

BILL ANALYSIS

C.S.H.B. 800
By: Murphy
Economic & Small Business Development
Committee Report (Substituted)

BACKGROUND AND PURPOSE

According to interested parties, research and development activity creates high-paying jobs that provide substantial benefit to the Texas economy, new technologies and applications that generate economic efficiency and growth, and partnerships with institutions of higher education that expand opportunities for innovation and learning. These interested parties contend, however, that research and development in Texas has lagged behind other states in recent years to the point that Texas' share of the national expenditures for research and development is smaller than the state's share of the overall national economy, which these parties correlate to the removal of a tax credit for research and development. The parties cite a recent study that estimates that the lack of a research and development tax credit in Texas has cost the state more than \$3 billion annually and more than 20,000 jobs.

C.S.H.B. 800 seeks to make Texas economically competitive in the field of research and development by establishing a tax credit for research and development and consequently encouraging new investments, promoting the creation of high-paying jobs, and complementing Texas' manufacturing industries through innovation and efficiency.

RULEMAKING AUTHORITY

It is the committee's opinion that rulemaking authority is expressly granted to the comptroller of public accounts in SECTION 3 of this bill.

ANALYSIS

C.S.H.B. 800 amends the Tax Code to exempt from the sales and use tax the sale, storage, or use of depreciable tangible personal property directly used in qualified research if the property is sold, leased, or rented to, or stored or used by a person who is engaged in qualified research and will not, as a taxable entity or as a member of a combined group that is a taxable entity, claim a tax credit for research and development (R&D) activities on a franchise tax report for the period during which the sale, storage, or use occurs. The bill defines "depreciable tangible personal property" as tangible personal property that has a useful life of more than one year and is subject to depreciation under generally accepted accounting principles or the federal Internal Revenue Code.

C.S.H.B. 800 requires the comptroller of public accounts, before the beginning of each regular session of the legislature, to submit to the legislature and the governor estimates of both the total number of persons who received such exemptions from the sales and use tax and the total amount of those exemptions and an evaluation of the effect of those exemptions in combination with the R&D tax credit authorized by the bill's provisions on the amount of qualified research performed in Texas, R&D employment in Texas, economic activity in Texas, and state tax revenues. The bill authorizes the comptroller to require a person who receives such an exemption to complete a form to provide the information necessary for the comptroller to make that evaluation. The bill establishes that the information provided on the form is confidential and not subject to disclosure under the state public information law. The bill requires the comptroller to

provide the estimates and evaluation as part of the comptroller's biannual report to the legislature and the governor on the effect of certain tax provisions.

C.S.H.B. 800 makes a taxable entity eligible for a credit against the franchise tax for any tax report in an amount equal to five percent of the difference between the qualified research expenses, as defined by the federal Internal Revenue Code, incurred by the entity for research conducted in Texas during the period on which the report is based and 50 percent of the average amount of qualified research expenses incurred during the three tax periods preceding the period on which the report is based. The bill provides for an alternate calculation of the amount of that R&D tax credit under the following circumstances:

- If the taxable entity contracts with one or more public or private institutions of higher education for the performance of qualified research and the taxable entity incurred qualified research expenses in Texas under the contract during the period on which the report is based, the amount of the credit for that report is 6.25 percent of the difference between all qualified research expenses incurred during the period on which the report is based and 50 percent of the average amount of all qualified research expenses incurred during the three tax periods preceding the period on which the report is based.
- If the taxable entity has no qualified research expenses in one or more of the three tax periods preceding the period on which the report is based, the amount of the credit for that report is 2.5 percent of the qualified research expenses incurred during that period.
- If the taxable entity contracts with one or more public or private institutions of higher education for the performance of qualified research and the taxable entity incurred qualified research expenses in Texas under the contract during the period on which the report is based but has no qualified research expenses in one or more of the three tax periods preceding the period on which the report is based, the amount of the credit is 3.125 percent of all qualified research expenses incurred during that period.

C.S.H.B. 800 makes a taxable entity ineligible for a franchise tax credit on a tax report for qualified research expenses incurred during the period on which the report is based if the entity, or a member of the combined group if the taxable entity is a combined group, received a sales and use tax exemption during that period, but the ineligibility expressly does not affect the taxable entity's eligibility to claim a carryforward of unused credit on that report.

