

By: Dunnam

H.B. No. 69

A BILL TO BE ENTITLED

AN ACT

1
2 relating to the allocation and apportionment of certain payments
3 used in the determination of the taxable earned surplus of a
4 corporation.

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

6 SECTION 1. Subchapter C, Chapter 171, Tax Code, is amended
7 by adding Section 171.1001 to read as follows:

8 Sec. 171.1001. DEFINITIONS. In this subchapter:

9 (1) "Arm's length" means the standard of conduct under
10 which unrelated parties having substantially equal bargaining
11 power, each acting in its own interest, would negotiate or carry out
12 a particular transaction.

13 (2) "Controlling interest" means:

14 (A) for a corporation, either 50 percent or more,
15 owned directly or indirectly, of the total combined voting power of
16 all classes of stock of the corporation, or 50 percent or more,
17 owned directly or indirectly, of the beneficial ownership interest
18 in the voting stock of the corporation; and

19 (B) for a partnership, association, trust, or
20 other entity, 50 percent or more, owned directly or indirectly, of
21 the capital, profits, or beneficial interest in the partnership,
22 association, trust, or other entity.

23 (3) "Interest payment" means an amount allowable as an
24 interest deduction under Section 163, Internal Revenue Code.

1 (4) "Management fee" means a fee for services of a
2 managerial or administrative nature, including services pertaining
3 to management, accounts receivable and payable, employee benefit
4 plans, insurance, legal matters, payroll, data processing,
5 purchasing, taxes, financial matters, securities, accounting,
6 reporting, and compliance.

7 (5) "Related party" means a person, corporation, or
8 other entity, including an entity that is treated as a pass-through
9 or disregarded entity for purposes of federal taxation, whether the
10 person, corporation, or entity is subject to the tax under this
11 chapter or not, in which one person, corporation, or entity, or set
12 of related persons, corporations, or entities, directly or
13 indirectly owns or controls a controlling interest in another
14 entity. To the extent necessary to carry out this section, the
15 comptroller shall adopt rules defining "related party" using
16 principles substantially similar to Section 318, Internal Revenue
17 Code.

18 (6) "Royalty payment" means a payment directly
19 connected to the acquisition, use, maintenance or management,
20 ownership, sale, exchange, or any other disposition of licenses,
21 trademarks, copyrights, trade names, trade dress, service marks,
22 mask works, trade secrets, patents, or any other similar types of
23 intangible assets as determined by the comptroller.

24 (7) "Valid business purpose" means one or more
25 business purposes, other than the avoidance or reduction of taxes,
26 that alone or in combination constitute the primary motivation for
27 a business activity or transaction that changes in a meaningful

1 way, apart from tax effects, the economic position of the entity. A
2 valid business purpose includes compliance with a regulatory
3 requirement of:

4 (A) the federal government;

5 (B) a state or local government;

6 (C) a foreign nation; or

7 (D) an agency or political subdivision of any
8 entity listed in Paragraphs (A)-(C).

9 SECTION 2. Subchapter C, Chapter 171, Tax Code, is amended
10 by adding Sections 171.1101-171.1103 to read as follows:

11 Sec. 171.1101. ADD-BACK OF PAYMENTS TO RELATED PARTY.

12 Except as provided by Section 171.1102, a corporation shall add
13 back to reportable federal taxable income any royalty payments,
14 interest payments, and management fees made to a related party
15 during the period on which earned surplus is based to the extent
16 deducted in computing reportable federal taxable income.

17 Sec. 171.1102. SAFE HARBORS FOR CERTAIN PAYMENTS AND FEES.

18 (a) A corporation is not required to add back royalty payments to a
19 related party to the extent:

20 (1) the related party during the period on which
21 earned surplus is based directly or indirectly paid or incurred the
22 amount to a person or entity that is not a related party, the
23 transaction was done for a valid business purpose, and the payments
24 were made at arm's length; or

25 (2) the royalty payments are paid or incurred to a
26 related party organized under the laws of a foreign nation, are
27 subject to a comprehensive income tax treaty between the foreign

1 nation and the United States, and are taxed in the foreign nation at
2 a tax rate equal to or greater than the rate under Section
3 171.002(a)(2).

4 (b) A corporation is not required to add back interest
5 payments to a related party to the extent:

6 (1) the interest is at or below the applicable federal
7 rate compounded annually for debt instruments under Section
8 1274(d), Internal Revenue Code, that was in effect at the time of
9 the agreement; or

10 (2) the related party during the period on which
11 earned surplus is based directly or indirectly paid or incurred the
12 amount to a person or entity that is not a related party, the
13 transaction was done for a valid business purpose, and the payments
14 were made at arm's length.

15 (c) A corporation is not required to add back a royalty
16 payment or an interest payment made to a related party, or a
17 management fee paid to a related party, if the combined tax paid to
18 this state, or to this state and one or more other states each of
19 which has a tax rate equal to or greater than the rate under Section
20 171.002(a)(2), by the corporation and the related party exceeds the
21 tax that would have been paid by the corporation if the royalty
22 payment or interest payment had not been made.

23 (d) A corporation is not required to add back a management
24 fee paid to a related party to the extent that the transaction was
25 done for a valid business purpose and the fee was paid at arm's
26 length.

27 Sec. 171.1103. ADJUSTMENT TO INCOME AND EXPENSES BY

1 COMPTROLLER. (a) The comptroller may distribute, apportion, or
2 allocate gross income, deductions, credits, or allowances between
3 or among two or more organizations, trades, or businesses, whether
4 or not incorporated, whether or not organized in the United States,
5 and whether or not affiliated, if:

6 (1) the organizations, trades, or businesses are owned
7 or controlled directly or indirectly by the same interests; and

8 (2) the comptroller determines that the distribution,
9 apportionment, or allocation is necessary to reflect an arm's
10 length standard, within the meaning of 26 C.F.R. Section 1.482-1,
11 and to clearly reflect the income of those organizations, trades,
12 or businesses.

13 (b) The comptroller shall apply the administrative and
14 judicial interpretations of Section 482, Internal Revenue Code, in
15 administering this section.

16 SECTION 3. (a) This Act takes effect January 1, 2007.