By: Keffer of Eastland, et al. H.B. No. 3

(Senate Sponsor - Ogden)

(In the Senate - Received from the House April 26, 2006; April 26, 2006, read first time and referred to Committee on Finance; April 29, 2006, reported favorably by the following vote: Yeas 11, Nays 4; April 29, 2006, sent to printer.)

A BILL TO BE ENTITLED

AN ACT

relating to certain taxes affecting businesses; making an appropriation; providing penalties.

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

SECTION 1. (a) Section 21.02, Tax Code, is amended by amending Subsection (a) and adding Subsection (e) to read as follows:

(a) Except as provided by Subsections [~~Subsection~~] (b) and (e) and by Sections 21.021, 21.04, and 21.05, tangible personal property is taxable by a taxing unit if:

(1) it is located in the unit on January 1 for more than a temporary period;

(2) it normally is located in the unit, even though it is outside the unit on January 1, if it is outside the unit only temporarily;

(3) it normally is returned to the unit between uses elsewhere and is not located in any one place for more than a temporary period; or

(4) the owner resides (for property not used for business purposes) or maintains the owner's [~~his~~] principal place of business in this state (for property used for business purposes) in the unit and the property is taxable in this state but does not have a taxable situs pursuant to Subdivisions (1) through (3) of this subsection [~~section~~].

(e) In this subsection, "portable drilling rig" includes equipment associated with the drilling rig. A portable drilling rig designed for land-based oil or gas drilling or exploration operations is taxable by the taxing unit in which the rig is located on January 1 if the rig was located in the appraisal district that appraises property for the unit for the preceding 365 consecutive days. If the drilling rig was not located in the appraisal district where it is located on January 1 for the preceding 365 days, it is taxable by the taxing unit in which the owner's principal place of business in this state is located on January 1.

(b) Section 21.02, Tax Code, as amended by this section, applies only to the taxable situs of property for an ad valorem tax year that begins on or after January 1, 2007.

(c) This section takes effect January 1, 2007.

SECTION 2. Subchapter A, Chapter 171, Tax Code, is amended to read as follows:

SUBCHAPTER A. DEFINITIONS; TAX IMPOSED

Sec. 171.0001. GENERAL DEFINITIONS. In this chapter:

(1) "Affiliated group" means a group of one or more entities in which a controlling interest is owned by a common owner or owners, either corporate or noncorporate, or by one or more of the member entities.

(2) "Assigned employee" has the meaning assigned by Section 91.001, Labor Code.

(3) "Banking corporation" means each state, national, domestic, or foreign bank, whether organized under the laws of this state, another state, or another country, or under federal law, including a limited banking association organized under Subtitle A, Title 3, Finance Code, and each bank organized under Section 25(a), Federal Reserve Act (12 U.S.C. Sections 611-631) (edge corporations), but does not include a bank holding company as that term is defined by Section 2, Bank Holding Company Act of 1956 (12 U.S.C. Section 1841).

(4) "Beginning date" means:

(A) for a taxable entity chartered or organized in this state, the date on which the taxable entity's charter or organization takes effect; and

(B) for any other taxable entity, the date on which the taxable entity begins doing business in this state.

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

(6) "Client company" has the meaning assigned by Section 91.001, Labor Code.

(7) "Combined group" means taxable entities that are part of an affiliated group engaged in a unitary business and that are required to file a group report under Section 171.1014.

(8) "Controlling interest" means:

(A) for a corporation, either 80 percent or more, owned directly or indirectly, of the total combined voting power of all classes of stock of the corporation, or 80 percent or more, owned directly or indirectly, of the beneficial ownership interest in the voting stock of the corporation; and

(B) for a partnership, association, trust, or other entity, 80 percent or more, owned directly or indirectly, of the capital, profits, or beneficial interest in the partnership, association, trust, or other entity.

(9) "Internal Revenue Code" means the Internal Revenue Code of 1986 in effect for the federal tax year beginning on January 1, 2006, and any regulations adopted under that code applicable to that period.

(10) "Lending institution" means an entity that makes loans and is regulated by the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Texas Department of Banking, the Office of Consumer Credit Commissioner, the Department of Savings and Mortgage Lending, the Credit Union Department, or any comparable regulatory body.

(11) "Management company" means a corporation, limited liability company, or other limited liability entity that conducts all or part of the active trade or business of another entity (the "managed entity") in exchange for:

(A) a management fee; and

(B) reimbursement of specified costs incurred in the conduct of the active trade or business of the managed entity, including "wages and cash compensation" as determined under Sections 171.1013(a) and (b).

(12) "Retail trade" means the activities described in Division G of the 1987 Standard Industrial Classification Manual published by the federal Office of Management and Budget.

(13) "Savings and loan association" means a savings and loan association or savings bank, whether organized under the laws of this state, another state, or another country, or under federal law.

(14) "Shareholder" includes a limited liability company's member and a limited banking association's participant.

(15) "Staff leasing services company" has the meaning assigned by Section 91.001, Labor Code.

(16) "Total revenue" means the total revenue of a taxable entity as determined under Section 171.1011.

(17) "Unitary business" means a single economic enterprise that is made up of separate parts of a single entity or of a commonly controlled group of entities that are sufficiently interdependent, integrated, and interrelated through their activities so as to provide a synergy and mutual benefit that produces a sharing or exchange of value among them and a significant flow of value to the separate parts. In determining whether a unitary business exists, the comptroller shall consider any relevant factor, including whether:

(A) the activities of the group members:

(i) are in the same general line, such as

manufacturing, wholesaling, retailing of tangible personal property, insurance, transportation, or finance; or

(ii) are steps in a vertically structured enterprise or process, such as the steps involved in the production of natural resources, including exploration, mining, refining, and marketing; and

(B) the members are functionally integrated through the exercise of strong centralized management, such as authority over purchasing, financing, product line, personnel, and marketing.

(18) "Wholesale trade" means the activities described in Division F of the 1987 Standard Industrial Classification Manual published by the federal Office of Management and Budget.

Sec. 171.0002. DEFINITION OF TAXABLE ENTITY. (a) Except as otherwise provided by this section, "taxable entity" means a partnership, corporation, banking corporation, savings and loan association, limited liability company, business trust, professional association, business association, joint venture, joint stock company, holding company, or other legal entity. The term includes a combined group. A joint venture does not include joint operating or co-ownership arrangements meeting the requirements of Treasury Regulation Section 1.761-2(a)(3) that elect out of federal partnership treatment as provided by Section 761(a), Internal Revenue Code.

(b) "Taxable entity" does not include:

(1) a sole proprietorship;

(2) a general partnership the direct ownership of which is entirely composed of natural persons;

(3) a passive entity as defined by Section 171.0003; or

(4) an entity that is exempt from taxation under Subchapter B.

(c) "Taxable entity" does not include an entity that is:

(1) a grantor trust as defined by Sections 671 and 7701(a)(30)(E), Internal Revenue Code, all of the grantors and beneficiaries of which are natural persons or charitable entities as described in Section 501(c)(3), Internal Revenue Code, excluding a trust taxable as a business entity pursuant to Treasury Regulation Section 301.7701-4(b);

(2) an estate of a natural person as defined by Section 7701(a)(30)(D), Internal Revenue Code, excluding an estate taxable as a business entity pursuant to Treasury Regulation Section 301.7701-4(b);

(3) an escrow;

(4) a family limited partnership that is a passive entity in which at least 80 percent of the interests are held, directly or indirectly, by members of the same family, including an individual's ancestors, lineal descendants, spouse, and brothers and sisters by the whole or half blood, and the estate of any of these persons, and that is a limited partnership:

(A) formed pursuant to the Texas Revised Limited Partnership Act (Article 6132a-1, Vernon's Texas Civil Statutes);

(B) formed pursuant to the limited partnership law of any other state; or

(C) treated as a partnership for federal income tax purposes;

(5) a passive investment partnership that is a passive entity and that is:

(A) formed pursuant to the Texas Revised Limited Partnership Act (Article 6132a-1, Vernon's Texas Civil Statutes);

(B) formed pursuant to the limited partnership law of any other state; or

(C) formed pursuant to the limited partnership laws of any foreign country;

(6) a passive investment partnership that is a passive entity and is a general partnership;

(7) a trust that is a passive entity:

(A) that is taxable as a trust under Section 641, Internal Revenue Code;

(B) all of the beneficiaries of which are natural persons or charitable entities as defined in Section 501(c)(3), Internal Revenue Code;

(C) that is not a trust taxable as a business entity pursuant to Treasury Regulation Section 301.7701-4(b); and

(D) that is organized as a trust and is described in Section 7701(a)(30)(E), Internal Revenue Code;

(8) a real estate investment trust (REIT) as defined by Section 856, Internal Revenue Code, and its "qualified REIT subsidiary" entities as defined by Section 856(i)(2), Internal Revenue Code, provided that:

(A) a REIT with any amount of its assets in direct holdings of real estate, other than real estate it occupies for business purposes, as opposed to holding interests in limited partnerships or other entities that directly hold the real estate, is a taxable entity; and

(B) a limited partnership or other entity that directly holds the real estate as described in Paragraph (A) is not exempt under this subdivision, without regard to whether a REIT holds an interest in it; or

(9) a real estate mortgage investment conduit (REMIC), as defined by Section 860D, Internal Revenue Code.

(d) An entity that can file as a sole proprietorship for federal tax purposes is not a sole proprietorship for purposes of Subsection (b)(1) and is not exempt under that subsection if the entity is formed in a manner under the statutes of this state or another state that limit the liability of the entity.

Sec. 171.0003. DEFINITION OF PASSIVE ENTITY. (a) An entity is a passive entity only if:

(1) the entity is a general or limited partnership or a trust, other than a business trust;

(2) during the period on which margin is based, the entity's federal gross income consists of at least 90 percent of the following income:

(A) dividends, interest, foreign currency exchange gain, periodic and nonperiodic payments with respect to notional principal contracts, option premiums, cash settlement or termination payments with respect to a financial instrument, and income from a limited liability company;

(B) distributive shares of partnership income to the extent that those distributive shares of income are greater than zero;

(C) gains from the sale of real property, commodities traded on a commodities exchange, and securities; and

(D) royalties, bonuses, or delay rental income from mineral properties and income from other nonoperating mineral interests; and

(3) the entity does not receive more than 10 percent of its federal gross income from conducting an active trade or business.

(a-1) In making the computation under Subsection (a)(3), income described by Subsection (a)(2) may not be treated as income from conducting an active trade or business.

(b) The income described by Subsection (a)(2) does not include:

(1) rent; or

(2) income received by a nonoperator from mineral properties under a joint operating agreement if the nonoperator is a member of an affiliated group and another member of that group is the operator under the same joint operating agreement.

Sec. 171.0004. DEFINITION OF CONDUCTING ACTIVE TRADE OR BUSINESS. (a) The definition in this section applies only to Section 171.0003.

(b) An entity conducts an active trade or business if:

(1) the activities being carried on by the entity include one or more active operations that form a part of the process of earning income or profit; and

(2) the entity performs active management and operational functions.

(c) Activities performed by the entity include activities performed by persons outside the entity, including independent contractors, to the extent the persons perform services on behalf of the entity and those services constitute all or part of the entity's trade or business.

(d) An entity conducts an active trade or business if assets, including royalties, patents, trademarks, and other intangible assets, held by the entity are used in the active trade or business of one or more related entities.

(e) For purposes of this section:

(1) the ownership of a royalty interest or a nonoperating working interest in mineral rights does not constitute conduct of an active trade or business; and

(2) payment of compensation to employees or independent contractors for financial or legal services reasonably necessary for the operation of the entity does not constitute conduct of an active trade or business.

Sec. 171.001. TAX IMPOSED. (a) A franchise tax is imposed on[~~:~~

[~~(1)~~] each taxable entity [~~corporation~~] that does business in this state or that is chartered or organized 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~~].

(b) [~~In this chapter:~~

[~~(1) "Banking corporation" means each state, national, domestic, or foreign bank, whether organized under the laws of this state, another state, or another country, or under federal law, including a limited banking association organized under Subtitle A, Title 3, Finance Code, and each bank organized under Section 25(a), Federal Reserve Act (12 U.S.C. Secs. 611-631) (edge corporations), but does not include a bank holding company as that term is defined by Section 2, Bank Holding Company Act of 1956 (12 U.S.C. Sec. 1841).~~

[~~(2) "Beginning date" means:~~

[~~(A) for a corporation chartered in this state, the date on which the corporation's charter takes effect; and~~

[~~(B) for a foreign corporation, the date on which the corporation begins doing business in this state.~~

[~~(3) "Corporation" 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.~~

[~~(4) "Charter" includes a limited liability company's certificate of organization.~~

[~~(5) "Internal Revenue Code" means the Internal Revenue Code of 1986 in effect for the federal tax year beginning on or after January 1, 1996, and before January 1, 1997, and any regulations adopted under that code applicable to that period.~~

[~~(6) "Officer" and "director" include a limited liability company's directors and managers and a limited banking association's directors and managers and participants if there are no directors or managers.~~

[~~(7) "Savings and loan association" means a savings and loan association or savings bank, whether organized under the laws of this state, another state, or another country, or under federal law.~~

[~~(8) "Shareholder" includes a limited liability company's member and a limited banking association's participant.~~

[~~(c)~~] The tax imposed under this chapter extends to the limits of the United States Constitution and the federal law adopted under the United States Constitution.

Sec. 171.0011. ADDITIONAL TAX. (a) Except as provided by Subsection (e), an [~~An~~] additional tax is imposed on a taxable entity [~~corporation~~] that for any reason becomes no longer subject to the [~~earned surplus component of the tax, without regard to whether the corporation remains subject to the taxable capital component of the~~] tax imposed under this chapter.

(b) The additional tax is equal to the appropriate rate under Section 171.002 of the taxable entity's taxable margin [~~4.5 percent of the corporation's net taxable earned surplus~~] computed on the period beginning on the day after the last day for which the tax imposed on taxable margin [~~net taxable earned surplus~~] was computed [~~under Section 171.1532~~] and ending on the date the taxable entity [~~corporation~~] is no longer subject to the [~~earned surplus component of the~~] tax imposed under this chapter.

(c) The additional tax imposed and any report required by the comptroller are due on the 60th day after the date the taxable entity [~~corporation~~] becomes no longer subject to the [~~earned surplus component of the~~] tax imposed under this chapter.

(d) Except as otherwise provided by this section, the provisions of this chapter apply to the tax imposed under this section.

(e) An additional tax is not imposed on a taxable entity that becomes no longer subject to the tax imposed under this chapter because the entity qualifies as a passive entity.

Sec. 171.002. RATES; COMPUTATION OF TAX. (a) Subject to Section 171.003 and except as provided by Subsection (b), the rate [~~The rates~~] of the franchise tax is one [~~are:~~

[~~(1) 0.25~~] percent per year of privilege period of [~~net~~] taxable margin [~~capital; and~~

[~~(2) 4.5 percent of net taxable earned surplus~~].