C.S.H.B. 800 requires the determination of which research expenses are qualified research expenses for purposes of computing the average amount of those expenses to be made in the same manner as such a determination for purposes of computing the expenses incurred during the period on which a tax report is based. The bill exempts from this requirement a credit to which a taxable entity was entitled under prior law relating to a credit for R&D activities as those provisions existed before January 1, 2008. The bill authorizes the comptroller to adopt rules for determining which research expenses are qualified research expenses to prevent disparities in those determinations that may result from the taxable entity using different accounting methods for the period on which the report is based, as compared to any preceding tax periods used in determining the average amount of qualified research expenses.

C.S.H.B. 800 sets out provisions relating to the attribution of a taxable entity's qualified research expenses if the taxable entity acquires a controlling interest in another taxable entity or in a separate unit of another taxable entity during a tax period with respect to which the acquiring taxable entity claims a franchise tax credit and sets out provisions relating to the transferring or selling entity's eligibility to claim a credit for qualified research expenses for a period during which the transfer or sale occurs.

C.S.H.B. 800 requires a franchise tax credit for qualified research expenses incurred by a member of a combined group to be claimed on the combined report required for the group, and establishes that the combined group is the taxable entity for purposes of the bill's provisions. The bill authorizes an upper tier entity that includes the total revenue of a lower tier entity for

purposes of computing its taxable margin to claim such a credit for qualified research expenses incurred by the lower tier entity to the extent of the upper tier entity's ownership interest in the lower tier entity.

C.S.H.B. 800 places the burden of establishing entitlement to and the value of the credit on the taxable entity and limits the total credit claimed for a report, including the amount of any carryforward credit, to 50 percent of the amount of franchise tax due for the report before any other applicable tax credits. The bill authorizes a taxable entity that is eligible for a credit that exceeds the limit to carry the unused credit forward until all of the credit has been claimed.

C.S.H.B. 800 prohibits a taxable entity from conveying, assigning, or transferring the franchise tax credit to another entity unless all of the assets of the taxable entity are conveyed, assigned, or transferred in the same transaction and requires a taxable entity to apply for the credit on or with the report for the period for which the credit is claimed.

C.S.H.B. 800 requires the comptroller to adopt rules and forms necessary to implement the bill's provisions authorizing a credit against the franchise tax.

C.S.H.B. 800 requires the comptroller, before the beginning of each regular session of the legislature, to submit to the legislature and the governor estimates of the total number of taxable entities that applied credits for the applicable research and development activities against the franchise tax, the total amount of those credits, and the total amount of unused credits carried forward. The bill authorizes the comptroller to require a taxable entity that claims a franchise tax credit to complete a form to provide the information necessary for the comptroller to make the evaluations required by the bill's provisions relating to the effect of the sales and use tax exemptions in combination with the franchise tax credit. The bill specifies that the information provided on the form is confidential and not subject to disclosure under the state public information law. The bill requires the comptroller to provide the estimates as part of the comptroller's biannual report to the legislature and the governor on the effect of certain tax provisions.

C.S.H.B. 800 requires the comptroller to submit the initial estimates of the total number of persons who received the sales and use tax exemptions under the bill's provisions, an estimate of the total amount of those exemptions, and the estimates relating to the franchise tax credits before the 84th Regular Legislative Session commences in January 2015. The bill specifies that the comptroller is not required to submit the initial evaluation required by the bill's provisions relating to the effect of the sales and use tax exemptions in combination with the franchise tax credit until January 2017, but requires the comptroller to submit that evaluation before the 85th Regular Legislative Session commences.

EFFECTIVE DATE

January 1, 2014.

COMPARISON OF ORIGINAL AND SUBSTITUTE

While C.S.H.B. 800 may differ from the original in minor or nonsubstantive ways, the following comparison is organized and highlighted in a manner that indicates the substantial differences between the introduced and committee substitute versions of the bill.

