

By: Paxton

H.B. No. 4003

A BILL TO BE ENTITLED

AN ACT

relating to the rates and computation of the franchise tax.

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

SECTION 1. Sections 171.002(a), (b), and (d), Tax Code, are amended to read as follows:

(a) Subject to Sections 171.003 and 171.1016 and except as provided by Subsection (b), the rate of the franchise tax is:

(1) for taxable margin of \$1 million or less, zero;

(2) for taxable margin that exceeds \$1 million but does not exceed \$10 million, 0.5 percent of the taxable margin that exceeds \$1 million; and

(3) for taxable margin that exceeds \$10 million, \$45,000 plus one percent of the taxable margin that exceeds \$10 million.

(b) Subject to Sections 171.003 and 171.1016, for those taxable entities primarily engaged in retail or wholesale trade, the rate of the franchise tax is:

(1) for taxable margin of \$1 million or less, zero;

(2) for taxable margin that exceeds \$1 million but does not exceed \$10 million, 0.25 percent of the taxable margin that exceeds \$1 million; and

(3) for taxable margin that exceeds \$10 million, \$22,500 plus 0.5 percent of the taxable margin that exceeds \$10 million ~~[for those taxable entities primarily engaged in retail or~~

1 ~~wholesale trade~~].

2 (d) A taxable entity is not required to pay any tax and is
3 not considered to owe any tax for a period if [+

4 [~~(1)~~] the amount of tax computed for the taxable entity
5 is less than \$5,000 [~~\$1,000, or~~

6 [~~(2) the amount of the taxable entity's total revenue~~
7 ~~from its entire business is less than or equal to \$300,000 or the~~
8 ~~amount determined under Section 171.006 per 12-month period on~~
9 ~~which margin is based~~].

10 SECTION 2. Subchapter A, Chapter 171, Tax Code, is amended
11 by adding Section 171.0023 to read as follows:

12 Sec. 171.0023. TAX LIABILITY OF CERTAIN TAXABLE ENTITIES.

13 (a) In this section, "taxable income" means:

14 (1) for a taxable entity treated for federal income
15 tax purposes as a corporation, the amount reportable as taxable
16 income on line 30, Internal Revenue Service Form 1120;

17 (2) for a taxable entity treated for federal income
18 tax purposes as a partnership, the amount reportable as ordinary
19 business income or loss on line 22, Internal Revenue Service Form
20 1065; or

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

26 (b) Except as provided by Subsection (c), a taxable entity
27 is not required to pay any tax and is not considered to owe any tax

1 for a period if the taxable entity's taxable income for the period
2 is zero or less.

3 (c) Subsection (b) does not apply to a taxable entity that
4 is a member of a combined group.

5 (d) Section 171.1011(a) applies to a reference in this
6 section to an Internal Revenue Service form, and Section
7 171.1011(b) applies to a reference in this section to an amount
8 reportable on a line number on an Internal Revenue Service form.

9 (e) The comptroller shall adopt rules as necessary to
10 accomplish the legislative intent prescribed by this section.

11 SECTION 3. The heading to Section 171.006, Tax Code, is
12 amended to read as follows:

13 Sec. 171.006. ADJUSTMENT OF ELIGIBILITY FOR ~~[NO TAX DUE,~~
14 ~~DISCOUNTS, AND]~~ COMPENSATION DEDUCTION.

15 SECTION 4. Section 171.006(b), Tax Code, is amended to read
16 as follows:

17 (b) On ~~[Beginning in 2010, on]~~ January 1 of each
18 even-numbered year, the amount ~~[amounts]~~ prescribed by Section
19 ~~[Sections 171.002(d)(2), 171.0021, and]~~ 171.1013(c) is ~~[are]~~
20 increased or decreased by an amount equal to the amount prescribed
21 by that section ~~[those sections]~~ on December 31 of the preceding
22 year multiplied by the percentage increase or decrease during the
23 preceding state fiscal biennium in the consumer price index and
24 rounded to the nearest \$10,000.