(b) The rate of the franchise tax is 0.5 percent per year of privilege period of taxable margin for those taxable entities primarily engaged in retail or wholesale trade. [~~The amount of franchise tax on each corporation is computed by adding the following:~~

[~~(1) the amount calculated by applying the tax rate prescribed by Subsection (a)(1) to the corporation's net taxable capital; and~~

[~~(2) the difference between:~~

[~~(A) the amount calculated by applying the tax rate prescribed by Subsection (a)(2) to the corporation's net taxable earned surplus; and~~

[~~(B) the amount determined under Subdivision (1).~~]

(c) A taxable entity is primarily engaged in retail or wholesale trade only if:

(1) the total revenue from its activities in retail or wholesale trade is greater than the total revenue from its activities in trades other than the retail and wholesale trades;

(2) except as provided by Subsection (c-1), less than 50 percent of the total revenue from activities in retail or wholesale trade comes from the sale of products it produces or products produced by an entity that is part of an affiliated group to which the taxable entity also belongs; and

(3) the taxable entity does not provide retail or wholesale utilities, including telecommunications services and electricity or gas. [~~In making a computation under Subsection (b), an amount computed under Subsection (b)(1) or (b)(2) that is zero or less is computed as a zero.~~]

(c-1) Subsection (c)(2) does not apply to total revenue from activities in a retail trade described by Major Group 58 of the Standard Industrial Classification Manual published by the federal Office of Management and Budget.

(d) A taxable entity [~~corporation~~] is not required to pay any tax and is not considered to owe any tax for a period if:

(1) the amount of tax computed for the taxable entity [~~corporation~~] is less than $1,000 [~~$100~~]; or

(2) the amount of the taxable entity's total revenue [~~corporation's gross receipts:~~

[~~(A)~~] from its entire business [~~under Section 171.105~~] is less than or equal to $300,000 or the amount determined under Section 171.006 [~~$150,000; and~~

[~~(B) from its entire business under Section 171.1051, including the amount excepted under Section 171.1051(a), is less than $150,000~~].

[~~Sec. 171.005. RATE OF TAX FOR CORPORATION IN PROCESS OF LIQUIDATION. The franchise tax rate on a corporation in the process of liquidation, as defined by Section 171.102 of this code, is the rate established by Section 171.002 of this code.~~]

Sec. 171.003. INCREASE IN RATE REQUIRES VOTER APPROVAL. (a) An increase in a rate provided by Section 171.002(a) or (b) takes effect only if approved by a majority of the registered voters voting in a statewide referendum held on the question of increasing the rate. The referendum must specify the increased rate or rates.

(b) This section does not apply to a decrease in a rate provided by Section 171.002(a) or (b). If a rate is decreased, this section applies to any subsequent increase in that rate.

(c) This section does not apply to any change in the tax imposed by this chapter in relation to:

(1) the manner in which the tax is computed, including the determination of margin and taxable margin and any allowable deductions or credits;

(2) the manner in which the tax is administered or enforced; or

(3) the applicability of the tax to certain entities.

Sec. 171.006. ADJUSTMENT OF ELIGIBILITY FOR EXEMPTION AND COMPENSATION DEDUCTION. (a) In this section, "consumer price index" means the average over a state fiscal biennium of the Consumer Price Index for All Urban Consumers (CPI-U), U.S. City Average, published monthly by the United States Bureau of Labor Statistics, or its successor in function.

(b) Beginning in 2009, on January 1 of each odd-numbered year, the amounts prescribed by Sections 171.002(d)(2) and 171.1013(c) are increased or decreased by an amount equal to the amount prescribed by those sections on December 31 of the preceding year multiplied by the percentage increase or decrease during the preceding state fiscal biennium in the consumer price index and rounded to the nearest $10,000.

(c) The amounts determined under Subsection (b) apply to a report originally due on or after the date the determination is made.

(d) The comptroller shall make the determination required by this section and may adopt rules related to making that determination.

(e) A determination by the comptroller under this section is final and may not be appealed.

SECTION 3. Section 171.052, Tax Code, is amended to read as follows:

Sec. 171.052. CERTAIN CORPORATIONS. (a) Except as provided by Subsection (c), an [~~An~~] insurance organization, title insurance company, or title insurance agent authorized to engage in insurance business in this state now required to pay an annual tax under Chapter 4 or 9, Insurance Code, measured by its gross premium receipts is exempted from the franchise tax. A nonadmitted insurance organization that is required to pay a gross premium receipts tax during a tax year is exempted from the franchise tax for that same tax year.

(b) Farm mutuals, local mutual aid associations, and burial associations are not subject to the franchise tax.

(c) An entity is subject to the franchise tax for a tax year in any portion of which the entity is in violation of an order issued by the Texas Department of Insurance under Section 2254.003(b), Insurance Code, that is final after appeal or that is no longer subject to appeal.

SECTION 4. Subchapter B, Chapter 171, Tax Code, is amended by adding Section 171.088 to read as follows:

Sec. 171.088. EXEMPTION--NONCORPORATE ENTITY ELIGIBLE FOR CERTAIN EXEMPTIONS. An entity that is not a corporation but that, because of its activities, would qualify for a specific exemption under this subchapter if it were a corporation, qualifies for the exemption and is exempt from the tax in the same manner and under the same conditions as a corporation.

SECTION 5. Subchapter C, Chapter 171, Tax Code, is amended, including the reenacting and amending of Section 171.109(g), Tax

Code, as amended by Chapters 801 and 1198, Acts of the 71st Legislature, Regular Session, 1989, to read as follows:

SUBCHAPTER C. DETERMINATION OF TAXABLE MARGIN [~~CAPITAL AND TAXABLE EARNED SURPLUS~~]; ALLOCATION AND APPORTIONMENT

Sec. 171.101. DETERMINATION OF [~~NET~~] TAXABLE MARGIN [~~CAPITAL~~]. (a) The [~~Except as provided by Subsections (b) and (c), the net~~] taxable margin [~~capital~~] of a taxable entity [~~corporation~~] is computed by:

(1) determining the taxable entity's margin, which is the lesser of:

(A) 70 percent of the taxable entity's total revenue from its entire business, as determined under Section 171.1011; or

(B) an amount computed by:

(i) determining the taxable entity's total revenue from its entire business, under Section 171.1011;

(ii) subtracting, at the election of the taxable entity, either:

(a) cost of goods sold, as determined under Section 171.1012; or

(b) compensation, as determined under Section 171.1013; and

(iii) subtracting, in addition to any subtractions made under Subparagraph (ii)(a) or (b), compensation, as determined under Section 171.1013, paid to an individual during the period the individual is serving on active duty as a member of the armed forces of the United States if the individual is a resident of this state at the time the individual is ordered to active duty and the cost of training a replacement for the individual; [~~adding the corporation's stated capital, as defined by Article 1.02, Texas Business Corporation Act, and the corporation's surplus, to determine the corporation's taxable capital;~~]

(2) apportioning the taxable entity's margin [~~corporation's taxable capital~~] to this state as provided by Section 171.106 [~~171.106(a) or (c), as applicable,~~] to determine the taxable entity's [~~corporation's~~] apportioned margin [~~taxable capital~~]; and

(3) subtracting from the amount computed under Subdivision (2) any other allowable deductions to determine the taxable entity's [~~corporation's net~~] taxable margin [~~capital~~].

(b) Notwithstanding Subsection (a)(1)(B)(ii), a staff leasing services company may subtract only compensation as determined under Section 171.1013.

(c) In making a computation under this section, an amount that is zero or less is computed as a zero [~~The net taxable capital of a limited liability company is computed by:~~

[~~(1) adding the company's members' contributions, as provided for under the Texas Limited Liability Company Act, and surplus to determine the company's taxable capital;~~

[~~(2) apportioning the amount determined under Subdivision (1) to this state in the same manner that the taxable capital of a corporation is apportioned to this state under Section 171.106(a) or (c), as applicable, to determine the company's apportioned taxable capital; and~~

[~~(3) subtracting from the amount computed under Subdivision (2) any other allowable deductions, to determine the company's net taxable capital.~~

[~~(c) The net taxable capital of a savings and loan association is computed by:~~

[~~(1) determining the association's net worth; and~~

[~~(2) apportioning the amount determined under Subdivision (1) to this state in the same manner that the taxable capital of a corporation is apportioned to this state under Section 171.106(a) to determine the association's net taxable capital~~].

(d) An election under Subsection (a)(1)(B)(ii) shall be made by the taxable entity on its annual report and is effective only for that annual report. The election may be changed by filing an amended report.

Sec. 171.1011. DETERMINATION OF TOTAL REVENUE FROM ENTIRE

BUSINESS. (a) In this section, a reference to an Internal Revenue Service form includes a variant of the form. For example, a reference to Form 1120 includes Forms 1120-A, 1120-S, and other variants of Form 1120. A reference to an Internal Revenue Service form also includes any subsequent form with a different number or designation that substantially provides the same information as the original form.

(b) In this section, a reference to an amount entered on a line number on an Internal Revenue Service form includes the corresponding amount entered on a variant of the form, or a subsequent form, with a different line number. The comptroller shall adopt rules as necessary to accomplish the legislative intent prescribed by this subsection and Subsection (a).

(c) Except as provided by this section, and subject to Section 171.1014, for the purpose of computing its taxable margin under Section 171.101, the total revenue of a taxable entity is:

(1) for a taxable entity treated for federal income tax purposes as a corporation, an amount computed by:

(A) adding:

(i) the amount entered on line 1c, Internal Revenue Service Form 1120; and

(ii) the amounts entered on lines 4 through 10, Internal Revenue Service Form 1120; and

(B) subtracting:

(i) bad debt expensed for federal income tax purposes that corresponds to items of gross receipts included in Subsection (c)(1)(A) for the current reporting period or a past reporting period;

(ii) to the extent included in Subsection (c)(1)(A), foreign royalties and foreign dividends, including amounts determined under Section 78 or Sections 951-964, Internal Revenue Code;

(iii) to the extent included in Subsection (c)(1)(A), net distributive income from partnerships and from trusts and limited liability companies treated as partnerships for federal income tax purposes and net distributive income from limited liability companies and corporations treated as S corporations for federal income tax purposes;

(iv) allowable deductions from Internal Revenue Service Form 1120, Schedule C, to the extent the relating dividend income is included in total revenue;

(v) to the extent included in Subsection (c)(1)(A), items of income attributable to an entity that is a disregarded entity for federal income tax purposes; and

(vi) to the extent included in Subsection (c)(1)(A), other amounts authorized by this section;

(2) for a taxable entity treated for federal income tax purposes as a partnership, an amount computed by:

(A) adding:

(i) the amount entered on line 1c, Internal Revenue Service Form 1065;

(ii) the amounts entered on lines 4 through 7, Internal Revenue Service Form 1065; and

(iii) the amounts entered on lines 2 through 11, Internal Revenue Service Form 1065, Schedule K; and

(B) subtracting:

(i) bad debt expensed for federal income tax purposes that corresponds to items of gross receipts included in Subsection (c)(2)(A) for the current reporting period or a past reporting period;

(ii) to the extent included in Subsection (c)(2)(A), foreign royalties and foreign dividends, including amounts determined under Section 78 or Sections 951-964, Internal Revenue Code;

(iii) to the extent included in Subsection (c)(2)(A), net distributive income from partnerships and from trusts and limited liability companies treated as partnerships for federal income tax purposes and net distributive income from limited liability companies and corporations treated as S

corporations for federal income tax purposes;

(iv) to the extent included in Subsection (c)(2)(A), items of income attributable to an entity that is a disregarded entity for federal income tax purposes; and

(v) to the extent included in Subsection (c)(2)(A), other amounts authorized by this section; or

(3) for a taxable entity other than a taxable entity treated for federal income tax purposes as a corporation or partnership, an amount determined in a manner substantially equivalent to the amount for Subdivision (1) or (2) determined by rules that the comptroller shall adopt.

(d) Subject to Section 171.1014, a corporation that is part of a federal consolidated group shall compute its total revenue under Subsection (c) as if it had filed a separate return for federal income tax purposes.

(e) A taxable entity that owns an interest in a passive entity that is not included in a group report under Section 171.1014 shall include in the taxable entity's total revenue the taxable entity's share of the net income of the passive entity, but only to the extent the net income of the passive entity was not generated by the margin of any other taxable entity.

(f) A taxable entity shall exclude from its total revenue, to the extent included under Subsection (c)(1)(A), (c)(2)(A), or (c)(3), flow-through funds that are mandated by law or fiduciary duty to be distributed to other entities, including taxes collected from a third party by the taxable entity and remitted by the taxable entity to a taxing authority.

(g) A taxable entity shall exclude from its total revenue, to the extent included under Subsection (c)(1)(A), (c)(2)(A), or (c)(3), only the following flow-through funds that are mandated by contract to be distributed to other entities:

(1) sales commissions to nonemployees, including split-fee real estate commissions;

(2) the tax basis as determined under the Internal Revenue Code of securities underwritten; and

(3) subcontracting payments handled by the taxable entity to provide services, labor, or materials in connection with the actual or proposed design, construction, remodeling, or repair of improvements on real property or the location of the boundaries of real property.

(g-1) A taxable entity that is a lending institution shall exclude from its total revenue, to the extent included under Subsection (c)(1)(A), (c)(2)(A), or (c)(3), proceeds from the principal repayment of loans.

(g-2) A taxable entity shall exclude from its total revenue, to the extent included under Subsection (c)(1)(A), (c)(2)(A), or (c)(3), the tax basis as determined under the Internal Revenue Code of securities and loans sold.

(g-3) A taxable entity that provides legal services shall exclude from its total revenue, to the extent included under Subsection (c)(1)(A), (c)(2)(A), or (c)(3):

(1) the following flow-through funds that are mandated by law, contract, or fiduciary duty to be distributed to the claimant by the claimant's attorney or to other entities on behalf of a claimant by the claimant's attorney:

(A) damages due the claimant;

(B) funds subject to a lien or other contractual obligation arising out of the representation, other than fees owed to the attorney;

(C) funds subject to a subrogation interest or other third-party contractual claim; and

(D) fees paid an attorney in the matter who is not a member, partner, shareholder, or employee of the taxable entity;

(2) reimbursement of the taxable entity's expenses incurred in prosecuting a claimant's matter that are specific to the matter and that are not general operating expenses; and

(3) the actual out-of-pocket expenses of the attorney, not to exceed $500 per case, of providing pro bono legal services to a person, but only if the attorney maintains records of the pro bono

services for auditing purposes in accordance with the manner in which those services are reported to the State Bar of Texas.

(h) If the taxable entity belongs to an affiliated group, the taxable entity may not exclude payments described by Subsection (f), (g), (g-1), (g-2), or (g-3) that are made to entities that are members of the affiliated group.

(i) Except as provided by Subsection (g), a payment made under an ordinary contract for the provision of services in the regular course of business may not be excluded.

(j) Any amount excluded under this section may not be included in the determination of cost of goods sold under Section 171.1012 or the determination of compensation under Section 171.1013.

(k) A taxable entity that is a staff leasing services company shall exclude from its total revenue payments received from a client company for wages, payroll taxes on those wages, employee benefits, and workers' compensation benefits for the assigned employees of the client company.

