

By: Wilson

H.B. No. 3146

A BILL TO BE ENTITLED

AN ACT

relating to franchise tax reform.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF TEXAS:

SECTION 1. Section 171.001(a), Tax Code, is amended to read as follows:

(a) A franchise tax is imposed on:

(1) each corporation, as defined in this section, that does business in this state or that is chartered or organized under the laws of this state. [~~authorized to do business in this state, and~~

~~(2) each limited liability company that does business in this state or that is organized under the laws of this state or is authorized to do business in this state.]~~

SECTION 2. Section 171.001(b)(3), Tax Code, is amended to read as follows:

(3) "Corporation" means every corporation, limited liability company, limited partnership, business trust, real estate investment trust, savings and loan association, banking corporation, and any other entity for which any of the owners have limited liability. [~~includes:~~

~~(A) a limited liability company, as defined under the Texas Limited Liability Company Act,~~

~~(B) a savings and loan association, and~~

~~(C) a banking corporation.]~~

1 SECTION 3. Section 171.001(b)(4), Tax Code, is amended to  
2 read as follows:

3 (4) "Charter" includes a limited liability company's  
4 certificate of organization, a limited partnership's certificate  
5 of limited partnership, and the registration of a limited liability  
6 partnership.

7 SECTION 4. Section 171.001(b)(6), Tax Code, is amended to  
8 read as follows:

9 (6) "Officer" and "director" include a limited  
10 liability company's directors and managers, ~~and~~ a limited banking  
11 association's directors and managers and participants if there are  
12 no directors or managers, and persons holding comparable positions  
13 of authority in an unincorporated entity subject to the tax imposed  
14 under this chapter.

15 SECTION 5. Section 171.001(b)(8), Tax Code, is amended to  
16 read as follows:

17 (8) "Shareholder" means any person who has an ownership  
18 interest in an entity subject to the tax imposed under this chapter  
19 ~~[includes a limited liability company's member and a limited~~  
20 ~~banking association's participant].~~

21 SECTION 6. Section 171.101(a), Tax Code, is amended to read  
22 as follows:

23 (a) Except as provided by Subsections (b) -(d) ~~[and (c)]~~, the  
24 net taxable capital of a corporation is computed by:

25 (1) adding the corporation's stated capital, as  
26 defined by Article 1.02, Texas Business Corporation Act, and the  
27 corporation's surplus, to determine the corporation's taxable

1 capital;

2 (2) apportioning the corporation's taxable capital to  
3 this state as provided by Section 171.106(a) or (c), as applicable,  
4 to determine the corporation's apportioned taxable capital; and

5 (3) subtracting from the amount computed under  
6 Subdivision (2) any other allowable deductions to determine the  
7 corporation's net taxable capital.

8 SECTION 7. Section 171.101, Tax Code, is amended by adding  
9 (d) to read as follows:

10 (d) The net taxable capital of a partnership or  
11 unincorporated association, other than a limited liability company  
12 or a savings and loan association, is computed by:

13 (1) adding the entity's capital accounts, undistributed  
14 profits, and surplus to determine the taxable entity's taxable  
15 capital;

16 (2) multiply that amount by the percentage of the entity's  
17 ownership interests directly owned by persons other than natural  
18 persons;

19 (3) apportioning the amount determined under Subdivision  
20 (2) to this state as provided by Section 171.106(a), (c), or (d), as  
21 applicable, to determine the entity's apportioned taxable capital;  
22 and

23 (4) subtracting from the amount computed under Subdivision  
24 (3) any other allowable deductions, to determine the entity's net  
25 taxable capital.

26 SECTION 8. Section 171.110(a), Tax Code, is amended to read  
27 as follows:

1 (a) The net taxable earned surplus of a corporation is  
2 computed by:

3 (1) determining the corporation's reportable federal  
4 taxable income, subtracting from that amount any amount included in  
5 reportable federal taxable income under Section 78 or Sections  
6 951-964, Internal Revenue Code, 1 and dividends received from a  
7 subsidiary, associate, or affiliated corporation that does not  
8 transact a substantial portion of its business or regularly  
9 maintain a substantial portion of its assets in the United States,  
10 and adding to that amount any compensation of officers or  
11 directors, or if a bank, any compensation of directors and  
12 executive officers, to the extent excluded in determining federal  
13 taxable income to determine the corporation's taxable earned  
14 surplus;

15 (2) If an entity subject to the tax imposed under this  
16 chapter is a partnership or an unincorporated association,  
17 excluding limited liability companies and savings and loan  
18 associations, and that entity is directly owned by a natural person  
19 who is entitled to a distributive share of the entity's income or  
20 loss, then subtract the natural person's distributive share of the  
21 entity's reportable taxable income or loss from the amount computed  
22 under Subdivision (1).

