

City of McKinney – March 17, 2015
Chapter 380 Agreements – Texas Use Taxes / Direct Payment Permits
Landon Homes, LP. & Pulte Homes of Texas, LP.

I. Purchasers Pay Texas “Sales” Tax to Vendors for Taxable Items or Can Obtain a Voluntarily Tax Permit and Self-Assess / Pay “Use” Taxes on Items

A. Local “Sales” Taxes are sourced to local taxing jurisdiction(s) based on a vendor’s Place(s) of Business location (also referred to as a Sales Outlet)

1. Places of Business / Sales Outlets –must receive 3 or more orders per year before being required to collect and remit local sales taxes.
2. Some Texas vendors collect & remit local sales taxes at respective Place(s) of Business and receive local sales tax grants (ie: via a Chapter 380 Agreement) for **sales taxes paid by their customers (including homebuilders)**.
3. Large Texas vendors generally have multiple Places of Business, which require local sales taxes to be collected based on the Sales Outlet **“from where items are shipped” rather than “from where orders are received”** absent a large purchaser issuing the vendor a Texas Direct Payment Permit (DPP) exemption certificate

B. Texas Direct Payment Permits (DPP)- “Voluntary Use Tax” permits allow taxpayers to self-assess and pay use taxes on taxable purchases

1. Local “Use” Taxes are sourced to local taxing jurisdiction(s) based on where items are **first used / first stored (ie: destination-based)**.
2. Permit holders must remit use taxes on **\$800,000 or more** of taxable purchases per year.
3. Direct Payment Permit holders have a very high probability of being audited by the Comptroller’s Office for proper use tax compliance.
4. Homebuilders do not sell tangible personal property or provide taxable services, so they are **not** required to hold sales tax permits (ie: no taxable sales)
5. Homebuilders can apply for a Texas Direct Payment Permit and issue exemption certificates to vendors (rather than pay sales taxes) and self-assess use taxes based on where building materials are used.

C. Rational for any Large Purchaser of Taxable Items to Accept Additional Use Tax Compliance and Reporting Responsibilities - Texas Direct Payment Permit (DPP)

1. Local Tax Rate Advantage - Oil & gas companies are the largest users of Texas Direct Payment Permits since the permit allows paying use taxes in remote areas rather than where vendors have Sales Outlets (ie: in larger cities) and where vendors may have “sales” tax sharing agreements with those cities.
2. Taxpayers that **“pay”** significant amounts of local sales taxes believe any local tax incentives should be due to the party **paying** the tax (ie: homebuilder) rather than the party **collecting** and remitting the tax (vendor).
3. A homebuilder who pays a significant amount of state and local **sales** tax on purchases prefers to pay use taxes and partner with the city where they build homes rather than pay sales taxes to a vendor’s Sales Outlet location.

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D. Economics and Accounting System Compliance Costs / Complications