(l) For purposes of Subsection (g)(1):

(1) "Sales commission" means:

(A) any form of compensation paid to a person for engaging in an act for which a license is required by Chapter 1101, Occupations Code; and

(B) compensation paid to a sales representative by a principal in an amount that is based on the amount or level of certain orders for or sales of the principal's product and that the principal is required to report on Internal Revenue Service Form 1099-MISC.

(2) "Principal" means a person who:

(A) manufactures, produces, imports, distributes, or acts as an independent agent for the distribution of a product for sale;

(B) uses a sales representative to solicit orders for the product; and

(C) compensates the sales representative wholly or partly by sales commission.

(m) A taxable entity shall exclude from its total revenue, to the extent included under Subsection (c)(1)(A), (c)(2)(A), or (c)(3), dividends and interest received from federal obligations.

(m-1) A taxable entity that is a management company shall exclude from its total revenue reimbursements of specified costs incurred in its conduct of the active trade or business of a managed entity, including "wages and cash compensation" as determined under Sections 171.1013(a) and (b).

(n) Except as provided by Subsection (o), a taxable entity that is a health care provider shall exclude from its total revenue, to the extent included under Subsection (c)(1)(A), (c)(2)(A), or (c)(3):

(1) the total amount of payments the health care provider received:

(A) under the Medicaid program, Medicare program, Indigent Health Care and Treatment Act (Chapter 61, Health and Safety Code), and Children's Health Insurance Program (CHIP);

(B) for professional services provided in relation to a workers' compensation claim under Title 5, Labor Code; and

(C) for professional services provided to a beneficiary rendered under the TRICARE military health system; and

(2) the actual cost to the health care provider for any uncompensated care provided, but only if the provider maintains records of the uncompensated care for auditing purposes and, if the provider later receives payment for all or part of that care, the provider adjusts the amount excluded for the tax year in which the payment is received.

(n-1) The comptroller shall adopt rules governing:

(1) the computation of the actual cost to a health care provider of any uncompensated care provided under Subsection (n)(2); and

(2) the audit requirements related to the computation

of those costs.

(o) A health care provider that is a health care institution shall exclude from its total revenue, to the extent included under Subsection (c)(1)(A), (c)(2)(A), or (c)(3), 50 percent of the amounts described by Subsection (n).

(p) In this section:

(1) "Federal obligations" means:

(A) stocks and other direct obligations of, and obligations unconditionally guaranteed by, the United States government and United States government agencies; and

(B) direct obligations of a United States government-sponsored agency.

(2) "Health care institution" means:

(A) an ambulatory surgical center;

(B) an assisted living facility licensed under Chapter 247, Health and Safety Code;

(C) an emergency medical services provider;

(D) a home and community support services agency;

(E) a hospice;

(F) a hospital;

(G) a hospital system;

(H) an intermediate care facility for the mentally retarded or a home and community-based services waiver program for persons with mental retardation adopted in accordance with Section 1915(c) of the federal Social Security Act (42 U.S.C. Section 1396n);

(I) a birthing center;

(J) a nursing home;

(K) an end stage renal disease facility licensed under Section 251.011, Health and Safety Code; or

(L) a pharmacy.

(3) "Health care provider" means a taxable entity that participates in the Medicaid program, Medicare program, Children's Health Insurance Program (CHIP), state workers' compensation program, or TRICARE military health system as a provider of health care services.

(4) "Obligation" means any bond, debenture, security, mortgage-backed security, pass-through certificate, or other evidence of indebtedness of the issuing entity. The term does not include a deposit, a repurchase agreement, a loan, a lease, a participation in a loan or pool of loans, a loan collateralized by an obligation of a United States government agency, or a loan guaranteed by a United States government agency.

(4-a) "Pro bono services" means the direct provision of legal services to the poor, without an expectation of compensation.

(4-b) "Out-of-pocket expenses" means, for purposes of Subsection (g-3)(3), expenses incurred by the attorney in relation to a case, including:

(A) postage expenses;

(B) telephone calls;

(C) faxes; and

(D) paper and other office supplies.

(5) "United States government" means any department or ministry of the federal government, including a federal reserve bank. The term does not include a state or local government, a commercial enterprise owned wholly or partly by the United States government, or a local governmental entity or commercial enterprise whose obligations are guaranteed by the United States government.

(6) "United States government agency" means an instrumentality of the United States government whose obligations are fully and explicitly guaranteed as to the timely payment of principal and interest by the full faith and credit of the United States government. The term includes the Government National Mortgage Association, the Department of Veterans Affairs, the Federal Housing Administration, the Farmers Home Administration, the Export-Import Bank, the Overseas Private Investment Corporation, the Commodity Credit Corporation, the Small Business Administration, and any successor agency.

(7) "United States government-sponsored agency" means an agency originally established or chartered by the United States government to serve public purposes specified by the United States Congress but whose obligations are not explicitly guaranteed by the full faith and credit of the United States government. The term includes the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association, the Farm Credit System, the Federal Home Loan Bank System, the Student Loan Marketing Association, and any successor agency.

(q) A taxable entity shall exclude from its total revenue, to the extent included under Subsection (c)(1)(A), (c)(2)(A), or (c)(3), all revenue received that is directly derived from the operation of a facility that is:

(1) located on property owned or leased by the federal government; and

(2) managed or operated primarily to house members of the armed forces of the United States.

(r) A taxable entity shall exclude, to the extent included under Subsection (c)(1)(A), (c)(2)(A), or (c)(3), total revenue received from oil or gas produced, during the dates certified by the comptroller pursuant to Subsection (s), from:

(1) an oil well designated by the Railroad Commission of Texas or similar authority of another state whose production averages less than 10 barrels a day over a 90-day period; and

(2) a gas well designated by the Railroad Commission of Texas or similar authority of another state whose production averages less than 250 mcf a day over a 90-day period.

(s) The comptroller shall certify dates during which the monthly average closing price of West Texas Intermediate crude oil is below $40 per barrel and the average closing price of gas is below $5 per MMBtu, as recorded on the New York Mercantile Exchange (NYMEX).

Sec. 171.1012. DETERMINATION OF COST OF GOODS SOLD. (a) In this section:

(1) "Goods" means real or tangible personal property sold in the ordinary course of business of a taxable entity.

(2) "Production" includes construction, installation, manufacture, development, mining, extraction, improvement, creation, raising, or growth.

(3)(A) "Tangible personal property" means:

(i) personal property that can be seen, weighed, measured, felt, or touched or that is perceptible to the senses in any other manner;

(ii) films, sound recordings, videotapes, books, and other similar property embodying words, ideas, concepts, images, or sound by the creator of the property for which, as costs are incurred in producing the property, it is intended or is reasonably likely that any tangible medium in which the property is embodied will be mass-distributed by the creator or any one or more third parties in a form that is not substantially altered; and

(iii) a computer program, as defined by Section 151.0031.

(B) "Tangible personal property" does not include:

(i) intangible property; or

(ii) services.

(b) Subject to Section 171.1014, a taxable entity that elects to subtract cost of goods sold for the purpose of computing its taxable margin shall determine the amount of that cost of goods sold as provided by this section.

(c) The cost of goods sold includes all direct costs of acquiring or producing the goods, including:

(1) labor costs;

(2) cost of materials that are an integral part of specific property produced;

(3) cost of materials that are consumed in the ordinary course of performing production activities;

(4) handling costs, including costs attributable to processing, assembling, repackaging, and inbound transportation

costs;

(5) storage costs, including the costs of carrying, storing, or warehousing property, subject to Subsection (e);

(6) depreciation, depletion, and amortization, to the extent associated with and necessary for the production of goods, including recovery described by Section 197, Internal Revenue Code;

(7) the cost of renting or leasing equipment, facilities, or real property directly used for the production of the goods, including pollution control equipment and intangible drilling and dry hole costs;

(8) the cost of repairing and maintaining equipment, facilities, or real property directly used for the production of the goods, including pollution control devices;

(9) costs attributable to research, experimental, engineering, and design activities directly related to the production of the goods, including all research or experimental expenditures described by Section 174, Internal Revenue Code;

(10) geological and geophysical costs incurred to identify and locate property that has the potential to produce minerals;

(11) taxes paid in relation to acquiring or producing any material, or taxes paid in relation to services that are a direct cost of production;

(12) the cost of producing or acquiring electricity sold; and

(13) a contribution to a partnership in which the taxable entity owns an interest that is used to fund activities, the costs of which would otherwise be treated as cost of goods sold of the partnership, but only to the extent that those costs are related to goods distributed to the taxable entity as goods-in-kind in the ordinary course of production activities rather than being sold.

(d) In addition to the amounts includable under Subsection (c), the cost of goods sold includes the following costs in relation to the taxable entity's goods:

(1) deterioration of the goods;

(2) obsolescence of the goods;

(3) spoilage and abandonment, including the costs of rework labor, reclamation, and scrap;

(4) if the property is held for future production, preproduction direct costs allocable to the property, including costs of purchasing the goods and of storage and handling the goods, as provided by Subsections (c)(4) and (c)(5);

(5) postproduction direct costs allocable to the property, including storage and handling costs, as provided by Subsections (c)(4) and (c)(5);

(6) the cost of insurance on a plant or a facility, machinery, equipment, or materials directly used in the production of the goods;

(7) the cost of insurance on the produced goods;

(8) the cost of utilities, including electricity, gas, and water, directly used in the production of the goods;

(9) the costs of quality control, including replacement of defective components pursuant to standard warranty policies, inspection directly allocable to the production of the goods, and repairs and maintenance of goods; and

(10) licensing or franchise costs, including fees incurred in securing the contractual right to use a trademark, corporate plan, manufacturing procedure, special recipe, or other similar right directly associated with the goods produced.

(e) The cost of goods sold does not include the following costs in relation to the taxable entity's goods:

(1) the cost of renting or leasing equipment, facilities, or real property that is not used for the production of the goods;

(2) selling costs, including employee expenses related to sales;

(3) distribution costs, including outbound transportation costs;

(4) advertising costs;

(5) idle facility expense;

(6) rehandling costs;

(7) bidding costs, which are the costs incurred in the solicitation of contracts ultimately awarded to the taxable entity;

(8) unsuccessful bidding costs, which are the costs incurred in the solicitation of contracts not awarded to the taxable entity;

(9) interest, including interest on debt incurred or continued during the production period to finance the production of the goods;

(10) income taxes, including local, state, federal, and foreign income taxes, and franchise taxes that are assessed on the taxable entity based on income;

(11) strike expenses, including costs associated with hiring employees to replace striking personnel, but not including the wages of the replacement personnel, costs of security, and legal fees associated with settling strikes;

(12) officers' compensation;

(13) costs of operation of a facility that is:

(A) located on property owned or leased by the federal government; and

(B) managed or operated primarily to house members of the armed forces of the United States; and

(14) any compensation paid to an undocumented worker used for the production of goods. As used in this subdivision:

(A) "undocumented worker" means a person who is not lawfully entitled to be present and employed in the United States; and

(B) "goods" includes the husbandry of animals, the growing and harvesting of crops, and the severance of timber from realty.

(f) A taxable entity may subtract as a cost of goods sold indirect or administrative overhead costs, including all mixed service costs, such as security services, legal services, data processing services, accounting services, personnel operations, and general financial planning and financial management costs, that it can demonstrate are allocable to the acquisition or production of goods, except that the amount subtracted may not exceed four percent of the taxable entity's total indirect or administrative overhead costs, including all mixed service costs. Any costs excluded under Subsection (e) may not be subtracted under this subsection.

(g) A taxable entity that is allowed a subtraction by this section for a cost of goods sold and that is subject to Section 263A, 460, or 471, Internal Revenue Code, shall capitalize that cost in the same manner and to the same extent that the taxable entity is required or allowed to capitalize the cost under federal law and regulations, except for costs excluded under Subsection (e), or in accordance with Subsections (c), (d), and (f).

(h) A taxable entity shall determine its cost of goods sold, except as otherwise provided by this section, in accordance with the methods permitted by federal statutes and regulations. This subsection does not affect the type or category of cost of goods sold that may be subtracted under this section.

(i) A taxable entity may make a subtraction under this section in relation to the cost of goods sold only if that entity owns the goods. The determination of whether a taxable entity is an owner is based on all of the facts and circumstances, including the various benefits and burdens of ownership vested with the taxable entity. A taxable entity furnishing labor or materials to a project for the construction, improvement, remodeling, repair, or industrial maintenance (as the term "maintenance" is defined in 34 T.A.C. Section 3.357) of real property is considered to be an owner of that labor or materials and may include the costs, as allowed by this section, in the computation of cost of goods sold. Solely for purposes of this section, a taxable entity shall be treated as the owner of goods being manufactured or produced by the entity under a contract with the federal government, including any subcontracts that support a contract with the federal government,

notwithstanding that the Federal Acquisition Regulation may require that title or risk of loss with respect to those goods be transferred to the federal government before the manufacture or production of those goods is complete.

(j) A taxable entity may not make a subtraction under this section for cost of goods sold to the extent the cost of goods sold was funded by partner contributions and deducted under Subsection (c)(13).

(k) Notwithstanding any other provision of this section, if the taxable entity is a lending institution that offers loans to the public and elects to subtract cost of goods sold, the entity may subtract as a cost of goods sold an amount equal to interest expense.

(k-1) Notwithstanding any other provision of this section, the following taxable entities may subtract as a cost of goods sold the costs otherwise allowed by this section in relation to tangible personal property that the entity rents or leases in the ordinary course of business of the entity:

(1) a motor vehicle rental or leasing company that remits a tax on gross receipts imposed under Section 152.026;

(2) a heavy construction equipment rental or leasing company; and

(3) a railcar rolling stock rental or leasing company.

(l) Notwithstanding any other provision of this section, a payment made by one member of an affiliated group to another member of that affiliated group not included in the combined group may be subtracted as a cost of goods sold only if it is a transaction made at arm's length.

(m) In this section, "arm's length" means the standard of conduct under which entities that are not related parties and that have substantially equal bargaining power, each acting in its own interest, would negotiate or carry out a particular transaction.

(n) In this section, "related party" means a person, corporation, or other entity, including an entity that is treated as a pass-through or disregarded entity for purposes of federal taxation, whether the person, corporation, or entity is subject to the tax under this chapter or not, in which one person, corporation, or entity, or set of related persons, corporations, or entities, directly or indirectly owns or controls a controlling interest in another entity.

Sec. 171.1013. DETERMINATION OF COMPENSATION. (a) Except as otherwise provided by this section, "wages and cash compensation" means the amount entered in the Medicare wages and tips box of Internal Revenue Service Form W-2 or any subsequent form with a different number or designation that substantially provides the same information. The term also includes, to the extent not included above:

(1) net distributive income from partnerships and from trusts and limited liability companies treated as partnerships for federal income tax purposes, but only if the person receiving the distribution is a natural person;

(2) net distributive income from limited liability companies and corporations treated as S corporations for federal income tax purposes, but only if the person receiving the distribution is a natural person; and

(3) stock awards and stock options deducted for federal income tax purposes.

