

Amend CSHB 3 as follows:

(1) Strike SECTION 2.01 (page 15, line 4, through page 22, line 12) and substitute a new SECTION 2.01 as follows:

SECTION 2.01. Title 2, Tax Code, is amended by adding Subtitle K to read as follows:

SUBTITLE K. REFORMED FRANCHISE TAX

CHAPTER 251. REFORMED FRANCHISE TAX

Sec. 251.001. DEFINITIONS. In this chapter:

(1) "Business" means an entity that employs an individual to perform services and includes a sole proprietorship with one or more employees.

(2) "Calendar quarter," "commission," "compensation fund," and "contribution" have the meanings assigned those terms by Section 201.011, Labor Code.

(3) "Employer" has the meaning assigned by Subchapter C, Chapter 201, Labor Code.

(4) "Taxable business" means a business to which this chapter applies.

(5) "Wages" means wages, as defined under Subchapter F, Chapter 201, Labor Code, paid by a taxable business and includes the amounts excluded by Sections 201.082(1) and (9), Labor Code.

Sec. 251.002. RULES. The comptroller may adopt rules to implement and administer this chapter.

Sec. 251.0025. RULES: AVOIDANCE OF DOUBLE TAXATION. (a) The comptroller shall adopt rules that shall work in conjunction with the rules adopted under Section 171.0013, so that when a taxable business entity is owned through an ownership chain, whether or not each entity in the chain is subject to taxation under this chapter, the direct and indirect owners of the taxable business entity are not subject to taxation with respect to the same wages.

(b) The avoidance of double taxation rules adopted under this section shall apply regardless of whether the direct or indirect owner itself elects to be subject to the tax under this chapter, is subject to the tax under Chapter 171, or is exempt from taxation under this chapter or Chapter 171.

Sec. 251.003. LOCATION OF SERVICE. (a) The tax imposed by

this chapter applies to wages for a service performed in this state or in and outside this state if:

(1) the service is localized in this state; or

(2) the service is not localized in any state and some of the service is performed in this state and:

(A) the base of operations is in this state, or there is no base of operations, but the service is directed or controlled from this state; or

(B) the base of operations or place from which the service is directed or controlled is not in a state in which a part of the service is performed, and the residence of the person who performs the service is in this state.

(b) The tax imposed by this chapter applies to wages for a service performed anywhere in the United States, including service performed entirely outside this state, if:

(1) the service is not localized in a state;

(2) the service is performed by an individual who is one of a class of employees who are required to travel outside this state in performance of their duties; and

(3) the individual's base of operations is in this state or, if there is no base of operations, the individual's service is directed or controlled from this state.

(c) The tax imposed by this chapter applies to wages for a service performed outside the United States by a citizen of the United States.

(d) For the purposes of this section, service is localized in a state if the service is performed entirely within the state or the service performed outside the state is incidental to the service performed in the state. In this section, a service that is "incidental" includes a service that is temporary or that consists of isolated transactions.

Sec. 251.004. TAXABLE BUSINESS. Subject to Section 251.007, the tax imposed by this chapter applies only to a business that is an employer that pays or is required to pay a contribution under Subtitle A, Title 4, Labor Code.

Sec. 251.005. ELECTION OF TAXES. (a) Except as otherwise provided by this section, a business may elect to pay the tax

imposed under this chapter or the tax imposed under Chapter 171.

(b) A business that is wholly or partially in the business of leasing employees, including but not limited to leasing between members of an affiliated group, shall pay the tax under this chapter, and for the purposes of this chapter and Chapter 171, the business is considered to have elected the tax under this chapter.

(c) A business that does not have any employees in this state may not elect to pay the tax under this chapter.

(d) The comptroller shall promulgate a form for a business to use to make an election under this section.

(e) The election cannot be changed until after the third anniversary of the date the election is made.

Sec. 251.006. TAX IMPOSED. If a business elects to pay the tax under this chapter, the tax is imposed on the business for each employee for whom the business pays or is required to pay a contribution for a calendar quarter without regard to whether:

(1) the employee is full-time or part-time; or

(2) the wages paid were for the entire calendar quarter or a portion of the calendar quarter.