25 SECTION 5. Section 171.1012, Tax Code, is amended to read as
26 follows:

27 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, live and prerecorded television and radio programs, books, and other similar property embodying words, ideas, concepts, images, or sound, without regard to the means or methods of distribution or the medium in which the property is embodied, for which, as costs are incurred in producing the property, it is intended or is reasonably likely that any 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 follows:

(1) for a taxable entity treated for federal income tax purposes as a corporation, the cost of goods sold is the amount reportable as cost of goods sold on line 2, Internal Revenue Service Form 1120;

(2) for a taxable entity treated for federal income tax purposes as a partnership, the cost of goods sold is the amount reportable as cost of goods sold on line 2, Internal Revenue Service Form 1065;

(3) for a taxable entity treated for federal income tax purposes as an S corporation, the cost of goods sold is the amount reportable as cost of goods sold on line 2, Internal Revenue Service Form 1120S; or

(4) for any other taxable entity, the cost of goods sold is an amount determined in a manner substantially equivalent to the amount for Subdivision (1), (2), or (3) determined by rules the comptroller shall adopt [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, reported on the federal income tax return on which the report under this chapter is based, 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~~

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

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

10 ~~[(1) deterioration of the goods;~~

11 ~~[(2) obsolescence of the goods;~~

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

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

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

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

24 ~~[(7) the cost of insurance on the produced goods;~~

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

27 ~~[(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~~

1 ~~the goods;~~

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

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

9 ~~[(12) officers' compensation;~~

10 ~~[(13) costs of operation of a facility that is:~~

11 ~~[(A) located on property owned or leased by the~~
12 ~~federal government; and~~

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

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

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

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

23 ~~[(f) A taxable entity may subtract as a cost of goods sold~~
24 ~~indirect or administrative overhead costs, including all mixed~~
25 ~~service costs, such as security services, legal services, data~~
26 ~~processing services, accounting services, personnel operations,~~
27 ~~and general financial planning and financial management costs, that~~

1 ~~it can demonstrate are allocable to the acquisition or production~~
2 ~~of goods, except that the amount subtracted may not exceed four~~
3 ~~percent of the taxable entity's total indirect or administrative~~
4 ~~overhead costs, including all mixed service costs. Any costs~~
5 ~~excluded under Subsection (c) may not be subtracted under this~~
6 ~~subsection.~~

7 ~~[(g) A taxable entity that is allowed a subtraction by this~~
8 ~~section for a cost of goods sold and that is subject to Section~~
9 ~~263A, 460, or 471, Internal Revenue Code, may capitalize that cost~~
10 ~~in the same manner and to the same extent that the taxable entity~~
11 ~~capitalized that cost on its federal income tax return or may~~
12 ~~expense those costs, except for costs excluded under Subsection~~
13 ~~(c), or in accordance with Subsections (c), (d), and (f). If the~~
14 ~~taxable entity elects to capitalize costs, it must capitalize each~~
15 ~~cost allowed under this section that it capitalized on its federal~~
16 ~~income tax return. If the taxable entity later elects to begin~~
17 ~~expensing a cost that may be allowed under this section as a cost of~~
18 ~~goods sold, the entity may not deduct any cost in ending inventory~~
19 ~~from a previous report. If the taxable entity elects to expense a~~
20 ~~cost of goods sold that may be allowed under this section, a cost~~
21 ~~incurred before the first day of the period on which the report is~~
22 ~~based may not be subtracted as a cost of goods sold. If the taxable~~
23 ~~entity elects to expense a cost of goods sold and later elects to~~
24 ~~capitalize that cost of goods sold, a cost expensed on a previous~~
25 ~~report may not be capitalized.~~

26 ~~[(h) A taxable entity shall determine its cost of goods~~
27 ~~sold, except as otherwise provided by this section, in accordance~~