(b) Subject to Section 171.1014, a taxable entity that elects to subtract compensation for the purpose of computing its taxable margin under Section 171.101 may subtract an amount equal to:

(1) subject to the limitation in Subsection (c), all wages and cash compensation paid by the taxable entity to its officers, directors, owners, partners, and employees; and

(2) the cost of all benefits the taxable entity provides to its officers, directors, owners, partners, and employees, including workers' compensation benefits, health care, employer contributions made to employees' health savings accounts, and retirement to the extent deductible for federal income tax

purposes.

(c) Notwithstanding the actual amount of wages and cash compensation paid by a taxable entity to its officers, directors, owners, partners, and employees, a taxable entity may not include more than $300,000, or the amount determined under Section 171.006, for any person in the amount of wages and cash compensation it determines under Section 171.101.

(c-1) Subject to Section 171.1014, a taxable entity that elects to subtract compensation for the purpose of computing its taxable margin under Section 171.101 may not subtract any wages or cash compensation paid to an undocumented worker. As used in this section "undocumented worker" means a person who is not lawfully entitled to be present and employed in the United States.

(d) A taxable entity that is a staff leasing services company:

(1) may not include as wages or cash compensation payments described by Section 171.1011(k); and

(2) shall determine compensation as provided by this section only for the taxable entity's own employees that are not assigned employees.

(e) Subject to the other provisions of this section, in determining compensation, a taxable entity that is a client company that contracts with a staff leasing services company for assigned employees:

(1) shall include payments made to the staff leasing services company for wages and benefits for the assigned employees as if the assigned employees were actual employees of the entity;

(2) may not include an administrative fee charged by the staff leasing services company for the provision of the assigned employees; and

(3) may not include any other amount in relation to the assigned employees, including payroll taxes.

(f) A taxable entity that is a management company:

(1) may not include as wages or cash compensation any amounts reimbursed by a managed entity; and

(2) shall determine compensation as provided by this section for only those wage and compensation payments that are not reimbursed by a managed entity.

(g) A taxable entity that is a managed entity shall include reimbursements made to the management company for wages and compensation as if the reimbursed amounts had been paid to employees of the managed entity.

(h) Subject to Section 171.1014, a taxable entity that elects to subtract compensation for the purpose of computing its taxable margin under Section 171.101 may not include as wages or cash compensation amounts paid to an employee whose primary employment is directly associated with the operation of a facility that is:

(1) located on property owned or leased by the federal government; and

(2) managed or operated primarily to house members of the armed forces of the United States.

Sec. 171.1014. COMBINED REPORTING; AFFILIATED GROUP ENGAGED IN UNITARY BUSINESS. (a) Taxable entities that are part of an affiliated group engaged in a unitary business shall file a combined group report in lieu of individual reports based on the combined group's business. The combined group may not include a taxable entity that conducts business outside the United States if 80 percent or more of the taxable entity's property and payroll, as determined by factoring under Chapter 141, are assigned to locations outside the United States. In applying Chapter 141, if either the property factor or the payroll factor is zero, the denominator is one. The combined group may not include a taxable entity that conducts business outside the United States and has no property or payroll if 80 percent or more of the taxable entity's gross receipts, as determined under Sections 171.103, 171.105, and 171.1055, are assigned to locations outside the United States.

(b) The combined group is a single taxable entity for purposes of the application of the tax imposed under this chapter.

(c) For purposes of Section 171.101, a combined group shall determine its total revenue by:

(1) determining the total revenue of each of its members as provided by Section 171.1011 as if the member were an individual taxable entity;

(2) adding the total revenues of the members determined under Subdivision (1) together; and

(3) subtracting, to the extent included under Section 171.1011(c)(1)(A), (c)(2)(A), or (c)(3), items of total revenue received from a member of the combined group.

(d) For purposes of Section 171.101, a combined group shall make an election to subtract either cost of goods sold or compensation that applies to all of its members.

(e) For purposes of Section 171.101, a combined group that elects to subtract costs of goods sold shall determine that amount by:

(1) determining the cost of goods sold for each of its members as provided by Section 171.1012 as if the member were an individual taxable entity;

(2) adding the amounts of cost of goods sold determined under Subdivision (1) together; and

(3) subtracting from the amount determined under Subdivision (2) any cost of goods sold amounts paid from one member of the combined group to another member of the combined group, but only to the extent the corresponding item of total revenue was subtracted under Subsection (c)(3).

(f) For purposes of Section 171.101, a combined group that elects to subtract compensation shall determine that amount by:

(1) determining the compensation for each of its members as provided by Section 171.1013 as if each member were an individual taxable entity;

(2) adding the amounts of compensation determined under Subdivision (1) together; and

(3) subtracting from the amount determined under Subdivision (2) any compensation amounts paid from one member of the combined group to another member of the combined group, but only to the extent the corresponding item of total revenue was subtracted under Subsection (c)(3).

(g) A combined group may elect to include in the combined group an exempt entity that would be included in the group if the entity were not exempt and to treat the exempt entity as if it were a taxable entity.

Sec. 171.1015. REPORTING FOR CERTAIN PARTNERSHIPS IN TIERED PARTNERSHIP ARRANGEMENT. (a) In this section, "tiered partnership arrangement" means an ownership structure in which all of the interests in one partnership, trust, or limited liability company that is treated for federal income taxes as a partnership or a limited liability company treated as an S corporation for federal income tax purposes (an "upper tier partnership") are owned by one or more other taxable entities (a "lower tier entity"). A tiered partnership arrangement may have two or more tiers.

(b) In addition to the tax it is required to pay under this chapter on its own taxable margin, a taxable entity that is a lower tier entity may pay the tax on the taxable margin of a higher tier partnership if the higher tier partnership submits a report to the comptroller showing the amount of taxable margin that each lower tier entity that owns it should include within the lower tier entity's own taxable margin, according to the profits interest of the lower tier entity. An upper tier partnership is not required to pay tax under this chapter on any taxable margin reported under this section.

(c) This section does not apply to that percentage of the taxable margin attributable to a lower tier entity by an upper tier partnership if the lower tier entity is not subject to the tax under this chapter. In this case, the higher tier partnership is liable for the tax on its taxable margin.

(d) The comptroller shall adopt rules to administer this section.

[~~Sec. 171.102. DETERMINATION OF TAXABLE CAPITAL OF~~

~~CORPORATION IN PROCESS OF LIQUIDATION. (a) "Corporation in the process of liquidation" means a corporation that:~~

[~~(1) adopts and pursues in good faith a plan to marshal the assets of the corporation, to pay or settle with the corporation's creditors and debtors, and to apportion the remaining assets of the corporation among the corporation's stockholders;~~

[~~(2) adopts the plan by a resolution approved by the corporation's board of directors and ratified by a majority of the stockholders of record; and~~

[~~(3) conducts the liquidation in the manner provided by the law of this state to dissolve a corporation.~~

[~~(b) The taxable capital of a corporation in the process of liquidation is the difference between the amount of the corporation's stock issued and the amount of the liquidating dividends paid on the stock.~~

[~~(c) The president and the secretary of the corporation shall file an affidavit with the comptroller containing information about the amount of liquidating dividends paid and a statement that the corporation is in the process of liquidation. The plan described by Subsection (a) of this section for the corporation's liquidation shall be attached to and be a part of the affidavit.~~

[~~(d) This section applies only to the computation of a corporation's taxable capital under Section 171.101 of this code.~~]

Sec. 171.103. DETERMINATION OF GROSS RECEIPTS FROM BUSINESS DONE IN THIS STATE FOR MARGIN [~~TAXABLE CAPITAL~~]. (a) Subject to Section 171.1055, in [~~In~~] apportioning margin [~~taxable capital~~], the gross receipts of a taxable entity [~~corporation~~] from its business done in this state is the sum of the taxable entity's [~~corporation's~~] receipts from:

[~~(1) each sale of tangible personal property if the property is delivered or shipped to a buyer in this state regardless of the FOB point or another condition of the sale, and each sale of tangible personal property shipped from this state to a purchaser in another state in which the seller is not subject to taxation;~~

[~~(2) each service performed in this state;~~

[~~(3) each rental of property situated in this state;~~

[~~(4) the use of a patent, copyright, trademark, franchise, or license in this state;~~

[~~(5) each sale of real property located in this state, including royalties from oil, gas, or other mineral interests; and~~

[~~(6) other business done in this state.~~

[~~Sec. 171.1032. DETERMINATION OF GROSS RECEIPTS FROM BUSINESS DONE IN THIS STATE FOR TAXABLE EARNED SURPLUS. (a) Except for the gross receipts of a corporation that are subject to the provisions of Section 171.1061, in apportioning taxable earned surplus, the gross receipts of a corporation from its business done in this state is the sum of the corporation's receipts from:~~]

(1) each sale of tangible personal property if the property is delivered or shipped to a buyer in this state regardless of the FOB point or another condition of the sale[~~, and each sale of tangible personal property shipped from this state to a purchaser in another state in which the seller is not subject to any tax on, or measured by, net income, without regard to whether the tax is imposed~~];

(2) each service performed in this state, except that receipts derived from servicing loans secured by real property are in this state if the real property is located in this state;

(3) each rental of property situated in this state;

(4) the use of a patent, copyright, trademark, franchise, or license in this state;

(5) each sale of real property located in this state, including royalties from oil, gas, or other mineral interests; and

(6) [~~each partnership or joint venture to the extent provided by Subsection (c); and~~

[~~(7)~~] other business done in this state.

(b) A combined group shall include in its gross receipts computed under Subsection (a) the gross receipts of each taxable entity that is a member of the combined group and that has a nexus with this state for the purpose of taxation. [~~A corporation shall~~

~~deduct from its gross receipts computed under Subsection (a) any amount to the extent included under Subsection (a) because of the application of Section 78 or Sections 951-964, Internal Revenue Code, any amount excludable under Section 171.110(k), and dividends received from a subsidiary, associate, or affiliated corporation that does not transact a substantial portion of its business or regularly maintain a substantial portion of its assets in the United States.~~

[~~(c) A corporation shall include in its gross receipts computed under Subsection (a) the corporation's share of the gross receipts of each partnership and joint venture of which the corporation is a part apportioned to this state as though the corporation directly earned the receipts, including receipts from business done with the corporation.~~

[~~Sec. 171.104. GROSS RECEIPTS FROM BUSINESS DONE IN TEXAS: DEDUCTION FOR FOOD AND MEDICINE RECEIPTS. A corporation may deduct from its receipts includable under Section 171.103(1) of this code the amount of the corporation's receipts from sales of the following items, if the items are shipped from outside this state and the receipts would be includable under Section 171.103(1) of this code in the absence of this section:~~

[~~(1) food that is exempted from the Limited Sales, Excise, and Use Tax Act by Section 151.314(a) of this code; and~~

[~~(2) health care supplies that are exempted from the Limited Sales, Excise, and Use Tax Act by Section 151.313 of this code.~~]

Sec. 171.105. [~~DETERMINATION OF GROSS RECEIPTS FROM ENTIRE BUSINESS FOR TAXABLE CAPITAL. (a) In apportioning taxable capital, the gross receipts of a corporation from its entire business is the sum of the corporation's receipts from:~~

[~~(1) each sale of the corporation's tangible personal property;~~

[~~(2) each service, rental, or royalty; and~~

[~~(3) other business.~~

[~~(b) If a corporation sells an investment or capital asset, the corporation's gross receipts from its entire business for taxable capital include only the net gain from the sale.~~

[~~Sec. 171.1051.~~] DETERMINATION OF GROSS RECEIPTS FROM ENTIRE BUSINESS FOR MARGIN [~~TAXABLE EARNED SURPLUS~~]. (a) Subject to Section 171.1055 [~~Except for the gross receipts of a corporation that are subject to the provisions of Section 171.1061~~], in apportioning margin [~~taxable earned surplus~~], the gross receipts of a taxable entity [~~corporation~~] from its entire business is the sum of the taxable entity's [~~corporation's~~] receipts from:

(1) each sale of the taxable entity's [~~corporation's~~] tangible personal property;

(2) each service, rental, or royalty; and

(3) [~~each partnership and joint venture as provided by Subsection (d); and~~

[~~(4)~~] other business.

(b) If a taxable entity [~~corporation~~] sells an investment or capital asset, the taxable entity's [~~corporation's~~] gross receipts from its entire business for taxable margin [~~earned surplus~~] includes only the net gain from the sale.

(c) A combined group shall include in its gross receipts computed under Subsection (a) the gross receipts of each taxable entity that is a member of the combined group, without regard to whether that entity has a nexus with this state for the purpose of taxation.

Sec. 171.1055. EXCLUSION OF CERTAIN RECEIPTS FOR MARGIN APPORTIONMENT. (a) In apportioning margin, receipts excluded from total revenue by a taxable entity under Section 171.1011 may not be included in either the receipts of the taxable entity from its business done in this state as determined under Section 171.103 or the receipts of the taxable entity from its entire business done as determined under Section 171.105.

(b) In apportioning margin, receipts derived from transactions between individual members of a combined group that are excluded under Section 171.1014(c)(3) may not be included in

the receipts of the taxable entity from its business done in this state as determined under Section 171.103, except that receipts derived from the sale of tangible personal property between individual members of a combined group where one member party to the transaction does not have nexus in this state shall be included in the receipts of the taxable entity from its business done in this state as determined under Section 171.103 to the extent that the member of the combined group that does not have nexus in this state resells the tangible personal property without modification to a purchaser in this state.

(c) In apportioning margin, receipts derived from transactions between individual members of a combined group that are excluded under Section 171.1014(c)(3) may not be included in the receipts of the taxable entity from its entire business done as determined under Section 171.105. [~~A corporation shall deduct from its gross receipts computed under Subsection (a) any amount to the extent included in Subsection (a) because of the application of Section 78 or Sections 951-964, Internal Revenue Code, any amount excludable under Section 171.110(k), and dividends received from a subsidiary, associate, or affiliated corporation that does not transact a substantial portion of its business or regularly maintain a substantial portion of its assets in the United States.~~

[~~(d) A corporation shall include in its gross receipts computed under Subsection (a) the corporation's share of the gross receipts of each partnership and joint venture of which the corporation is a part.~~]

Sec. 171.106. APPORTIONMENT OF MARGIN [~~TAXABLE CAPITAL AND TAXABLE EARNED SURPLUS~~] TO THIS STATE. (a) [~~Except as provided by Subsections (c) and (d), a corporation's taxable capital is apportioned to this state to determine the amount of the tax imposed under Section 171.002(b)(1) by multiplying the corporation's taxable capital by a fraction, the numerator of which is the corporation's gross receipts from business done in this state, as determined under Section 171.103, and the denominator of which is the corporation's gross receipts from its entire business, as determined under Section 171.105.~~

[~~(b)~~] Except as provided by this section [~~Subsections (c) and (d)~~], a taxable entity's margin [~~corporation's taxable earned surplus~~] is apportioned to this state to determine the amount of tax imposed under Section 171.002 [~~171.002(b)(2)~~] by multiplying the margin [~~taxable earned surplus~~] by a fraction, the numerator of which is the taxable entity's [~~corporation's~~] gross receipts from business done in this state, as determined under Section 171.103 [~~171.1032~~], and the denominator of which is the taxable entity's [~~corporation's~~] gross receipts from its entire business, as determined under Section 171.105 [~~171.1051~~].