23 (3) adding to that amount any expense accrued or paid to a  
24 related entity, which was not subject to the tax imposed under this  
25 chapter, including, but not limited to, management fees, the use of  
26 an intangible, or interest on inter-company loan transactions, to  
27 the extent deducted in arriving at the corporation's reportable

1 federal taxable income;

2 (4) subtracting from that amount the corporation's share of  
3 income, loss, or deduction from a limited liability company,  
4 limited partnership, or S corporation included in the corporation's  
5 reportable federal taxable income under the provisions of Section  
6 702(a) or 1366(a), Internal Revenue Code, to the extent included in  
7 the net taxable earned surplus of the limited liability company,  
8 limited partnership, or S corporation or to the extent it would be  
9 included in the net taxable earned surplus, excluding income from  
10 payments described in Subdivision (3), of the limited liability  
11 company, limited partnership, or S corporation, if the entity were  
12 doing business in this state;

13 (5) [~~(2)~~] apportioning the corporation's taxable earned  
14 surplus to this state as provided by Section 171.106(b) or (c), as  
15 applicable, to determine the corporation's apportioned taxable  
16 earned surplus;

17 (6) [~~(3)~~] adding the corporation's taxable earned surplus  
18 allocated to this state as provided by Section 171.1061; [~~and~~]

19 (7) [~~(4)~~] subtracting from that amount any allowable  
20 deductions and any business loss that is carried forward to the tax  
21 reporting period and deductible under Subsection (e).

22 (b) A corporation is not required to add the compensation of  
23 officers or directors as required by Subsection (a)(1) if the  
24 corporation is:

25 (1) a corporation that has not more than 35 shareholders; or

26 (2) an S corporation, as that term is defined by Section  
27 1361, Internal Revenue Code.

1           (c) Subsection (b) does not apply to a subsidiary  
2 corporation unless it applies to the subsidiary's parent  
3 corporation.

4           (d) A corporation's reportable federal taxable income is  
5 the corporation's federal taxable income after Schedule C special  
6 deductions and before net operating loss deductions as computed  
7 under the Internal Revenue Code, except that an S corporation's  
8 reportable federal taxable income is the amount of the income  
9 reportable to the Internal Revenue Service as taxable to the  
10 corporation's shareholders.

11           (e) Reportable federal taxable income shall be determined  
12 before adjustment for distributions to owners and includes all  
13 income taxable to the entity or the owners for federal income tax  
14 purposes.

15           (f) [~~(e)~~] For purposes of this section, a business loss is  
16 any negative amount after apportionment and allocation. The  
17 business loss shall be carried forward to the year succeeding the  
18 loss year as a deduction to net taxable earned surplus, then  
19 successively to the succeeding four taxable years after the loss  
20 year or until the loss is exhausted, whichever occurs first, but for  
21 not more than five taxable years after the loss year.  
22 Notwithstanding the preceding sentence, a business loss from a tax  
23 year that ends before January 1, 1991, may not be used to reduce net  
24 taxable earned surplus. A business loss can be carried forward only  
25 by the corporation that incurred the loss and cannot be transferred  
26 to or claimed by any other entity, including the survivor of a  
27 merger if the loss was incurred by the corporation that did not

1 survive the merger.

2 (g) [~~(f)~~] A corporation may use either the "first in-first  
3 out" or "last in-first out" method of accounting to compute its net  
4 taxable earned surplus, but only to the extent that the corporation  
5 used that method on its most recent federal income tax report  
6 originally due on or before the date on which the corporation's  
7 franchise tax report is originally due.

8 (h) [~~(g)~~] For purposes of this section, an approved  
9 Employee Stock Ownership Plan controlling a minority interest and  
10 voted through a single trustee shall be considered one shareholder.

11 (i) [~~(h)~~] A corporation shall report its net taxable earned  
12 surplus based solely on its own financial condition. Consolidated  
13 reporting is prohibited.

14 (j) [~~(i)~~] For purposes of this section, any person  
15 designated as an officer is presumed to be an officer if that  
16 person:

17 (1) holds an office created by the board of directors  
18 or under the corporate charter or bylaws; and

19 (2) has legal authority to bind the corporation with  
20 third parties by executing contracts or other legal documents.

21 (k) [~~(j)~~] A corporation may rebut the presumption described  
22 in Subsection (i) that a person is an officer if it conclusively  
23 shows, through the person's job description or other documentation,  
24 that the person does not participate or have authority to  
25 participate in significant policy making aspects of the corporate  
26 operations.

27 SECTION 9. For an entity becoming subject to the franchise

1 tax under this Act:

2 (1) income or losses occurring before January 1, 2003 may  
3 not be considered for purposes of the earned surplus component;

4 (2) for entities in existence on January 1, 2003, that would  
5 have been subject to the franchise tax had this Act been in effect  
6 on January 1, 2003, the first report due under this Act will be  
7 either a final report, if applicable, or an annual report due May  
8 15, 2004; and

9 (3) for entities that would have become subject to the  
10 franchise tax after January 1, 2003, had this Act been in effect on  
11 January 1, 2003, the first report due under this Act will be an  
12 initial report or a final report, if applicable.

13 SECTION 10. This Act takes effect September 1, 2003.