~~with the methods used on the federal income tax return on which the report under this chapter is based. 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, other than an entity primarily engaged in an activity described by category 5932 of the 1987 Standard Industrial Classification Manual published by the federal Office of Management and Budget, may subtract as a cost of goods sold an amount equal to interest expense. For purposes of this subsection, an entity engaged in lending to unrelated parties solely for agricultural production offers loans to the public.]~~

~~[(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.]~~

~~[(1) 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.]~~

~~[(o) If a taxable entity, including a taxable entity with respect to which cost of goods sold is determined pursuant to Section 171.1014(e)(1), whose principal business activity is film or television production or broadcasting or the distribution of tangible personal property described by Subsection (a)(3)(A)(ii), or any combination of these activities, elects to subtract cost of goods sold, the cost of goods sold for the taxable entity shall be the costs described in this section in relation to the property and include depreciation, amortization, and other expenses directly related to the acquisition, production, or use of the property, including expenses for the right to broadcast or use the property.]~~

SECTION 6. Section 171.1013, Tax Code, is amended by adding Subsection (i) to read as follows:

(i) Subject to Section 171.1014 and the limitation in Subsection (c), a taxable entity that elects to subtract compensation for the purpose of computing its taxable margin under

1 Section 171.101 may include as wages and cash compensation any
2 compensation paid to an independent contractor as reported on
3 Internal Revenue Service Form 1099, or any subsequent form with a
4 different number or designation that substantially provides the
5 same information.

6 SECTION 7. Section 171.1015(d), Tax Code, is amended to
7 read as follows:

8 (d) Section 171.002(d) does not apply to an upper tier
9 entity if, before the attribution of any total revenue by a lower
10 tier entity to an upper tier entity under this section, the lower
11 tier entity does not meet the criteria of Section 171.002(d)
12 ~~[171.002(d)(1) or (d)(2)]~~.

13 Effective January 1, 2011, Section 171.103(b), Tax Code, is
14 amended to read as follows:

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

19 Effective January 1, 2011, Section 171.1055(b), Tax Code, is
20 amended to read as follows:

21 (b) In apportioning margin, receipts derived from
22 transactions between individual members of a combined group that
23 are excluded under Section 171.1014(c)(3) may not be included in
24 the receipts of the taxable entity from its business done in this
25 state as determined under Section 171.103~~[, except that receipts~~
26 ~~ultimately derived from the sale of tangible personal property~~
27 ~~between individual members of a combined group where one member~~

1 ~~party to the transaction does not have nexus in this state shall be~~
2 ~~included in the receipts of the taxable entity from its business~~
3 ~~done in this state as determined under Section 171.103 to the extent~~
4 ~~that the member of the combined group that does not have nexus in~~
5 ~~this state resells the tangible personal property without~~
6 ~~substantial modification to a purchaser in this state. "Receipts~~
7 ~~ultimately derived from the sale" means the amount paid for the~~
8 ~~tangible personal property by the third party purchaser].~~

9 SECTION 8. Section 171.204(b), Tax Code, is amended to read
10 as follows:

11 (b) The comptroller may require a taxable entity that does
12 not owe any tax because of the application of Section 171.0023
13 ~~[171.002(d)(2)]~~ to file an abbreviated information report with the
14 comptroller stating the amount of the taxable entity's taxable
15 income as defined by that section ~~[total revenue from its entire~~
16 ~~business]~~. The comptroller may not require a taxable entity
17 described by this subsection to file an information report that
18 requires the taxable entity to report or compute its margin.

19 SECTION 9. Sections 171.0021, 171.1016(d), and 171.103(c)
20 and (d), Tax Code, are repealed.

21 SECTION 10. This Act applies only to a report originally due
22 on or after the effective date of this Act.

23 SECTION 11. Except as otherwise provided by this Act, this
24 Act takes effect January 1, 2010.