

BILL ANALYSIS

Senate Research Center
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S.B. 885
By: Harris
Economic Development
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AUTHOR'S / SPONSOR'S STATEMENT OF INTENT

Today 34 of the 47 states that have a broad-based business tax offer some type of credit for research and development. Texas is one of the few states that does not offer an incentive for research and development, so we have disarmed ourselves at a time when the rough economy is causing other states to aggressively entice new business investment. Research and development represents high-paying jobs in a clean industry at a time when we are losing jobs and under pressure to reduce our industrial emissions.

In 2006, the most recent year for which data are available, companies across the U.S. spent a total of \$247 billion on research and development, employing 1.1 million engineers and scientists.

In 2006, Texas spent \$13.3 billion in research and development—only 5.4 percent of the nation's total at a time when the state accounted for 7.7 percent of the nation's economic activity. This figure will only get worse if Texas does not reenact the research and development tax credit.

As proposed, S.B. 885 provides a taxable entity with a tax credit against taxes imposed under Chapter 171 (Franchise Tax), Tax Code. The bill provides that the credit equals five percent of the sum of the excess of qualified research expenses and certain basic research payments incurred in this state; provides that for a company to benefit from the credit it has to increase its research and development spending; and provides that the credit is limited to one-half of a business's franchise tax.

RULEMAKING AUTHORITY

Rulemaking authority is expressly granted to comptroller of public accounts in SECTION 1 (Section 171.748, Tax Code) of this bill.

SECTION BY SECTION ANALYSIS

SECTION 1. Amends Chapter 171, Tax Code, by adding Subchapter O-1, as follows:

SUBCHAPTER O-1. TAX CREDIT FOR CERTAIN RESEARCH AND DEVELOPMENT ACTIVITIES

Sec. 171.741. DEFINITIONS. Defines "base amount," "basic research payment," "qualified research expense," and "strategic investment area."

Sec. 171.742. ELIGIBILITY. (a) Provides that a taxable entity is eligible for a credit against the tax imposed under this chapter in the amount and under the conditions and limitations provided by this subchapter.

(b) Authorizes a taxable entity to claim a credit under Section 171.743(d) or take a carryforward credit without regard to whether the strategic investment area in which the entity incurred qualified research expenses or made basic research payments subsequently loses its designation as a strategic investment area.

Sec. 171.743. CALCULATION OF CREDIT. (a) Provides that the credit for any report equals five percent of the sum of the excess of qualified research expenses incurred in this state during the period on which the tax is based over the base amount for this state,

and the basic research payments determined under Section 41(e)(1)(A), Internal Revenue Code, for this state during the period on which the tax is based.

(b) Authorizes a taxable entity to elect to compute the credit for qualified research expenses incurred in this state in a manner consistent with the alternative incremental credit described in Section 41(c)(4), Internal Revenue Code, only if for the corresponding federal tax period a federal election was made to compute the federal credit under Section 41(c)(4), Internal Revenue Code; the taxable entity was a member of a consolidated group for which a federal election was made under Section 41(c)(4), Internal Revenue Code; or the taxable entity did not claim the federal credit under Section 41(a)(1), Internal Revenue Code.

(c) Provides that for purposes of the alternate credit computation method in Subsection (b), the credit percentages applicable to qualified research expenses described in Sections 41(c)(4)(A)(i), (ii), and (iii), Internal Revenue Code, are 0.41 percent, 0.55 percent, and 0.69 percent, respectively.

(d) Authorizes a taxable entity, in computing the credit under this section, to multiply by two the amount of any qualified research expenses and basic research payments made in a strategic investment.

(e) Provides that the burden of establishing entitlement to and the value of the credit is on the taxable entity.

(f) Defines "gross receipts."

Sec. 171.744. **LIMITATIONS.** Prohibits the sum of the total credit claimed under this subchapter for a report, including the amount of any carryforward credit under Section 171.745, and the amount of unused credits accrued under Subchapter O (Tax Credit for Certain Research and Development Activities) before its repeal on January 1, 2008, and claimed on the report as authorized by Section 18(d) (relating to a corporation claiming unused tax credits), Chapter 1 (H.B. 3), Acts of the 79th Legislature, 3rd Called Session, 2006, from exceeding 50 percent of the amount of franchise tax due for the report before any other applicable tax credits.

