opposed to a necessary delay in transit, even though the property is subsequently shipped outside Texas;

(H) the drop shipment of tangible personal property in Texas. A drop shipment is a shipment of tangible personal property from a seller directly to a purchaser's customer, at the request of the purchaser, without passing through the hands of the purchaser. This results in Texas gross receipts for the seller and the purchaser.

(30) Telecommunication services.

(A) Gross receipts from telephone calls that both originate and terminate in Texas are sourced to Texas.

(B) Gross receipts from telephone calls that originate in Texas but terminate outside of Texas or that originate outside of Texas but terminate in Texas are not sourced to Texas.

(C) Gross receipts from telecommunication services other than those services in subparagraph (A) or (B) of this paragraph are sourced to Texas if the services are performed in Texas. For example, a telephone company that provides a long distance carrier access to the telephone company's local exchange network in Texas is performing a service in Texas. Any fee that the telephone company charges the long distance carrier for access to the local exchange network in Texas is a Texas receipt regardless of whether the access is related to an interstate call. A fee that is charged to obtain access to a local exchange network in Texas and that is based on the duration of an interstate telephone call are not sourced to Texas.

(31) Television broadcaster licensing income. For reports originally due on or after January 1, 2018, a broadcaster's gross receipts from licensing income from broadcasting or otherwise distributing film programming by any means are sourced to Texas if the legal domicile of the broadcaster's customer is in this state. In this subparagraph, the following words and terms shall have the following meaning:

(A) Broadcaster--A taxable entity, not including a cable service provider or a direct broadcast satellite service, that is a television station licensed by the Federal Communications Commission, television broadcast network, cable television network, or television distribution company.

(B) Customer--A person, including a licensee, who has a direct connection or contractual relationship with a broadcaster under which the broadcaster derives revenue.

(C) Film programming--All or part of a live or recorded performance, event, or production intended to be distributed for visual and auditory perception by an audience.

(D) Programming--Includes news, entertainment, sporting events, plays, stories, or other literary, commercial, educational, or artistic works.

(32) Texas waters. Gross receipts from transactions that occur in Texas waters are sourced to Texas. Texas waters are considered to extend to 10.359 statute miles, or nine nautical miles, from the Texas coastline.

(33) Transportation services. Gross receipts from the transportation of goods or passengers are sourced to Texas by:

(A) including gross receipts from the transportation of goods or passengers that both originates and terminates in Texas; or

(B) the multiplication of total transportation receipts by the ratio of total compensated mileage in the transportation of goods and passengers in Texas to total compensated mileage.

(f) Natural gas production.

(1) Gross receipts that a gas producer realizes from the contract price of gas that the gas producer produces and that the purchaser takes pursuant to the terms of sales are sourced to Texas, if the gas is delivered in Texas.

(2) Gross receipts that a gas producer realizes from a purchaser's payment under a sale or purchase contract for gas to be produced even if no gas is produced and delivered to the purchaser, are sourced to the location of the payor.

(3) Gross receipts that a gas producer realizes from a purchaser's payments to terminate a gas purchase contract are sourced to the location of the payor.

(4) Gross receipts that a gas producer realizes from a contract amendment that relates to the price of the gas sold are treated as gross receipts from the sales of gas and are sourced to Texas if delivery is made to a location in Texas. Gross receipts that the gas producer realizes from a contract amendment that relates to a provision other than the price of gas sold are sourced to the location of the payor.

(5) Gross receipts that a gas producer realizes from litigation awards for a breach of contract, reimbursements for litigation-related expenses (e.g., documented attorney's fees or court costs), or interest (upon which the parties have agreed, that the records of the producer reflects, or in an amount that a court has ordered) are sourced to the location of the payor.

(6) Gross receipts that a gas producer realizes from a judgment, compromise, or settlement relating to the recovery of a contract price of gas produced are sourced to Texas to the extent the contract specified delivery to a location in Texas. Gross receipts that a gas producer realizes from a judgment, compromise, or settlement that relates to several claims or causes of action shall be prorated based upon the documented amounts due under the contract for each claim or cause of action according to the records of the producer. For example, a settlement sum of $100,000 for a pricing dispute of $25,000 and for failure to pay for gas not taken in the amount of $225,000, would result in receipts of $10,000 from gas sales (100,000 X 25,000/250,000) and receipts from other business of $90,000 (100,000 X 225,000/250,000). Records of the producer shall include, but are not limited to the following: contracts, settlement agreements, accounting records and entries, court pleadings and worksheets, including calculations reflecting settlement amounts.

The agency certifies that legal counsel has reviewed the adoption and found it to be a valid exercise of the agency's legal authority.