(b) [~~(c)~~] A taxable entity's margin [~~corporation's taxable capital or earned surplus~~] that is derived, directly or indirectly, from the sale of management, distribution, or administration services to or on behalf of a regulated investment company, including a taxable entity [~~corporation~~] that includes trustees or sponsors of employee benefit plans that have accounts in a regulated investment company, is apportioned to this state to determine the amount of the tax imposed under Section 171.002 by multiplying the taxable entity's [~~corporation's~~] total margin [~~taxable capital or earned surplus~~] from the sale of services to or on behalf of a regulated investment company by a fraction, the numerator 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 the investment company shareholders who are commercially domiciled in this state or, if the shareholders are individuals, are residents of this state, and 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. [~~The corporation shall make a separate computation to allocate taxable capital and earned surplus.~~] In this subsection, "regulated investment company" has the meaning assigned by Section 851(a), Internal Revenue Code.

(c) [~~(d)~~] A taxable entity's margin [~~corporation's taxable~~

~~capital or taxable earned surplus~~] that is derived, directly or indirectly, from the sale of management, administration, or investment services to an employee retirement plan is apportioned to this state to determine the amount of the tax imposed under Section 171.002 by multiplying the taxable entity's [~~corporation's~~] total margin [~~taxable capital or earned surplus~~] from the sale of services to an employee retirement plan company by a fraction, 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 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. [~~The corporation shall make a separate computation to apportion taxable capital and earned surplus.~~] In this section, "employee retirement plan" means a plan or other arrangement that is qualified under Section 401(a), Internal Revenue Code, or satisfies the requirements of Section 403, Internal Revenue Code, or a government plan described in Section 414(d), Internal Revenue Code. The term does not include an individual retirement account or individual retirement annuity within the meaning of Section 408, Internal Revenue Code.

(d) [~~(e) On or before January 1, 1998, each entity registered with the State Securities Board under The Securities Act (Article 581, Vernon's Texas Civil Statutes) that provides management, administration, or investment services to an employee retirement plan, must file a report with the comptroller containing such information as the comptroller deems necessary in order to determine the fiscal impact of Subsection (d). The State Securities Board and the Securities Commissioner shall cooperate with the comptroller in obtaining the information. The Securities Commissioner shall impose the penalties provided in The Securities Act (Article 581-1 et seq., Vernon's Texas Civil Statutes) against any entity that the comptroller certifies is delinquent in the filing of the report required by this section.~~

[~~(f) On or before September 1, 1998, the comptroller shall issue a report which evaluates the statewide fiscal impact of Subsection (d). If the comptroller determines that implementing Subsection (d) will not have a negative fiscal impact on this state, Subsection (d) shall be effective for reports or returns originally due on or after January 1, 1999. If the comptroller determines that there will be a negative fiscal impact, that subsection shall not be implemented.~~

[~~(g) If this Act and another Act of the 75th Legislature, Regular Session, 1997, make the same substantive change from the current law but differ in text, this Act prevails regardless of the relative dates of enactment.~~

[~~(h)~~] A banking corporation shall exclude from the numerator of the bank's apportionment factor interest earned on federal funds and interest earned on securities sold under an agreement to repurchase that are held in this state in a correspondent bank that is domiciled in this state. In this subsection, "correspondent" has the meaning assigned by 12 C.F.R. Section 206.2(c).

(e) [~~(i)~~] Receipts from services that a defense readjustment project performs in a defense economic readjustment zone are not receipts from business done in this state.

[~~Sec. 171.1061. ALLOCATION OF CERTAIN TAXABLE EARNED SURPLUS TO THIS STATE. An item of income included in a corporation's taxable earned surplus, except that portion derived from dividends and interest, that a state, other than this state, or a country, other than the United States, cannot tax because the activities generating that item of income do not have sufficient unitary connection with the corporation's other activities conducted within that state or country under the United States Constitution, is allocated to this state if the corporation's commercial domicile is in this state. Income that can only be allocated to the state of commercial domicile because the income has insufficient unitary connection with any other state or country shall be allocated to this state or another state or country not of~~

~~expenses related to that income. A portion of a corporation's taxable earned surplus allocated to this state under this section may not be apportioned under Section 171.110(a)(2).~~]

Sec. 171.107. DEDUCTION OF COST OF SOLAR ENERGY DEVICE FROM MARGIN [~~TAXABLE CAPITAL OR TAXABLE EARNED SURPLUS~~] APPORTIONED TO THIS STATE. (a) In this section, "solar energy device" means a system or series of mechanisms designed primarily to provide heating or cooling or to produce electrical or mechanical power by collecting and transferring solar-generated energy. The term includes a mechanical or chemical device that has the ability to store solar-generated energy for use in heating or cooling or in the production of power.

(b) A taxable entity [~~corporation~~] may deduct from [~~its apportioned taxable capital the amortized cost of a solar energy device or from~~] its apportioned margin [~~taxable earned surplus~~] 10 percent of the amortized cost of a solar energy device if:

(1) the device is acquired by the taxable entity [~~corporation~~] for heating or cooling or for the production of power;

(2) the device is used in this state by the taxable entity [~~corporation~~]; and

(3) the cost of the device is amortized in accordance with Subsection (c) [~~of this section~~].

(c) The amortization of the cost of a solar energy device must:

(1) be for a period of at least 60 months;

(2) provide for equal monthly amounts or conform to federal depreciation schedules;

(3) begin on the month in which the device is placed in service in this state; and

(4) cover only a period in which the device is in use in this state.

(d) A taxable entity [~~corporation~~] that makes a deduction under this section shall file with the comptroller an amortization schedule showing the period in which a deduction is to be made. On the request of the comptroller, the taxable entity [~~corporation~~] shall file with the comptroller proof of the cost of the solar energy device or proof of the device's operation in this state.

[~~(e) A corporation may elect to make the deduction authorized by this section either from apportioned taxable capital or apportioned taxable earned surplus for each separate regular annual period. An election for an initial period applies to the second tax period and to the first regular annual period.~~]

Sec. 171.108. DEDUCTION OF COST OF CLEAN COAL PROJECT FROM MARGIN [~~TAXABLE CAPITAL OR TAXABLE EARNED SURPLUS~~] APPORTIONED TO THIS STATE. (a) In this section, "clean coal project" has the meaning assigned by Section 5.001, Water Code.

(b) A taxable entity [~~corporation~~] may deduct from its apportioned margin [~~taxable capital the amortized cost of equipment or from its apportioned taxable earned surplus~~] 10 percent of the amortized cost of equipment:

(1) that is used in a clean coal project;

(2) that is acquired by the taxable entity [~~corporation~~] for use in generation of electricity, production of process steam, or industrial production;

(3) that the taxable entity [~~corporation~~] uses in this state; and

(4) the cost of which is amortized in accordance with Subsection (c).

(c) The amortization of the cost of capital used in a clean coal project must:

(1) be for a period of at least 60 months;

(2) provide for equal monthly amounts;

(3) begin in the month during which the equipment is placed in service in this state; and

(4) cover only a period during which the equipment is used in this state.

(d) A taxable entity [~~corporation~~] that makes a deduction under this section shall file with the comptroller an amortization

schedule showing the period for which the deduction is to be made. On the request of the comptroller, the taxable entity [~~corporation~~] shall file with the comptroller proof of the cost of the equipment or proof of the equipment's operation in this state.

[~~(c) A corporation may elect to make the deduction authorized by this section from apportioned taxable capital or apportioned taxable earned surplus, but not from both, for each separate regular annual period. An election for an initial period applies to the second tax period and to the first regular annual period.~~

[~~Sec. 171.109. SURPLUS. (a) In this chapter:~~

[~~(1) "Surplus" means the net assets of a corporation minus its stated capital. For a limited liability company, "surplus" means the net assets of the company minus its members' contributions. Surplus includes unrealized, estimated, or contingent losses or obligations or any writedown of assets other than those listed in Subsection (i) of this section net of appropriate income tax provisions. The definition under this subdivision does not apply to earned surplus.~~

[~~(2) "Net assets" means the total assets of a corporation minus its total debts.~~

[~~(3) "Debt" means any legally enforceable obligation measured in a certain amount of money which must be performed or paid within an ascertainable period of time or on demand.~~

[~~(a-1) A legally enforceable obligation that requires the return of a like-kind property that was borrowed will be considered debt if it is a liability according to generally accepted accounting principles and if the return must be made within an ascertainable period of time or on demand. The amount that will be considered debt is the fair market value measured on the last day on which the report is based as required by Section 171.153. For purposes of this subsection, "like-kind property" means the same quantity, quality, and nature or character as the property borrowed.~~

[~~(b) Except as otherwise provided in this section, a corporation must compute its surplus, assets, and debts according to generally accepted accounting principles. If generally accepted accounting principles are unsettled or do not specify an accounting practice for a particular purpose related to the computation of surplus, assets, or debts, the comptroller by rule may establish rules to specify the applicable accounting practice for that purpose.~~

[~~(c) A corporation whose taxable capital is less than $1 million may report its surplus according to the method used in the corporation's most recent federal income tax return originally due on or before the date on which the corporation's franchise tax report is originally due. In determining if taxable capital is less than $1 million, the corporation shall apply the methods the corporation used in computing that federal income tax return unless another method is required under this chapter.~~

[~~(d) A corporation shall report its surplus based solely on its own financial condition. Consolidated reporting of surplus is prohibited.~~

[~~(e) Unless the provisions of Section 171.111 apply due to an election under that section, a corporation may not change the accounting methods used to compute its surplus more often than once every four years without the written consent of the comptroller. A change in accounting methods is not justified solely because it results in a reduction of tax liability.~~

[~~(f) A corporation declaring dividends shall exclude those dividends from its taxable capital, and a corporation receiving dividends shall include those dividends in its gross receipts and taxable capital as of the earlier of:~~

[~~(1) the date the dividends are declared, if the dividends are actually paid within one year after the declaration date; or~~

[~~(2) the date the dividends are actually paid.~~

[~~(g) All oil and gas exploration and production activities conducted by a corporation that reports its surplus according to~~

~~generally accepted accounting principles as required or permitted by this chapter must be reported according to the successful efforts or the full cost method of accounting.~~

[~~(h) A parent or investor corporation must use the cost method of accounting in reporting and calculating the franchise tax on its investments in subsidiary corporations or other investees. The retained earnings of a subsidiary corporation or other investee before acquisition by the parent or investor corporation may not be excluded from the cost of the subsidiary corporation or investee to the parent or investor corporation and must be included by the parent or investor corporation in calculating its surplus.~~

[~~(i) The following accounts may also be excluded from surplus, to the extent they are in conformance with generally accepted accounting principles or the appropriate federal income tax method, whichever is applicable:~~

[~~(1) a reserve or allowance for uncollectable accounts; and~~

[~~(2) a contra-asset account for depletion, depreciation, or amortization.~~

[~~(j) A corporation may not exclude from surplus:~~

[~~(1) liabilities for compensation and other benefits provided to employees, other than wages, that are not debt as of the end of the accounting period on which the taxable capital component is based, including retirement, medical, insurance, postretirement, and other similar benefits; and~~

[~~(2) deferred investment tax credits.~~

[~~(k) Notwithstanding any other provision in this chapter, a corporation subject to the tax imposed by this chapter shall use double entry bookkeeping to account for all transactions that affect the computation of that tax.~~

[~~(l) The "first in-first out" and "last in-first out" methods of accounting are acceptable methods for computing surplus.~~

[~~(m) A corporation may not use the push-down method of accounting in computing or reporting its surplus.~~

[~~(n) A corporation must use the equity method of accounting when reporting an investment in a partnership or joint venture.~~

[~~Sec. 171.110. DETERMINATION OF NET TAXABLE EARNED SURPLUS. (a) The net taxable earned surplus of a corporation is computed by:~~

[~~(1) determining the corporation's reportable federal taxable income, subtracting from that amount any amount excludable under Subsection (k), any amount included in reportable federal taxable income under Section 78 or Sections 951-964, Internal Revenue Code, and dividends received from a subsidiary, associate, or affiliated corporation that does not transact a substantial portion of its business or regularly maintain a substantial portion of its assets in the United States, and adding to that amount any compensation of officers or directors, or if a bank, any compensation of directors and executive officers, to the extent excluded in determining federal taxable income to determine the corporation's taxable earned surplus;~~

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

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

[~~(4) subtracting from that amount any allowable deductions and any business loss that is carried forward to the tax reporting period and deductible under Subsection (c).~~

[~~(b) Except as provided by Subsection (c), a corporation is not required to add the compensation of officers or directors as required by Subsection (a)(1) if the corporation is:~~

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

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

[~~(c) A subsidiary corporation may not claim the exclusion under Subsection (b) if it has a parent corporation that does not qualify for the exclusion. For purposes of this subsection, a~~

~~corporation qualifies as a parent if it ultimately controls the subsidiary, even if the control arises through a series or group of other subsidiaries or entities. Control is presumed if a parent corporation directly or indirectly owns, controls, or holds a majority of the outstanding voting stock of a corporation or ownership interests in another entity.~~

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

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

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

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

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

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

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

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

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

[~~(k) Dividends and interest received from federal obligations are not included in earned surplus or gross receipts for earned surplus purposes.~~

[~~(l) In this section:~~

[~~(1) "Federal obligations" means:~~

[~~(A) stocks and other direct obligations of, and obligations unconditionally guaranteed by, the United States government and United States government agencies; and~~

[~~(B) direct obligations of a United States government-sponsored agency.~~

[~~(2) "Obligation" means any bond, debenture, security, mortgage-backed security, pass-through certificate, or other evidence of indebtedness of the issuing entity. The term does not include a deposit, a repurchase agreement, a loan, a lease, a participation in a loan or pool of loans, a loan collateralized by an obligation of a United States government agency, or a loan guaranteed by a United States government agency.~~

[~~(3) "United States government" means any department or ministry of the federal government, including a federal reserve~~

~~bank. The term does not include a state or local government, a commercial enterprise owned wholly or partly by the United States government, or a local governmental entity or commercial enterprise whose obligations are guaranteed by the United States government.~~

[~~(4) "United States government agency" means an instrumentality of the United States government whose obligations are fully and explicitly guaranteed as to the timely payment of principal and interest by the full faith and credit of the United States government. The term includes the Government National Mortgage Association, the Department of Veterans Affairs, the Federal Housing Administration, the Farmers Home Administration, the Export-Import Bank, the Overseas Private Investment Corporation, the Commodity Credit Corporation, the Small Business Administration, and any successor agency.~~

[~~(5) "United States government-sponsored agency" means an agency originally established or chartered by the United States government to serve public purposes specified by the United States Congress but whose obligations are not explicitly guaranteed by the full faith and credit of the United States government. The term includes the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association, the Farm Credit System, the Federal Home Loan Bank System, the Student Loan Marketing Association, and any successor agency.~~]

Sec. 171.111. TEMPORARY CREDIT ON TAXABLE MARGIN. [~~NET TAXABLE EARNED SURPLUS.~~] (a) Not later than March 1, 2007, a taxable entity [~~1992, a corporation~~] may notify the comptroller in writing of its intent to preserve its right to take a credit in an amount allowed by this section on the tax due on taxable margin. The taxable entity [~~net taxable earned surplus. The comptroller may not grant an extension. The corporation~~] may thereafter elect to claim the credit for the current year and future year at or before the original due date of any report due after January 1, 2007, [~~1992,~~] until the taxable entity [~~corporation~~] revokes the election or this section expires, whichever is earlier. A taxable entity [~~corporation~~] may claim the credit for not more than 20 consecutive privilege periods beginning with the first report due under this chapter after January 1, 2007. [~~1992.~~] A taxable entity [~~corporation~~] may make only one election under this section and the election may not be conveyed, assigned, or transferred to another entity.