Sec. 251.007. TAX IMPOSED ON EMPLOYERS. (a) Notwithstanding Section 251.006, if a business elects to pay the tax under this chapter, the tax is imposed on the business for each individual who performs a service for the business for compensation, without regard to whether the business pays a contribution for a calendar quarter for the individual, if the individual is an employee of the business as provided by this section for all or a part of the calendar quarter.

(b) An individual is an employee of a business for purposes of this section if the business has a right to direct and control how the individual performs the service for which the individual is provided compensation, indicated by factors that include, but are not limited to:

(1) whether the individual is subject to the business's instructions about when, where, and how to work;

(2) whether the individual is trained to perform services in a particular manner;

(3) the extent to which the individual has

unreimbursed business expenses;

(4) the extent to which the individual has a significant investment in the facilities the individual uses in performing the services;

(5) the extent to which the individual makes the individual's services available to the relevant market, by advertising, maintaining a visible business location, or otherwise;

(6) the extent to which the individual can realize a profit or loss;

(7) the manner in which the individual is paid by the business;

(8) whether a written contract between the individual and the business provides that the individual is or is not an employee;

(9) whether the business provides the individual with employee-type benefits, including insurance, a pension plan, vacation pay, or sick pay;

(10) whether the relationship between the individual and the business is considered permanent or for a limited period; and

(11) the extent to which services performed by the individual are a key aspect of the affairs of the business.

Sec. 251.008. BASE AMOUNT OF WAGES. The base amount of wages for each employee is the total amount of wages paid to the employee during the calendar quarter.

Sec. 251.009. RATE. (a) Except as provided by Subsection (b), the rate of the tax for a business that elects to pay the tax under this chapter is equal to 1.15 percent of the base amount of wages for each employee as determined under Section 251.008.

(b) For a corporation that elects to pay the tax under this chapter and that had no employees in this state at any time between January 1, 2004, and January 1, 2005, but currently has employees in this state, the rate of the tax is equal to the greater of:

(1) 1.15 percent of the base amount of wages for each employee as determined under Section 251.008; or

(2) the amount of the franchise tax paid by the

corporation in the previous report year.

(c) Subsection (b) expires December 31, 2008.

Sec. 251.010. EXEMPTION FOR GOVERNMENTAL ENTITIES. The tax imposed under this chapter does not apply to a governmental entity.

Sec. 251.011. EXEMPTION FOR SMALL BUSINESS. A business whose gross receipts in this state as determined under Section 171.1032 for the applicable calendar year are less than or equal to \$150,000 is exempt from the taxes imposed under this chapter for that year.

Sec. 251.012. EXEMPTION FOR CERTAIN CHARITIES. (a) The tax imposed under this chapter does not apply to an organization exempt from federal income tax under Section 501(a) of the Internal Revenue Code of 1986 by being listed as an exempt organization in Section 501(c)(3) of that code.

(b) An organization exempt from federal income tax under Section 501(a) of the Internal Revenue Code of 1986 by being listed as an exempt organization under a provision of Section 501(c) other than Section 501(c)(3) may elect to pay the tax under this chapter or to pay the tax under Chapter 171. If the organization elects to pay the tax under Chapter 171, and Chapter 171 provides that the organization is exempt from taxation under that chapter, the organization may claim or continue to claim that exemption in the manner provided by Chapter 171.

Sec. 251.013. TAX NOT DEDUCTED FROM WAGES. A taxable business may not deduct the tax imposed under this chapter from any wages of the taxable business's employees.

Sec. 251.014. CRIMINAL PENALTY. (a) A person who violates Section 251.013 commits an offense.

(b) An offense under this section is a Class A misdemeanor.

Sec. 251.015. CIVIL PENALTY. (a) A person who violates Section 251.013 is liable to the state for a civil penalty not to exceed \$500 for each violation. Each day a violation continues may be considered a separate violation for purposes of a civil penalty assessment.