1. The accounting system costs for any taxpayer to begin self-assessing Texas use taxes on taxable purchases is significant – especially when a taxpayer is not required to hold a sales tax or use tax permit. Absent receiving a local use tax grant from a city where building materials are used, there is often no financial benefit for a taxpayer to re-direct taxes to a job site and utilize a Texas DPP.
2. Many Texas vendors' accounting systems do NOT allow a vendor to collect local sales taxes at some of its Sales Outlets while accepting a Texas DPP Exemption Certificate for other locations. In many situations, a Texas DPP exemption certificate is either accepted globally for all of a vendor's Sales Outlet locations or not at all.
3. Unless a taxpayer receives use tax grants from cities that benefit the most from the issuance of a Texas DPP exemption certificate **AND unless the cities provide use tax grants that are relatively consistent, the process does not provide economic benefits for McKinney or a taxpayer.** Incremental use tax revenues benefit a city where construction occurs only if a homebuilder issues its exemption certificate to a vendor while the homebuilder also pays for all accounting system and ongoing use tax compliance / audit defense costs.
4. Homebuilders have provided a list of their largest building material vendors that were anticipated to be issued Texas DPP Exemption Certificates, along with supporting documentation from the Comptroller's website demonstrating that none of those vendors have active Sales Outlets in the City of McKinney, including a recent verification between September 2014 and current. **In all situations, McKinney would receive new local use tax revenue and would not lose any local sales tax revenue by adopting this approach.**
5. The City Council previously approved Chapter 380 grants on September 16, 2014 for both homebuilders based on the incremental 2% city use taxes generated for building materials used in McKinney. These Agreements will help generate 1.2% of "net" new tax revenues for the City of McKinney and only offset .8% of use tax expenses for each homebuilder before considering up-front accounting system / personnel costs required to comply with tax administrative services that are not currently required of homebuilders by Texas law.
6. Based on a review of the Sales Outlets of many large vendors in Texas, the largest cities in Texas have substantially more building material vendor Sales Outlets than other Texas cities. When a taxpayer issues its Texas DPP exemption certificate to vendors, the cities where construction occurs will receive use tax revenue on **ALL** directly purchased building materials incorporated into new homes such as lumber, concrete, doors, trusses, shingles, sheetrock, windows, appliances, brick, stone, hardware, etc. Conversely, it is highly unlikely that a city where significant new construction occurs would obtain even a small portion of vendor Sales Outlets for many of the types of direct building materials referenced above.

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E. Chapter 380 Agreement Language

1. The McKinney City Council amended Sections 4.01 and 5.06 of the respective Chapter 380 agreements on September 16, 2014 by stating *“Purchases from suppliers or vendors having a sales tax outlet situated within the City’s corporate limits shall not be eligible for consideration in the calculation of the Grant.”*
2. The language inserted into the respective Chapter 380 Agreements appears to have been drafted to prevent the City from ever losing ANY local sales taxes from a prospective vendor that may open a Sales Outlet in McKinney during the term of these Agreements ... even when that vendor is not required to collect McKinney sales tax based on Texas sourcing rules.
3. Texas law requires for any **vendor that has multiple Sales Outlets to collect local sales tax for the Sales Outlet from where items are shipped.** Unless a vendor, with multiple Sales Outlets, opens an outlet in McKinney during the term of these Agreements **AND ships items from its McKinney Sales Outlet**, no local sales tax would ever be due to the City of McKinney.
4. Since some of the larger vendors anticipated to be issued Texas DPP Exemption Certificates have over 30 Sales Outlets in the State of Texas, the language used in Sections 4.01 and 5.06 of the Agreements would better follow Texas local sourcing rules if they were amended to: *“Purchases from suppliers or vendors having a sales tax outlet situated within the City’s corporate limits **and where items are shipped from that location** shall not be eligible for consideration in the calculation of the Grant.”* Homebuilders recommend using language in Chapter 380 Agreements that more accurately complies with Texas local tax sourcing rules.
5. Taxpayers are required to follow Texas local use tax sourcing rules when filing Texas Use Tax Returns (as outlined in the Comptroller brochure attached – see page 4 of the State brochure below). **When filing Texas Use Tax Returns, a homebuilder is required to track where materials are used (ie: where “use” tax is due) rather than from where materials are shipped (where “sales” tax would have been due).** The provisions added to Sections 4.01 and 5.06 increase monitoring and tracking expenses of building materials beyond the current requirements necessary to file Texas Use Tax Returns.
6. Homebuilders may consider purchasing materials from a different vendor that does not have a Sales Outlet in McKinney, so they can issue Texas Direct Payment Permit Exemption Certificates “consistently” without monitoring potentially hundreds of material shipments from a single vendor to confirm from where materials were shipped. As a comment, the provision added in Sections 4.01 and 5.06 of these Chapter 380 Agreements could work to harm a vendor that opens a future Sales Outlet in McKinney.

Guidelines for Collecting Local Sales and Use Taxes - see page 4 of link to State Brochure attached: “More Than One Place of Business”

http://www.window.state.tx.us/taxinfo/taxpubs/tx94_105.pdf