(b) The credit allowed under this section for any privilege period is computed by:

(1) determining the amount, as of the end of the taxable entity's accounting year ending in 2006, of the difference between (i) the taxable entity's deductible temporary differences and net operating loss carryforwards, net of related valuation allowance amounts, shown on the taxable entity's books and records on the last day of its taxable year ending in 2006, and (ii) the taxable entity's taxable temporary differences as shown on those books and records on that date. The amount of other net deferred tax items may be less than zero. For the purpose of computing the amount of the taxable entity's other net deferred tax items, any credit carryforward allowed under this chapter shall be excluded from the amount of deductible temporary differences to the extent such credit carryforward amount, net of any related valuation allowance amount, is otherwise included in the taxable entity's deductible temporary differences, net of related valuation allowance amounts, shown on the taxable entity's books and records on the last day of the taxable entity's taxable year ending in 2006;

[~~(1) determining the amount, as of the end of the corporation's accounting year ending in 1991, that is the difference between the basis used for financial accounting purposes and the basis used for federal income tax purposes of an asset or a liability that at some future date will reverse,~~]

(2) apportioning the amount determined under Subdivision (1) to this state in the same manner taxable margin [~~earned surplus~~] is apportioned under Section 171.106 [~~171.106(b) or (c), as applicable,~~] on the first report due on or after January 1, 2007; [~~1992,~~]

(3) multiplying the amount determined under Subdivision (2) by 10 [~~five~~] percent; and

(4) multiplying the amount determined under Subdivision (3) by the tax rate prescribed by Section 171.002(a)(2).

(c) [~~In computing the amount under Subsection (b)(1), the corporation may not consider differences that result from deferred investment tax credits, allowances for funds used during construction, or any other timing difference for which a deferred tax liability is not required under generally accepted accounting principles.~~

[~~(d) After making the election under Subsection (a) the corporation must, for purposes of computing its taxable capital under this chapter, use the same accounting methods under generally accepted accounting principles to account for the assets and liabilities that determine the amount of the credit that the corporation uses to compute the credit. Notwithstanding Section 171.109(e), if a corporation changes an accounting method for an asset or liability that determines, in whole or in part, the amount of the credit during the period the election is in effect, the election is automatically revoked.~~

[~~(e)~~] A taxable entity [~~corporation~~] that notifies the comptroller of its intent to preserve its right to take a credit allowed by this section shall submit with its notice of intent a statement of the amount determined under Subsection (b)(1). The comptroller may request that the taxable entity [~~corporation~~] submit in the annual report for each succeeding privilege period in which the taxable entity [~~corporation~~] is eligible to take a credit information relating to the amount determined under Subsection (b)(1). The taxable entity [~~corporation~~] shall submit in the form and content the comptroller requires any information relating to the assets and liabilities that determine the amount of the credit, the amount determined under Subsection (b)(1), or any other matter relevant to the computation of the credit for which the taxable entity [~~corporation~~] is eligible.

(d) A credit that a taxable entity is entitled to under this section does not convey, and may not be assigned or transferred, in relation to a transaction in which the taxable entity is purchased by another entity.

(e) [~~(f) A credit allowed under this section may not be carried forward or backward or used to create a business loss carryover under Section 171.110.~~

[~~(g) A corporation may not use a credit allowed under this section in connection with the computation of the corporation's tax on net taxable capital.~~

[~~(h) In addition to the tax imposed by Section 171.002, an additional tax is imposed on each corporation during each year the corporation takes the credit allowed under this section. The additional tax is equal to 0.2 percent of the corporation's net taxable capital per year of privilege period.~~

[~~(i)~~] This section expires September 1, 2026. [~~2012.~~

[~~Sec. 171.112. GROSS RECEIPTS FOR TAXABLE CAPITAL. (a) For purposes of this section, "gross receipts" means all revenues that would be recognized annually under a generally accepted accounting principles method of accounting, without deduction for the cost of property sold, materials used, labor performed, or other costs incurred, unless otherwise specifically provided in this chapter.~~

[~~(b) Except as otherwise provided in this section, a corporation must compute gross receipts in accordance with generally accepted accounting principles. If generally accepted accounting principles are unsettled or do not specify an accounting practice for a particular purpose related to the computation of gross receipts, the comptroller by rule may establish rules to specify the applicable accounting practice.~~

[~~(c) A corporation whose taxable capital is less than $1 million may report its gross receipts according to the method used in the corporation's most recent federal income tax return originally due on or before the date on which the corporation's franchise tax report is originally due. In determining if taxable~~

~~capital is less than $1 million, the corporation shall apply the methods the corporation used in computing that federal income tax return unless another method is required under this chapter.~~

[~~(d) A corporation shall report its gross receipts based solely on its own financial condition. Consolidated reporting is prohibited.~~

[~~(e) Unless the provisions of Section 171.111 apply due to an election under that section, a corporation may not change its accounting methods used to calculate gross receipts more often than once every four years without the express written consent of the comptroller. A change in accounting methods is not justified solely because it results in a reduction of tax liability.~~

[~~(f) Notwithstanding any other provision in this chapter, a corporation subject to the tax imposed by this chapter shall use double entry bookkeeping to account for all transactions that affect the computation of that tax.~~

[~~(g) Chapter 141 does not apply to this chapter.~~

[~~(h) Except as otherwise provided by this section, a corporation shall use the same accounting methods to apportion its taxable capital as it used to compute its taxable capital.~~]

Sec. 171.1121. GROSS RECEIPTS FOR MARGIN [~~TAXABLE EARNED SURPLUS~~]. (a) For purposes of this section, "gross receipts" means all revenues reportable by a taxable entity [~~corporation~~] on its federal tax return, without deduction for the cost of property sold, materials used, labor performed, or other costs incurred, unless otherwise specifically provided in this chapter. [~~"Gross receipts" does not include revenues that are not included in taxable earned surplus. For example, Schedule C special deductions and any amounts subtracted from reportable federal taxable income under Section 171.110(a)(1) are not included in taxable earned surplus and therefore are not considered gross receipts.~~]

(b) Except as otherwise provided by this section, a taxable entity [~~corporation~~] shall use the same accounting methods to apportion margin [~~taxable earned surplus~~] as used in computing reportable federal taxable income.

(c) A taxable entity [~~A corporation shall report its gross receipts based solely on its own financial condition. Consolidated reporting is prohibited.~~

[~~(d) Unless the provisions of Section 171.111 apply due to an election under that section, a corporation~~] may not change its accounting methods used to calculate gross receipts more often than once every four years without the express written consent of the comptroller. A change in accounting methods is not justified solely because it results in a reduction of tax liability.

[~~(e) A corporation's share of a partnership's gross receipts that is included in the corporation's federal taxable income must be used in computing the corporation's gross receipts under this section. Unless otherwise provided by this chapter, a corporation may not deduct costs incurred from the corporation's share of a partnership's gross receipts. The gross receipts must be apportioned as though the corporation directly earned them.~~

[~~Sec. 171.113. ALTERNATE METHOD OF DETERMINING TAXABLE CAPITAL AND GROSS RECEIPTS FOR CERTAIN CORPORATIONS. (a) This section applies only to:~~

[~~(1) a corporation organized as a close corporation under Part 12, Texas Business Corporation Act, that has not more than 35 shareholders;~~

[~~(2) a foreign corporation organized under the close corporation law of another state that has not more than 35 shareholders; and~~

[~~(3) an S corporation as that term is defined by Section 1361, Internal Revenue Code of 1986 (26 U.S.C. Section 1361).~~

[~~(b) A corporation to which this section applies may elect to compute its surplus, assets, debts, and gross receipts according to the method the corporation uses to report its federal income tax instead of as provided by Sections 171.109(b) and (g) and Section 171.112(b). This section does not affect the application of the other subsections of Sections 171.109 and 171.112 and other~~

~~provisions of this chapter to a corporation making the election.~~

[~~(c) The comptroller may adopt rules as necessary to specify the reporting requirements for corporations to which this section applies.~~

[~~(d) This section does not apply to a subsidiary corporation unless it applies to the parent corporation of the subsidiary.~~

[~~(e) The election under Subsection (b) becomes effective when written notice of the election is received by the comptroller from the corporation. An election under Subsection (b) must be postmarked not later than the due date for the electing corporation's franchise tax report to which the election applies.~~]

SECTION 6. Subchapter D, Chapter 171, Tax Code, is amended to read as follows:

SUBCHAPTER D. PAYMENT OF TAX

Sec. 171.151. PRIVILEGE PERIOD COVERED BY TAX. The franchise tax shall be paid for each of the following:

(1) an initial period beginning on the taxable entity's [~~corporation's~~] beginning date and ending on the day before the first anniversary of the beginning date;

(2) a second period beginning on the first anniversary of the beginning date and ending on December 31 following that date; and

(3) after the initial and second periods have expired, a regular annual period beginning each year on January 1 and ending the following December 31.

Sec. 171.152. DATE ON WHICH PAYMENT IS DUE. (a) Payment of the tax covering the initial period is due within 90 days after the date that the initial period ends or, if applicable, within 91 days after the date of the merger.

(b) Payment of the tax covering the second period is due on the same date as the tax covering the initial period.

(c) Payment of the tax covering the regular annual period is due May 15, of each year after the beginning of the regular annual period. However, if the first anniversary of the taxable entity's [~~corporation's~~] beginning date is after October 3 and before January 1, the payment of the tax covering the first regular annual period is due on the same date as the tax covering the initial period.

[~~Sec. 171.153. BUSINESS ON WHICH TAX ON NET TAXABLE CAPITAL IS BASED. (a) The tax covering the initial period is reported on the initial report and is based on the business done by the corporation during the period beginning on the corporation's beginning date and:~~

[~~(1) ending on the last accounting period ending date that is at least six months after the beginning date and at least 60 days before the original due date of the initial report; or~~

[~~(2) if there is no such period ending date in Subdivision (1) of this subsection, then ending on the day that is the last day of a calendar month and that is nearest to the end of the corporation's first year of business; or~~

[~~(3) ending on the day after the merger occurs, for the survivor of a merger which occurs after the day on which the tax is based in Subdivision (1) or Subdivision (2), whichever is applicable, of Subsection (a) and before January 1, of the year an initial report is due by the survivor.~~

[~~(b) The tax covering the second period is reported on the initial report and is based on the same business on which the tax covering the initial period is based and is to be prorated based on the length of the second period.~~

[~~(c) The tax covering the regular annual period is based on the business done by the corporation during its last accounting period that ends in the year before the year in which the tax is due, unless a corporation is the survivor of a merger which occurs between the end of its last accounting period in the year before the report year and January 1 of the report year, in which case the tax will be based on the financial condition of the surviving corporation for the 12-month period ending on the day after the merger. However, if the first anniversary of the corporation's beginning date is after October 3 and before January 1, the tax~~

~~covering the first regular annual period is based on the same business on which the tax covering the initial period is based and is reported on the initial report.~~

[~~Sec. 171.1531. CREDIT FOR SURVIVOR OF MERGER. (a) "Credit period" means the period from the date of the merger or the date the survivor was required to pay franchise tax, whichever is later, through the end of the privilege period for which tax was actually paid by the nonsurvivors.~~

[~~(b) The survivor of a merger is entitled to a credit against the tax computed on its net taxable capital under Section 171.002(b)(1) in the amount of the franchise tax computed on net taxable capital paid by the nonsurvivors for the credit period, provided the tax computed on net taxable capital paid by the survivor for the credit period is based on the survivor's financial condition after the merger. Only a survivor that is subject to the franchise tax is entitled to the merger credit. The merger credit shall be allocated among survivors based on net taxable capital reported, and as provided by Section 171.153.~~

[~~(c) The credit will be limited to the lesser of the amount of tax on net taxable capital paid for the credit period by the survivor or by the nonsurvivors.~~]

Sec. 171.1532. BUSINESS ON WHICH TAX ON NET TAXABLE MARGIN [~~EARNED SURPLUS~~] IS BASED. (a) The tax covering the privilege periods included on the initial report[~~, as required by Section 171.153,~~] is based on the business done by the taxable entity [~~corporation~~] during the period beginning on the taxable entity's [~~corporation's~~] beginning date and:

(1) ending on the last accounting period ending date that is at least 60 days before the original due date of the initial report; or

(2) if there is no such period ending date in Subdivision (1) [~~of this subsection~~], then ending on the day that is the last day of a calendar month and that is nearest to the end of the taxable entity's [~~corporation's~~] first year of business.

(b) The tax covering the regular annual period, other than a regular annual period included on the initial report, is based on the business done by the taxable entity [~~corporation~~] during the period beginning with the day after the last date upon which [~~net~~] taxable margin [~~earned surplus~~] on a previous report was based and ending with its last accounting period ending date for federal income tax purposes in the year before the year in which the report is originally due.

Sec. 171.154. PAYMENT TO COMPTROLLER. A taxable entity [~~corporation~~] on which a tax is imposed by this chapter shall pay the tax to the comptroller.

Sec. 171.158. PAYMENT BY FOREIGN TAXABLE ENTITY [~~CORPORATION~~] BEFORE WITHDRAWAL FROM STATE. (a) Except as provided by Subsection (b) [~~of this section~~], a foreign taxable entity [~~corporation~~] holding a registration or certificate of authority to do business in this state may withdraw from doing business in this state by filing a certificate of withdrawal with the secretary of state. The secretary of state shall file the certificate of withdrawal as provided by law.

(b) The foreign taxable entity [~~corporation~~] may not withdraw from doing business in this state unless it has paid, before filing the certificate of withdrawal, any tax or penalty imposed by this chapter on the taxable entity [~~corporation~~].

SECTION 7. Subchapter E, Chapter 171, Tax Code, is amended to read as follows:

SUBCHAPTER E. REPORTS AND RECORDS

Sec. 171.201. INITIAL REPORT. (a) Except as provided by Section 171.2022, a taxable entity [~~corporation~~] on which the franchise tax is imposed shall file an initial report with the comptroller containing:

(1) information showing the financial condition of the taxable entity [~~corporation~~] on the day that is the last day of a calendar month and that is nearest to the end of the taxable entity's [~~corporation's~~] first year of business;

(2) the name and address of:

(A) each officer, [~~and~~] director, and manager of the taxable entity [~~corporation~~];

(B) for a limited partnership, each general partner;

(C) for a general partnership or limited liability partnership, each managing partner or, if there is not a managing partner, each partner; or

(D) for a trust, each trustee;

(3) the name and address of the agent of the taxable entity [~~corporation~~] designated under Section 171.354; and

(4) other information required by the comptroller.