(b) A person who does not pay the tax imposed by this chapter on wages paid to an individual who performs services for the person because the person determines that the individual is not an

employee for purposes of this chapter is liable to the state for a civil penalty equal to twice the amount of tax owed under this chapter in relation to the individual unless the person can demonstrate that there was a reasonable basis for the determination.

(c) On request of the comptroller, the attorney general shall file suit to collect a penalty under this section.

Sec. 251.016. REPORTS AND PAYMENT. (a) Each taxable business shall, on or before the last day of the month immediately following each calendar quarter, file a report on wages in a form prescribed by the commission.

(b) The tax imposed under this chapter is due at the same time, collected in the same manner, and subject to the same penalties and interest as contributions assessed under Subtitle A, Title 4, Labor Code.

(c) To the extent practicable, the commission shall combine the reporting and payment of contributions and the reporting and payment of the tax imposed under this chapter.

Sec. 251.017. ENFORCEMENT. The comptroller may enforce the collection of the tax under this chapter as provided by Subtitles A and B.

Sec. 251.018. DISPOSITION OF PROCEEDS. All proceeds from the collection of the taxes imposed under this chapter shall be deposited to the credit of the general revenue fund.

Sec. 251.019. CREDITS AGAINST INSURANCE PREMIUM TAXES. (a) Subject to Subsection (b), a business that pays insurance premium taxes under Subtitle B, Title 3, Insurance Code, and elects to pay the tax under this chapter is entitled to a credit of the entire amount of tax paid under this chapter against any premium tax that the business may owe.

(b) The business may not receive a credit in an amount that exceeds the amount of the tax or assessment due after applying any other credits. The business may carry any unused credit forward for not more than five years but it may not, at any time, receive a credit in an amount that exceeds the amount of the tax or assessment due, after applying any other credits.

(c) The business may not convey, assign, or transfer the

credit allowed under this section to another entity unless all of the assets of the business are conveyed, assigned, or transferred in the same transaction.

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

Sec. 251.020. CREDITS FOR CERTAIN PROVIDERS OF HEALTH CARE SERVICES. (a) Except as provided by Subsection (f), a taxable business that participates in either the Medicaid program or the Medicare program as a provider of health care services and that receives not less than 15 percent of the business's revenue during a calendar quarter from payments received under the Medicaid or Medicare program, or both, is entitled to a credit in the amount provided by Subsection (b) against the taxes imposed under this chapter for that calendar quarter.

(b) The amount of the credit is equal to 40 percent of the total amount of payments the taxable business received from payments under the Medicaid and Medicare programs during that calendar quarter that can be verified, if necessary.

(c) A taxable business may not receive a credit in an amount that exceeds the amount of the tax or assessment due after applying any other credits.

(d) A taxable business may not convey, assign, or transfer the credit allowed under this section to another entity unless all of the assets of the business are conveyed, assigned, or transferred in the same transaction.

(e) The comptroller shall adopt rules to implement this section. The Health and Human Services Commission shall assist the comptroller in the formulation and adoption of the rules.

(f) A taxable business that participates in the Medicaid or Medicare program as a provider of durable medical equipment or as a vendor of pharmaceuticals may not count payments for those services for purposes of qualifying for the exemption under this section.

(2) Strike SECTIONS 2.02 and 2.03 (page 22, line 13, through page 24, line 26) and substitute new SECTIONS 2.02–2.06 as follows, renumbering subsequent SECTIONS appropriately:

SECTION 2.02. Section 171.001(a), Tax Code, is amended to read as follows:

(a) Subject to Section 171.0012, a [A] franchise tax is imposed on:

(1) each corporation that does business in this state or that is chartered 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.