Sec. 171.745. **CARRYFORWARD.** Authorizes a taxable entity, if a taxable entity is eligible for a credit that exceeds the limitation under Section 171.744, to carry the unused credit forward for not more than 20 consecutive reports. Provides that credits, including credit carryforwards, are considered to be used in the following order: a credit carryforward of unused credits accrued under Subchapter O before its repeal on January 1, 2008, and claimed as authorized by Section 18(d), Chapter 1 (H.B. 3), Acts of the 79th Legislature, 3rd Called Session, 2006; a credit carryforward under this subchapter; and a current year credit.

Sec. 171.746. **DETERMINATION OF STRATEGIC INVESTMENT AREAS.** (a) Requires the comptroller, not later than September 1 each year, to determine areas that qualify as strategic investment areas using the most recently completed full calendar year data available on that date and, not later than October 1, is required to publish a list and map of the designated areas.

(b) Provides that the designation is effective for the following calendar year for purposes of credits available under this subchapter.

Sec. 171.747. **BIENNIAL REPORT BY COMPTROLLER.** (a) Requires the comptroller, before the beginning of each regular session of the legislature, to submit to the governor, the lieutenant governor, and the speaker of the house of representatives a report that states:

(1) the total amount of expenses and payments incurred by taxable entities that claim a credit under this subchapter;

(2) the total amount of credits applied against the tax under this chapter and the amount of unused credits including:

(A) the total amount of franchise tax due by taxable entities claiming a credit under this subchapter before and after the application of the credit;

(B) the average percentage reduction in franchise tax due by taxable entities claiming a credit under this subchapter;

(C) the percentage of tax credits that were awarded to taxable entities with fewer than 100 employees; and

(D) the two-digit standard industrial classification of taxable entities claiming a credit under this subchapter;

(3) the geographical distribution of expenses and payments giving rise to a credit authorized by this subchapter;

(4) the effect of the credit provided by this subchapter on the amount of research and development performed in this state and employment in research and development in this state; and

(5) the effect of the credit provided under this subchapter on employment, capital investment, and personal income in this state and on state tax revenues.

(b) Requires that the final report issued prior to the expiration of this subchapter include historical information on the credit authorized under this subchapter.

(c) Prohibits the comptroller from including in the report information that is confidential by law.

(d) Authorizes the comptroller, for purposes of this section, to require a taxable entity that claims a credit under this subchapter to submit information, on a form provided by the comptroller, on the location of the taxable entity's research expenses and payments in this state and any other information necessary to complete the report required by this section.

Sec. 171.748. **COMPTROLLER POWERS AND DUTIES.** Requires the comptroller to adopt rules and forms necessary to implement this subchapter.

Sec. 171.749. **ASSIGNMENT PROHIBITED.** Prohibits a taxable entity from conveying, assigning, or transferring the credit allowed under this subchapter to another entity unless all of the assets of the taxable entity are conveyed, assigned, or transferred in the same transaction.

Sec. 171.750. **EXPIRATION.** (a) Provides that this subchapter expires December 31, 2013.

(b) Provides that the expiration of this subchapter does not affect the carryforward of a credit under Section 171.745 that was accrued before the date this subchapter expires.

SECTION 2. Amends Section 403.030(a), Government Code, as effective April 1, 2009, as follows:

(a) Requires the comptroller, before each regular session of the legislature, for purposes of evaluating the effect on economic development in this state, to collect and make available information that contains a summary of the report required by Section 403.014 (Report on Effect of Certain Tax Provisions) and information on the effect on revenues of

apportionment under Section 171.106 (Apportionment of Margin to This State), Tax Code, rather than revenues of allocation or apportionment under Sections 171.106 and 171.1061, Tax Code, and contains a summary of the reports the comptroller is required to submit by other law to evaluate the effectiveness of Tax Code provisions, including a report required by Section 171.747, rather than including reports required by Sections 171.707, 171.727, 171.759, and 171.809, Tax Code.

SECTION 3. Amends Section 228.153(a)(1), Insurance Code, as effective April 1, 2009, to redefine "strategic investment area."

SECTION 4. Amends Section 313.051(a), Tax Code, to provide that this subchapter applies only to a school district that has territory in a strategic investment area, as defined by Section 171.741, rather than 171.721.

SECTION 5. Makes application of this Act prospective.

SECTION 6. Effective date: January 1, 2010.