(b) The taxable entity [~~corporation~~] shall file the report on or before the date the payment is due under [~~Subsection (a) of~~] Section 171.152(a) [~~171.152~~].

Sec. 171.202. ANNUAL REPORT. (a) Except as provided by Section 171.2022, a taxable entity [~~corporation~~] on which the franchise tax is imposed shall file an annual report with the comptroller containing:

(1) financial information of the taxable entity [~~corporation~~] necessary to compute the tax under this chapter;

(2) the name and address of each officer and director of the taxable entity [~~corporation~~];

(3) the name and address of the agent of the taxable entity [~~corporation~~] designated under Section 171.354; and

(4) other information required by the comptroller.

(b) The taxable entity [~~corporation~~] shall file the report before May 16 of each year after the beginning of the regular annual period. The report shall be filed on forms supplied by the comptroller.

(c) The comptroller shall grant an extension of time to a taxable entity [~~corporation~~] that is not required by rule to make its tax payments by electronic funds transfer for the filing of a report required by this section to any date on or before the next November 15, if a taxable entity [~~corporation~~]:

(1) requests the extension, on or before May 15, on a form provided by the comptroller; and

(2) remits with the request:

(A) not less than 90 percent of the amount of tax reported as due on the report filed on or before November 15; or

(B) 100 percent of the tax reported as due for the previous calendar year on the report due in the previous calendar year and filed on or before May 14.

(d) In the case of a taxpayer whose previous return was its initial report, the optional payment provided under Subsection (c)(2)(B) or (e)(2)(B) must be equal to [~~the greater of:~~

[~~(1)~~] an amount produced by multiplying the [~~net~~] taxable margin [~~capital~~], as reported on the initial report filed on or before May 14, by the rate of tax in Section 171.002 [~~171.002(a)(1)~~] that is effective January 1 of the year in which the report is due[~~; or~~

[~~(2) an amount produced by multiplying the net taxable earned surplus, as reported on the initial report filed on or before May 14, by the rate of tax in Section 171.002(a)(2) that is effective January 1 of the year in which the report is due~~].

(e) The comptroller shall grant an extension of time for the filing of a report required by this section by a taxable entity [~~corporation~~] required by rule to make its tax payments by electronic funds transfer to any date on or before the next August 15, if the taxable entity [~~corporation~~]:

(1) requests the extension, on or before May 15, on a form provided by the comptroller; and

(2) remits with the request:

(A) not less than 90 percent of the amount of tax reported as due on the report filed on or before August 15; or

(B) 100 percent of the tax reported as due for the previous calendar year on the report due in the previous calendar year and filed on or before May 14.

(f) The comptroller shall grant an extension of time to a taxable entity [~~corporation~~] required by rule to make its tax

payments by electronic funds transfer for the filing of a report due on or before August 15 to any date on or before the next November 15, if the taxable entity [~~corporation~~]:

(1) requests the extension, on or before August 15, on a form provided by the comptroller; and

(2) remits with the request the difference between the amount remitted under Subsection (e) and 100 percent of the amount of tax reported as due on the report filed on or before November 15.

(h) If the sum of the amounts paid under Subsections (e)(2) and (f)(2) is at least 99 percent of the amount reported as due on the report filed on or before November 15, penalties for underpayment with respect to the amount paid under Subsection (f)(2) are waived.

(i) If a taxable entity [~~corporation~~] requesting an extension under Subsection (c) or (e) does not file the report due in the previous calendar year on or before May 14, the taxable entity [~~corporation~~] may not receive an extension under Subsection (c) or (e) unless the taxable entity [~~corporation~~] complies with Subsection (c)(2)(A) or (e)(2)(A), as appropriate.

Sec. 171.2022. EXEMPTION FROM REPORTING REQUIREMENTS. A taxable entity [~~corporation~~] that does not owe any tax under this chapter for any period is not required to file a report under Section 171.201 or[~~,~~] 171.202[~~, or 171.2021~~]. The exemption applies only to a period for which no tax is due.

Sec. 171.203. PUBLIC INFORMATION REPORT. (a) A corporation on which the franchise tax is imposed, regardless of whether the corporation is required to pay any tax, shall file a report with the comptroller containing:

(1) the name of each corporation in which the corporation filing the report owns a 10 percent or greater interest and the percentage owned by the corporation;

(2) the name of each corporation that owns a 10 percent or greater interest in the corporation filing the report;

(3) the name, title, and mailing address of each person who is an officer or director of the corporation on the date the report is filed and the expiration date of each person's term as an officer or director, if any;

(4) the name and address of the agent of the corporation designated under Section 171.354 [~~of this code~~]; and

(5) the address of the corporation's principal office and principal place of business.

(b) The corporation shall file the report once a year on a form prescribed by the comptroller.

(c) The comptroller shall forward the report to the secretary of state.

(d) The corporation shall send a copy of the report to each person named in the report under Subsection (a)(3) who is not currently employed by the corporation or a related corporation listed in Subsection (a)(1) or (2). An officer or director of the corporation or another authorized person must sign the report under a certification that:

(1) all information contained in the report is true and correct to the best of the person's knowledge; and

(2) a copy of the report has been mailed to each person identified in this subsection on the date the return is filed.

(e) If a person's name is included in a report under Subsection (a)(3) and the person is not an officer or director of the corporation on the date the report is filed, the person may file with the comptroller a sworn statement disclaiming the person's status as shown on the report. The comptroller shall maintain a record of statements filed under this subsection and shall make that information available on request using the same procedures the comptroller uses for other requests for public information.

(f) A public information report that is filed electronically complies with the signature and certification requirements prescribed by Subsection (d).

Sec. 171.2035. ADDITIONAL PUBLIC INFORMATION REPORT. (a) A taxable entity that has more than 100,000 employees in this state shall file a report with the comptroller stating the number of the

taxable entity's employees in this state that receive assistance for that employee or the employee's family under the Children's Health Insurance Program (CHIP) or the Medicaid program.

(b) A taxable entity described by Subsection (a) shall file the report once a year on a form prescribed by the comptroller.

Sec. 171.204. INFORMATION REPORT. (a) Except as provided by Subsection (b), to determine eligibility for the exemption provided by Section 171.2022, or to determine the amount of the franchise tax or the correctness of a franchise tax report, the comptroller may require [~~an officer of~~] a taxable entity [~~corporation~~] that may be subject to the tax imposed under this chapter to file an information report with the comptroller stating the amount of the taxable entity's margin [~~corporation's taxable capital and earned surplus~~], or any other information the comptroller may request that is necessary to make a determination under this subsection.

(b) The comptroller may require a taxable entity [~~an officer of a corporation~~] that does not owe any tax because of the application of Section 171.002(d)(2) to file an abbreviated information report with the comptroller stating the amount of the taxable entity's total revenue [~~corporation's gross receipts~~] from its entire business. The comptroller may not require a taxable entity [~~corporation~~] described by this subsection to file an information report that requires the taxable entity [~~corporation~~] to report or compute its margin [~~earned surplus or taxable capital~~].

Sec. 171.205. ADDITIONAL INFORMATION REQUIRED BY COMPTROLLER. The comptroller may require a taxable entity [~~corporation~~] on which the franchise tax is imposed to furnish to the comptroller information from the taxable entity's [~~corporation's~~] books and records that has not been filed previously and that is necessary for the comptroller to determine the amount of the tax.

Sec. 171.206. CONFIDENTIAL INFORMATION. Except as provided by Section 171.207 [~~of this code~~], the following information is confidential and may not be made open to public inspection:

(1) information that is obtained from a record or other instrument that is required by this chapter to be filed with the comptroller; or

(2) information, including information about the business affairs, operations, profits, losses, cost of goods sold, compensation, or expenditures of a taxable entity [~~corporation~~], obtained by an examination of the books and records, officers, partners, trustees, agents, or employees of a taxable entity [~~corporation~~] on which a tax is imposed by this chapter.

Sec. 171.207. INFORMATION NOT CONFIDENTIAL. The following information is not confidential and shall be made open to public inspection:

(1) information contained in a document filed under this chapter with a county clerk as notice of a tax lien; and

(2) information contained in a report required by Section 171.203 or 171.2035 [~~of this code~~].

Sec. 171.208. PROHIBITION OF DISCLOSURE OF INFORMATION. A person, including a state officer or employee or an owner [~~a shareholder~~] of a taxable entity [~~corporation~~], who has access to a report filed under this chapter may not make known in a manner not permitted by law the amount or source of the taxable entity's [~~corporation's~~] income, profits, losses, expenditures, cost of goods sold, compensation, or other information in the report relating to the financial condition of the taxable entity [~~corporation~~].

Sec. 171.209. RIGHT OF OWNER [~~SHAREHOLDER~~] TO EXAMINE OR RECEIVE REPORTS. If an owner [~~a person owning at least one share of outstanding stock~~] of a taxable entity [~~corporation~~] on whom the franchise tax is imposed presents evidence of the ownership to the comptroller, the person is entitled to examine or receive a copy of an initial or annual report that is filed under Section 171.201 or 171.202 [~~of this code~~] and that relates to the taxable entity [~~corporation~~].

Sec. 171.210. PERMITTED USE OF CONFIDENTIAL INFORMATION. (a) To enforce this chapter, the comptroller or attorney general may use information made confidential by this chapter.

(b) The comptroller or attorney general may authorize the use of the confidential information in a judicial proceeding in which the state is a party. The comptroller or attorney general may authorize examination of the confidential information by:

(1) another state officer of this state;

(2) a law enforcement official of this state; or

(3) a tax official of another state or an official of the federal government if the other state or the federal government has a reciprocal arrangement with this state.

Sec. 171.211. EXAMINATION OF [~~CORPORATE~~] RECORDS. To determine the franchise tax liability of a taxable entity [~~corporation~~], the comptroller may investigate or examine the records of the taxable entity [~~corporation~~].

Sec. 171.212. REPORT OF CHANGES TO FEDERAL INCOME TAX RETURN. (a) A taxable entity [~~corporation~~] must file an amended report under this chapter if:

(1) the taxable entity's [~~corporation's net~~] taxable margin [~~earned surplus~~] is changed as the result of an audit or other adjustment by the Internal Revenue Service or another competent authority; or

(2) the taxable entity [~~corporation~~] files an amended federal income tax return or other return that changes the taxable entity's [~~corporation's net~~] taxable margin [~~earned surplus~~].

(b) The taxable entity [~~corporation~~] shall file the amended report under Subsection (a)(1) not later than the 120th day after the date the revenue agent's report or other adjustment is final. For purposes of this subsection, a revenue agent's report or other adjustment is final on the date on which all administrative appeals with the Internal Revenue Service or other competent authority have been exhausted or waived.

(c) The taxable entity [~~corporation~~] shall file the amended report under Subsection (a)(2) not later than the 120th day after the date the taxable entity [~~corporation~~] files the amended federal income tax return or other return. For purposes of this subsection, a taxable entity [~~corporation~~] is considered to have filed an amended federal income tax return if the taxable entity [~~corporation~~] is a member of an affiliated group during a period in which an amended consolidated federal income tax report is filed.

(d) If a taxable entity [~~corporation~~] fails to comply with this section, the taxable entity [~~corporation~~] is liable for a penalty of 10 percent of the tax that should have been reported under this section and that had not previously been reported to the comptroller. The penalty prescribed by this subsection is in addition to any other penalty provided by law.

SECTION 8. The heading to Subchapter F, Chapter 171, Tax Code, is amended to read as follows:

SUBCHAPTER F. FORFEITURE OF CORPORATE AND BUSINESS PRIVILEGES

SECTION 9. Subchapter F, Chapter 171, Tax Code, is amended by adding Section 171.2515 to read as follows:

Sec. 171.2515. FORFEITURE OF RIGHT OF TAXABLE ENTITY TO TRANSACT BUSINESS IN THIS STATE. (a) The comptroller may, for the same reasons and using the same procedures the comptroller uses in relation to the forfeiture of the corporate privileges of a corporation, forfeit the right of a taxable entity to transact business in this state.

(b) The provisions of this subchapter, including Section 171.255, that apply to the forfeiture of corporate privileges apply to the forfeiture of a taxable entity's right to transact business in this state.

SECTION 10. Section 171.351, Tax Code, is amended to read as follows:

Sec. 171.351. VENUE OF SUIT TO ENFORCE CHAPTER. Venue of a civil suit against a taxable entity [~~corporation~~] to enforce this chapter is either in a county where the taxable entity's [~~corporation's~~] principal office is located according to its charter or certificate of authority or in Travis County.

SECTION 11. Section 171.353, Tax Code, is amended to read as follows:

Sec. 171.353. APPOINTMENT OF RECEIVER. If a court forfeits a taxable entity's [~~corporation's~~] charter or certificate of authority, the court may appoint a receiver for the taxable entity [~~corporation~~] and may administer the receivership under the laws relating to receiverships.

SECTION 12. Section 171.354, Tax Code, is amended to read as follows:

Sec. 171.354. AGENT FOR SERVICE OF PROCESS. Each taxable entity [~~corporation~~] on which a tax is imposed by this chapter shall designate a resident of this state as the taxable entity's [~~corporation's~~] agent for the service of process.

SECTION 13. Sections 171.362(a), (d), and (e), Tax Code, are amended to read as follows:

(a) If a taxable entity [~~corporation~~] on which a tax is imposed by this chapter fails to pay the tax when it is due and payable or fails to file a report required by this chapter when it is due, the taxable entity [~~corporation~~] is liable for a penalty of five percent of the amount of the tax due.

(d) If a taxable entity [~~corporation~~] electing to remit under [~~Paragraph (A) of Subdivision (2) of Subsection (c) of~~] Section 171.202(c)(2)(A) [~~171.202 of this code~~] remits less than the amount required, the penalties imposed by this section and the interest imposed under Section 111.060 [~~of this code~~] are assessed against the difference between the amount required to be remitted under [~~Paragraph (A) of Subdivision (2) of Subsection (c) of~~] Section 171.202(c)(2)(A) [~~171.202~~] and the amount actually remitted on or before May 15.

(e) If a taxable entity [~~corporation~~] remits the entire amount required by [~~Subsection (c) of~~] Section 171.202(c) [~~171.202 of this code~~], no penalties will be imposed against the amount remitted on or before November 15.

SECTION 14. Sections 171.363(a) and (b), Tax Code, are amended to read as follows:

(a) A taxable entity [~~corporation~~] commits an offense if the taxable entity [~~corporation~~] is subject to the provisions of this chapter and the taxable entity [~~corporation~~] wilfully:

(1) fails to file a report;

(2) fails to keep books and records as required by this chapter;

(3) files a fraudulent report;

(4) violates any rule of the comptroller for the administration and enforcement of the provisions of this chapter; or

(5) attempts in any other manner to evade or defeat any tax imposed by this chapter or the payment of the tax.