SECTION 2.03. Section 171.001(b)(3), Tax Code, is amended to read as follows:

(3) "Corporation":

(A) includes:

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

(ii) [~~B~~] a savings and loan association;
[and]

(iii) [~~C~~] a banking corporation;

(iv) a sole proprietorship with one or more employees;

(v) a partnership owned solely by natural persons with one or more employees;

(vi) a form of business, with or without employees, that is operating, organized, or registered under the laws of this state in a manner that provides liability limitations for a person who holds an ownership interest in the business; and

(vii) a partnership or joint venture owned at least in part by another form of business and with one or more employees; and

(B) does not include:

(i) a trust, estate, or escrow;

(ii) a real estate investment trust and its subsidiary entities;

(iii) a master limited partnership;

(iv) a family limited partnership;

(v) a regulated investment company;

(vi) a real estate mortgage investment conduit;

(vii) an investment partnership;

(viii) a sole proprietorship without any

employees;

(ix) a partnership without any employees;

or

(x) an entity, arrangement, or investment vehicle without any employees that is used solely for a finance, securitization, or monetization purpose, or any partner, beneficiary, or member of such entity.

SECTION 2.04. Section 171.001, Tax Code, is amended by adding Subsection (d) to read as follows:

(d) For purposes of Subsection (a), a corporation does business in this state if the corporation is a foreign corporation and is:

(1) holding a partnership interest, including an interest as an assignee, as a general partner in a general partnership that is doing business in this state;

(2) holding a partnership interest, including an interest as an assignee, as a general partner in a limited partnership that is doing business in this state; or

(3) holding a partnership interest, including an interest as an assignee, as a limited partner in a limited partnership that is doing business in this state.

SECTION 2.05. Subchapter A, Chapter 171, Tax Code, is amended by adding Sections 171.0012 and 171.0013 to read as follows:

Sec. 171.0012. ELECTION OF TAXES. (a) Except as provided by Subsection (b), a corporation may elect to pay the tax imposed under this chapter or the tax imposed under Chapter 251.

(b) A business that is in the business of leasing employees may not elect to pay the tax imposed under this chapter and shall pay the tax imposed under Chapter 251.

(c) The comptroller shall promulgate a form for a corporation to use to make an election under this section. If the corporation is an entity described in Sections 171.001(b)(3)(A)(iv)-(vii) and any interests in the corporation are owned by natural persons, the election form must be signed by each of those natural persons and by an authorized officer of the business. The election form shall provide that the business and

those natural persons agree that the taxable earned surplus of the business shall be calculated pursuant to this chapter without regard to any exclusion, exemption, or prohibition in Section 24, Article VIII, Texas Constitution.

(d) The election cannot be changed until after the third anniversary of the date the election is made.

Sec. 171.0013. RULES: AVOIDANCE OF DOUBLE TAXATION. (a) The comptroller shall adopt rules that shall work in conjunction with the rules adopted under Section 251.0025, so that when a corporation is owned through an ownership chain, whether or not each entity in the chain is subject to taxation under this chapter, the direct and indirect owners of the corporation are not subject to taxation with respect to the same taxable earned surplus.

(b) The avoidance of double taxation rules adopted under this section shall apply regardless of whether the direct or indirect owner itself elects to be subject to the tax under Chapter 251, is subject to the tax under this chapter, or is exempt from taxation under this chapter or Chapter 251.

SECTION 2.06. Section 171.110, Tax Code, is amended by adding Subsections (m)-(o) to read as follows:

(m) Notwithstanding any other provision of this chapter, in determining net taxable earned surplus, payments to related entities for the following purposes are disallowed to the extent they exceed arm's-length rates and terms:

- (1) intangible expenses;
- (2) interest charges; or
- (3) management fees.

(n) For the purpose of Subsection (m), the comptroller has the same power as the Internal Revenue Service under Section 482, Internal Revenue Code of 1986, as effective January 1, 2006.

(o) For purposes of Subsections (m) and (n), "arm's-length rates and terms" means that:

- (1) two or more related members enter into a written agreement for the transaction;
- (2) such agreement is of a duration and contains rates and payment terms substantially similar to those that the related member would be able to obtain from an unrelated entity; and

(3) the borrower or payor substantially adheres to the payment terms of the agreement governing the transaction or any amendments to it, provided that there is a presumption that an interest rate does not exceed arm's-length rates and terms if the rate conforms to Sections 482 and 1274, Internal Revenue Code of 1986, as effective January 1, 2006.