BILL ANALYSIS

C.S.H.B. 4611
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Ways & Means
Committee Report (Substituted)

BACKGROUND AND PURPOSE

H.B. 3, 79th Legislature, 3rd Special Session, 2006, restructured the state's franchise tax by expanding the tax to include newly taxed entities and to change how the tax is calculated. Under the revised franchise tax (commonly known as the "margin tax"), which became effective January 1, 2008 and applies to all tax returns filed on or after that date, the apportionment methods and policies were not intended to be changed except as specified in H.B. 3. During the senate's consideration of H.B. 3, Senator Williams and Senator Ogden specifically established legislative intent as it applied to the apportionment of gross receipts from the sale of loans and securities treated as inventory. Prior to the passage of H.B. 3, the comptroller of public accounts' franchise tax rules required taxpayers to use the gross receipts from the sale of loans or securities treated as inventory in determining their apportionment factor.

After the passage of H.B. 3, the comptroller's office asserted that H.B. 3 changed the apportionment treatment of receipts from the sale of loans and securities treated as inventory. Under the comptroller's interpretation of H.B. 3, banks and security firms could no longer use the gross receipts from the sale of loans and securities treated as inventory to calculate their apportionment factor. Instead, taxpayers would have been required to use the net proceeds from the sale of loans and securities treated as inventory. Contrary to legislative intent, the effect of the comptroller's interpretation would have significantly increased the franchise tax liability of banks doing business in Texas.

H.B. 3928, 80th Legislature, Regular Session, 2007, corrected, clarified, and revised several provisions in franchise tax law. H.B. 3928 contained a provision addressing the apportionment treatment of the proceeds from the sale of loans and securities treated as inventory. Specifically, Section 171.106(f) was added to provide that the gross proceeds of the sale of loans and securities treated as inventory for federal income tax purposes would be considered gross receipts for apportionment purposes. The supporters of the clarification explained that the legislative intent behind this change was to ensure that the apportionment treatment of the gross proceeds from the sale of securities and loans treated as inventory was the same as before the changes to the franchise tax. This legislative intent was expressed during consideration of H.B. 3928 by the House Committee on Ways and Means, the full house, the Senate Committee on Finance, and the full senate.

Since the legislature's passage of H.B. 3928 in May 2007, the banking industry has worked with the comptroller's office to determine how the clarification of the apportionment treatment of the gross receipts from the sale of securities and loans treated as inventory would be implemented. The comptroller's office under the "old" franchise tax had several letter rulings discussing and explaining how securities and loans were treated as inventory under generally accepted accounting principles, specifically Financing Accounting Standard No. 115 (FAS 115), but no detailed expression of the comptroller's interpretation of "inventory for federal income tax purposes." Under the "old" franchise tax, taxpayers essentially relied on the comptroller's guidance expressed in the letter rulings and followed the guidance outlining the treatment of securities and loans as inventory. The comptroller's guidance specified that securities and loans categorized as Securities Available for Sale and Trading Securities under FAS 115 were

generally considered inventory and the gross proceeds from the sale of these categorized securities and loans were considered gross receipts for apportionment purposes.

The comptroller's office has developed a new policy and guidance outlining its interpretation of Section 171.106(f) language: "A loan or security is treated as inventory of a seller for federal income tax purposes." Specifically, the comptroller's office provides that Section 171.106(f) only applies to securities and loans for which a taxable entity is required or elects treatment under Section 475(a)(1), Internal Revenue Code, or accounts for securities and loans under Section 471, Internal Revenue Code.

The comptroller's policy position on Section 171.106(f) can be complied with most easily by the large multistate banks, due to the large security trading components of these businesses. These large multistate banks with security broker divisions have already established all the necessary procedures and policies needed to comply with Section 475(a)(1), Internal Revenue Code.

The comptroller's policy position on Section 171.106(f) will create significant administrative burdens and potential regulatory issues for small to medium-sized banks that exclusively do business in Texas and are commonly recognized as the state's community banks. These banks do not normally have large security trading components but do sell securities and loans as part of their normal course of business. These banks are faced with implementing costly and extensive administrative procedures and policies to comply with the comptroller's position or will suffer from significantly higher franchise tax burdens (as a percentage of income) than their large multistate counterparts.

C.S.H.B. 4611 restores the comptroller's policy, as it existed before the 2006 changes to the franchise tax, regarding the apportionment treatment of the proceeds from the sale of securities and loans that were generally treated as inventory and implements the legislature's original intent. This change will put all banks, regardless of their size, on the same footing in terms of complying with and qualifying to use the gross proceeds from the sale of securities and loans in calculating their apportionment factor.

C.S.H.B. 4611 provides that that if a lending institution categorizes a loan or security as Securities Available for Sale or as Trading Securities under Financial Accounting Standard No. 115, the gross proceeds of the sale of that loan or security are considered gross receipts.

RULEMAKING AUTHORITY

It is the committee's opinion that this bill does not expressly grant any additional rulemaking authority to a state officer, department, agency, or institution.

ANALYSIS

C.S.H.B. 4611 amends provisions of the Tax Code relating to the franchise tax to specify that if a lending institution categorizes a loan or security as "Securities Available for Sale" or as "Trading Securities" under Financial Accounting Standard No. 115, the gross proceeds of the sale of that loan or security are considered gross receipts. The bill defines "Financial Accounting Standard No. 115" and "security."

EFFECTIVE DATE

January 1, 2010.

COMPARISON OF ORIGINAL AND SUBSTITUTE

C.S.H.B. 4611 applies to a loan or security categorized by a lending institution as certain types of securities, whereas the original applies to a loan or security treated as inventory of the seller

for federal income tax purposes or generally accepted accounting principles. The substitute adds definitions not in the original for "Financial Accounting Standard No. 115" and "security." The substitute differs from the original by providing for a January 1, 2010, effective date, whereas the original provides for a September 1, 2009, effective date.