(b) A person commits an offense if the person is an accountant or an agent for or an officer or employee of a taxable entity [~~corporation~~] and the person knowingly enters or provides false information on any report, return, or other document filed by the taxable entity [~~corporation~~] under this chapter.

SECTION 15. Section 171.401, Tax Code, is amended to read as follows:

Sec. 171.401. REVENUE DEPOSITED IN GENERAL REVENUE FUND. The revenue from the tax imposed by this chapter [~~on corporations~~] shall be deposited to the credit of the general revenue fund.

SECTION 16. (a) Section 313.007, Tax Code, is amended to read as follows:

Sec. 313.007. EXPIRATION. Subchapters B, C, and D expire December 31, 2011 [~~2007~~].

(b) Section 313.024(a), Tax Code, is amended to read as follows:

(a) This subchapter and Subchapters C and D apply only to property owned by an entity [~~a corporation or limited liability company~~] to which Chapter 171 [~~Section 171.001~~] applies.

(c) Section 313.024(b), Tax Code, is amended to read as follows:

(b) To be eligible for a limitation on appraised value under

this subchapter, the entity [~~corporation or limited liability company~~] must use the property in connection with:

(1) manufacturing;

(2) research and development;

(3) a clean coal project, as defined by Section 5.001, Water Code;

(4) a gasification project for a coal and biomass mixture; or

(5) renewable energy electric generation.

(d) Section 313.025(b), Tax Code, is amended to read as follows:

(b) The governing body of a school district is not required to consider an application for a limitation on appraised value that is filed with the governing body under Subsection (a). If the governing body of the school district does elect to consider an application, the governing body shall request that the Texas Education Agency [~~engage a third person to~~] conduct an economic impact evaluation of the application on behalf of the school district, and that agency shall conduct the evaluation as soon as practicable. The governing body shall provide to the Texas Education Agency any information requested by that agency. The Texas Education Agency may develop a methodology to allow comparisons of economic impact for different schedules of addition of qualified investment or qualified property as part of the economic impact evaluation. The economic impact evaluation of the Texas Education Agency is binding on the governing body of the school district and the applicant. The governing body shall provide a copy of the evaluation to the applicant on request. The Texas Education Agency may charge and collect a fee sufficient to cover the costs of providing the economic impact evaluation. The governing body of a school district shall [~~and~~] approve or disapprove an application before the 121st day after the date the application is filed, unless the Texas Education Agency's economic impact evaluation has not been received or an extension is agreed to by the governing body and the applicant.

(e) Section 313.051, Tax Code, is amended to read as follows:

Sec. 313.051. APPLICABILITY. (a) This subchapter applies only to a school district that has territory in:

(1) a strategic investment area, as defined by Section 171.721;[~~, Tax Code,~~] or

(2) [~~in~~] a county:

(A) [~~(1)~~] that has a population of less than 50,000;

(B) [~~(2)~~] that is not partially or wholly located in a metropolitan statistical area; and

(C) [~~(3)~~] in which, from 1990 to 2000, according to the federal decennial census, the population:

(i) [~~(A)~~] remained the same;

(ii) [~~(B)~~] decreased; or

(iii) [~~(C)~~] increased, but at a rate of not more than three percent per annum.

(a-1) Notwithstanding Subsection (a), if on January 1, 2002, this subchapter applied to a school district in whose territory is located a federal nuclear facility, this subchapter continues to apply to the school district regardless of whether the school district ceased or ceases to be described by Subsection (a) after that date.

(b) The governing body of a school district to which this subchapter applies may enter into an agreement in the same manner as a school district to which Subchapter B applies may do so under Subchapter B, subject to Sections 313.052-313.054. Except as otherwise provided by this subchapter, the provisions of Subchapter B apply to a school district to which this subchapter applies. For purposes of this subchapter, a property owner is required to create only at least 10 new jobs on the owner's qualified property. At least 80 percent of all the new jobs created must be qualifying jobs as defined by Section 313.021(3), except that, for a school district described by Subsection (a)(2), each qualifying job must

pay at least 110 percent of the average weekly wage for manufacturing jobs in the region designated for the regional planning commission, council of governments, or similar regional planning agency created under Chapter 391, Local Government Code, in which the district is located.

(f) Section 313.051(b), Tax Code, as amended by this section, applies only to a limitation on the appraised value for school district maintenance and operations ad valorem tax purposes for which the owner files an application on or after the effective date of this Act. A limitation on the appraised value for school district maintenance and operations ad valorem tax purposes for which the owner files an application before the effective date of this Act is governed by the law as it existed immediately before the effective date of this Act, and that law is continued in effect for that purpose.

SECTION 17. (a) The repeal of Section 171.111, Tax Code, by this Act does not affect a credit that accrued under that section before the effective date of this Act.

(b) A corporation that has any unused credits accrued before the effective date of this Act under Section 171.111, Tax Code, may claim those unused credits on or with the tax report for the period in which the credits were accrued, and the former law under which the corporation accrued the credits is continued in effect for purposes of determining the amount of the credits the corporation may claim and the manner in which the corporation may claim the credits.

SECTION 18. (a) The following provisions of Chapter 171, Tax Code, are repealed:

(1) Subchapter L;

(2) Subchapter M;

(3) Subchapter N;

(4) Subchapter O;

(5) Subchapter P;

(6) Subchapter Q;

(7) Subchapter R;

(8) Subchapter S;

(9) Subchapter T;

(10) Subchapter U as added by Chapter 209, Acts of the 78th Legislature, Regular Session, 2003; and

(11) Subchapter U as added by Chapter 1274, Acts of the 78th Legislature, Regular Session, 2003.

(b) This section does not affect a credit authorized by a provision listed in Subsection (a) of this section that accrued under Chapter 171, Tax Code, before the effective date of this Act or a credit that continues to accrue under Section 19 of this Act.

(c) A corporation that has any unused credits accrued before the effective date of this Act under a provision other than Subchapter O, P, or Q, Chapter 171, Tax Code, may claim those unused credits on or with the tax report for the period in which the credits were accrued, and the former law under which the corporation accrued the credits is continued in effect for purposes of determining the amount of the credits the corporation may claim and the manner in which the corporation may claim the credits.

(d) A corporation that has any unused credits accrued before the effective date of this Act under Subchapter O, Chapter 171, Tax Code, may claim those unused credits on or with the tax report for the period in which the credit was accrued. However, if the corporation was allowed to carry forward unused credits under that subchapter, the corporation may continue to apply those credits on or with each consecutive report until the earlier of the date the credit would have expired under the terms of Subchapter O, Chapter 171, Tax Code, had it continued in existence, or December 31, 2027, and the former law under which the corporation accrued the credits is continued in effect for purposes of determining the amount of the credits the corporation may claim and the manner in which the corporation may claim the credits.

(e) A corporation that has any unused credits accrued before the effective date of this Act under Subchapter P, Chapter 171, Tax Code, may claim those unused credits on or with the tax report for

the period in which the credit was accrued. However, if the corporation was allowed to carry forward unused credits under that subchapter, the corporation may continue to apply those credits on or with each consecutive report until the earlier of the date the credit would have expired under the terms of Subchapter P, Chapter 171, Tax Code, had it continued in existence, or December 31, 2012, and the former law under which the corporation accrued the credits is continued in effect for purposes of determining the amount of the credits the corporation may claim and the manner in which the corporation may claim the credits.

(f) A corporation that has any unused credits accrued before the effective date of this Act under Subchapter Q, Chapter 171, Tax Code, may claim those unused credits on or with the tax report for the period in which the credit was accrued. However, if the corporation was allowed to carry forward unused credits under that subchapter, the corporation may continue to apply those credits on or with each consecutive report until the earlier of the date the credit would have expired under the terms of Subchapter Q, Chapter 171, Tax Code, had it continued in existence, or December 31, 2012, and the former law under which the corporation accrued the credits is continued in effect for purposes of determining the amount of the credits the corporation may claim and the manner in which the corporation may claim the credits.

(g) The comptroller shall adopt rules to administer this section.

SECTION 19. A written agreement between the Texas Department of Economic Development or its successor and a taxpayer effective before June 1, 2006, that allows for credits against the tax imposed under Chapter 171, Tax Code, continues in effect and the credits allowed under the agreement continue to accrue and may be claimed in the manner provided by the agreement against the tax imposed under Chapter 171, Tax Code, as amended by this Act, for the duration of the agreement. The former law under which the agreement was made and under which the taxpayer received the entitlement to the credits is continued in effect for purposes of determining the amount of the credits the taxpayer may claim and the manner in which the taxpayer may claim the credits.

SECTION 20. The comptroller shall adopt rules to implement the legislative intent in Sections 171.1012(e)(14) and 171.1013(c-1), Tax Code.

SECTION 21. The franchise tax imposed by Chapter 171, Tax Code, as amended by this Act, is not an income tax and Pub. L. No. 86-272 does not apply to the tax.

SECTION 22. (a) Subject to other provisions of this section, this Act applies to reports originally due on or after the effective date of this Act.

(b) For an entity becoming subject to the franchise tax under this Act:

(1) margin or gross receipts occurring before June 1, 2006, may not be considered for purposes of determining taxable margin or for apportionment purposes;

(2) an entity subject to the franchise tax on January 1, 2008, that was not previously subject to the tax and for which January 1, 2008, is not the beginning date, shall file an annual report due May 15, 2008, based on the period:

(A) if the entity has an accounting period that ends on or after January 1, 2007, and before June 1, 2007:

(i) beginning on the later of:

(a) June 1, 2006; or

(b) the date the entity was organized in this state or, if a foreign entity, the date it began doing business in this state; and

(ii) ending on the date that accounting period ends in 2007;

(B) if the entity has an accounting period that ends on or after June 1, 2007, and before December 31, 2007:

(i) beginning on the date that accounting period begins; and

(ii) ending on the date that accounting

period ends in 2007; and

(C) if the entity has an accounting period that ends on December 31, 2007, or if the entity does not have an accounting period that ends in 2007:

(i) beginning on the later of:

(a) January 1, 2007; or

(b) the date the entity was organized in the state or, if a foreign entity, the date it began doing business in this state; and

(ii) ending on December 31, 2007; and

(3) an entity subject to the franchise tax as it existed before the effective date of this Act at any time after December 31, 2006, and before January 1, 2008, but not subject to the franchise tax on January 1, 2008, shall file a final report for the privilege of doing business at any time after June 30, 2007, and before January 1, 2008, based on the period:

(A) beginning on the later of:

(i) January 1, 2007; or

(ii) the date the entity was organized in this state or, if a foreign entity, the date it began doing business in this state; and

(B) ending on the date the entity became no longer subject to the franchise tax.

(c) For purposes of this Act, an existing partnership is considered as continuing if it is not terminated.

(d) A partnership is considered terminated only if no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership.

(e) For a merger or consolidation of two or more partnerships, the resulting partnership is, for purposes of this Act, considered the continuation of any merging or consolidating partnership whose members own an interest of more than 50 percent in the capital and profits of the resulting partnership.

(f) For a division of a partnership into two or more partnerships, the resulting partnerships, other than any resulting partnership the members of which had an interest of 50 percent or less in the capital and profits of the prior partnership, are, for purposes of this Act, considered a continuation of the prior partnership.

SECTION 23. (a) The comptroller shall require the entities specified by this section to file an information report in the manner provided by this section. The information report is confidential and exempt from disclosure under Chapter 552, Government Code.

(b) The information report required under this section must contain the same information that an entity required to file the report would have submitted in its report due to the comptroller in 2006 under Chapter 171, Tax Code, if the changes made by this Act to Chapter 171, Tax Code, had been in effect January 1, 2006. The information report shall also contain the total of maintenance and operations school property taxes paid by the entity to school districts in Texas in the 2005, 2006, and 2007 tax years. The comptroller shall provide the forms and instructions to the entities required to file a report under this section.

(c) The comptroller shall take action to revoke the charter, as that term is defined by Section 171.0001, Tax Code, as added by this Act, of an entity that does not file an information return in the manner and under the time limits provided by this section.

(d) The comptroller shall identify and require the following entities to file an information report under this section:

(1) the 1,000 entities that paid or are required to pay the most franchise tax for the annual reporting period ending December 31, 2005, under Chapter 171, Tax Code, as that chapter existed on the effective date of this section;

(2) the 1,000 entities doing business in this state that had the greatest amount of gross receipts in 2005, as determined under Sections 171.105 and 171.1051, Tax Code, as those sections existed on the effective date of this section;

(3) the 1,000 entities doing business in this state with the greatest number of employees in this state, according to records maintained by the Texas Workforce Commission, in 2005; and

(4) the 1,000 entities doing business in this state with the greatest school maintenance-and-operations property tax levy in this state, according to records maintained or collected for this purpose by the Property Tax Division of the Office of the Comptroller, in 2005;

(e) An entity may be listed in one or more of the categories under Subsection (d) of this section. An entity that is listed more than once is required by this section to file only one information return.

(f) The comptroller:

(1) shall identify the entities described by Subsection (d) of this section;

(2) shall prepare all forms and instructions required for those entities to file their information reports as required by this section;

(3) shall provide those forms and instructions to those entities on or after November 15, 2006, but before December 2, 2006;

(4) shall require the entities to submit their information reports on or before February 15, 2007, and February 15, 2008;

(5) may not grant any extensions for filing the information reports; and

(6) shall report to the governor, the lieutenant governor, and the members of the legislature, on or before April 1, 2007, and April 1, 2008, the results of the information reports, stating the amount of revenue generated by the tax under Chapter 171, Tax Code, in each year, the amount that would have been generated from the entities submitting information reports under this section if the changes made by this Act to Chapter 171, Tax Code, had been in effect January 1, 2006, and the school maintenance and operations property taxes paid by the entities in the 2005, 2006, and 2007 tax years.

(g) The report required under Subsection (f)(6) of this section may not be formatted in a manner or include any information that discloses or effectively discloses the specific identity of a reporting entity.

(h) This section takes effect as provided by Section 27 of this Act.

SECTION 24. (a) The supreme court has exclusive and original jurisdiction over a challenge to the constitutionality of this Act or any part of this Act and may issue injunctive or declaratory relief in connection with the challenge.

(b) The supreme court shall rule on a challenge filed under this section on or before the 120th day after the date the challenge is filed.

(c) This section takes effect as provided by Section 27 of this Act.

SECTION 25. (a) The amount of $2 million is appropriated out of the general revenue fund to the comptroller of public accounts for the state fiscal biennium ending August 31, 2007, for the implementation of this Act and for audit and enforcement activities.

(b) This section takes effect as provided by Section 27 of this Act.

SECTION 26. Except as otherwise provided by Section 27 of this Act, this Act takes effect January 1, 2008, and applies to reports originally due on or after that date.

SECTION 27. A section of this Act that provides that it takes effect as provided by this section takes effect June 1, 2006, if this Act receives a vote of two-thirds of all the members elected to each house, as provided by Section 39, Article III, Texas Constitution. If this Act does not receive the vote necessary for effect on that date, that section takes effect September 1, 2006.

* * * * *