Filed with the Office of the Secretary of State on January 4, 2021.

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William Hamner
Special Counsel for Tax Administration
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PART 3. TEACHER RETIREMENT SYSTEM OF TEXAS

CHAPTER 47. QUALIFIED DOMESTIC RELATIONS ORDERS

34 TAC §47.17

The Teacher Retirement System of Texas (TRS) adopts amendments to §47.17, relating to Calculation for Alternate Payee Benefits Before a Member's Benefit Begins, of Chapter 47, in Title 34, Part 3, of the Texas Administrative Code without changes to the proposed text as originally published in the November 6, 2020, issue of the *Texas Register* (45 TexReg 7988). The rule will not be republished.

REASONED JUSTIFICATION

TRS adopts amendments to TRS §47.17, relating to calculation of alternate payee benefits before a member's benefit begins. The adopted amendments change how reductions to member standard annuity payments are calculated after an alternate payee of a TRS member has elected to receive benefits under Texas Government Code §804.005. Recently, TRS has encountered multiple situations in which the reductions were so great that a member's standard annuity ended up being negative. The adopted amendments would prevent this outcome, simplify how TRS calculates the reductions, and be actuarially neutral to the fund. In addition, while some TRS members may face an increased reduction to their annuity payments in certain limited circumstances under the adopted rule, this increased reduction will never exceed the reduction those TRS members would have incurred if the member had retired before their former spouse elected for benefits under TRS §47.17 and the member's benefits were divided under the applicable qualified domestic relations order (QDRO).

Government Code §804.005 and TRS §47.17 authorize an alternate payee to elect to receive a portion of the actuarial equivalent of a member's accrued retirement benefit at the time of election in lieu of the interest awarded to the alternate payee under a QDRO. The alternate payee can make this election once the member is 62 years old or eligible for normal-age retirement, whichever is later, so long as the member has not yet retired.

If an alternate payee elects to receive these benefits, TRS must reduce the member's monthly standard annuity benefit when the member eventually retires based on the payments to the alternate payee. Under the existing rule, TRS bases the reduction on the actuarial equivalent of the alternate payee's benefits at the time the member retires, which means that the reduction to the member's benefit increases over time after the alternate payee elects to receive Section 804.005 benefits. In some instances, the increase to the reduction can become so great that the member ends up with a negligible or negative annuity at the time of retirement.

To remedy this issue, TRS adopts these amendments that reduce the member's standard annuity at the time of retirement by the alternate payee's unadjusted QDRO share of the member's accrued benefit at the time of the alternate payee's Section 804.005 election. This calculation bases the reduction to the member's annuity on the actuarial equivalent of the alternate payee's benefits at the time the alternate payee elected to receive the payments. For example, if at the time of an alternate payee's election a member's accrued benefit was $1,000 and the alternate payee's QDRO interest was 50%, the reduction to the member's standard annuity at the time of retirement would simply be $500. In addition, the reduction to the member's standard annuity would not increase in the time between the alternate payee's Section 804.005 election and the member's retirement as it would under the current rule, which means that a member will never have a negative annuity under the adopted rule

In addition to this amended calculation, TRS staff also adopts several non-substantive or conforming amendments to TRS §47.17 that streamline the rule and improve its readability. Under the amended rule, TRS also removes the Tables for Interest Annuity Factors and Interest Accumulation Factors provided by the TRS actuary of record because the tables are no longer necessary to calculate benefits under the amended rule. The new actuarial table will only include the Life Annuity Factors that were originally adopted to be effective on September 1, 2019.

Lastly, TRS has determined that the adopted amended rule shall only apply to member retirements with effective dates of retirement or other distribution events that occur after the effective date of the rule. The rule will also only apply to alternate payee elections made after the effective date of the rule.

COMMENTS

No comments on the proposed adoption of the amendments were received.

STATUTORY AUTHORITY

Amended §47.17 is adopted under the authority of Government Code §825.102 which authorizes the TRS Board of Trustees to adopt rules for the eligibility for membership, the administration of the funds of the retirement system, and the transaction of business of the board and Government Code §804.005, which requires that a distribution made pursuant to that section be the actuarial equivalent of the accrued retirement benefit of the member of the retirement system, determined as if the member retired on the date of the alternate payee's election.

CROSS-REFERENCE TO STATUTE

The adopted amendments to §47.17 implement Chapter 804, Subchapter A, Texas Government Code, concerning Qualified Domestic Relations Orders.

The agency certifies that legal counsel has reviewed the adoption and found it to be a valid exercise of the agency's legal authority.

Filed with the Office of the Secretary of State on December 29, 2020.

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Teacher Retirement System of Texas
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