INTRODUCED

SECTION 1. LEGISLATIVE FINDINGS AND PURPOSES. (a) The legislature finds that:
(1) Texas economic activity accounts for

HOUSE COMMITTEE SUBSTITUTE

SECTION 1. Same as introduced version.

more than eight percent of the economic activity in the United States, but accounts for only five percent of research and development spending in the United States;

(2) research and development activities create:

(A) high-paying jobs that provide substantial benefits to the Texas economy; and

(B) new technologies and applications that generate economic efficiency and growth; and

(3) private-sector research and development activities create partnerships between private-sector entities and institutions of higher education, and those partnerships expand opportunities for innovation and learning.

(b) Based on the findings specified in Subsection (a) of this section, the purposes of this Act are to:

(1) make Texas economically competitive in the field of research and development;

(2) reduce the tax burden on research and development activities in Texas and encourage new investments in this state;

(3) promote the creation of new, highly skilled, high-paying jobs in Texas; and

(4) complement this state's manufacturing industries by encouraging innovation and efficiency in applying new technologies and producing new products.

SECTION 2. SALES AND USE TAX EXEMPTION. Subchapter H, Chapter 151, Tax Code, is amended by adding Section 151.3182 to read as follows:

Sec. 151.3182. CERTAIN PROPERTY AND SERVICES USED IN RESEARCH AND DEVELOPMENT ACTIVITIES. (a)

In this section:

(1) "Internal Revenue Code" has the meaning assigned by Section 171.651.

(2) "Qualified research" and "qualified

SECTION 2. SALES AND USE TAX EXEMPTION. Subchapter H, Chapter 151, Tax Code, is amended by adding Section 151.3182 to read as follows:

Sec. 151.3182. CERTAIN PROPERTY USED IN RESEARCH AND DEVELOPMENT ACTIVITIES;

REPORTING OF ESTIMATES AND EVALUATION. (a) In this section:

(1) "Depreciable tangible personal property" means tangible personal property that:

(A) has a useful life that exceeds one year; and

(B) is subject to depreciation under:

(i) generally accepted accounting principles; or

(ii) Section 167 or 168, Internal Revenue Code.

(2) "Internal Revenue Code" has the meaning assigned by Section 171.651.

(3) "Qualified research" has the meaning

service" have the meanings assigned by Section 41, Internal Revenue Code.

(b) The sale, storage, use, or other consumption of tangible personal property directly used or consumed in qualified research or of qualified services is exempted from the taxes imposed by this chapter if the property or services are sold, leased, or rented to, or stored, used, or consumed by, a person who:

- (1) is engaged in qualified research; and
- (2) will not, as a taxable entity as defined by Section 171.0002 or as a member of a combined group that is a taxable entity, claim a credit under Subchapter M, Chapter 171, on a franchise tax report for the period during which the sale, storage, use, or other consumption occurs.

SECTION 3. FRANCHISE TAX CREDIT. Chapter 171, Tax Code, is amended by adding Subchapter M to read as follows:

SUBCHAPTER M. TAX CREDIT FOR

83R 25230

Substitute Document Number: 83R 19701

assigned by Section 41, Internal Revenue Code.

(b) The sale, storage, or use of depreciable tangible personal property directly used in qualified research is exempted from the taxes imposed by this chapter if the property is sold, leased, or rented to, or stored or used by, a person who:

- (1) is engaged in qualified research; and
- (2) will not, as a taxable entity as defined by Section 171.0002 or as a member of a combined group that is a taxable entity, claim a credit under Subchapter M, Chapter 171, on a franchise tax report for the period during which the sale, storage, or use occurs.

(c) Before the beginning of each regular session of the legislature, the comptroller shall submit to the legislature and the governor:

(1) an estimate of the total number of persons who received exemptions under this section and an estimate of the total amount of those exemptions; and

(2) an evaluation of the effect of the exemption under this section, in combination with the credit authorized by Subchapter M, Chapter 171, on:

(A) the amount of qualified research performed in this state;

(B) employment in research and development in this state;

(C) economic activity in this state; and

(D) state tax revenues.

(d) The comptroller may require a person who receives an exemption under this section to complete a form to provide the information necessary for the comptroller to make the evaluation required by Subsection (c)(2). The information provided on the form is confidential and not subject to disclosure under Chapter 552, Government Code.

(e) The comptroller shall provide the estimates and evaluation required by Subsection (c) as part of the report required by Section 403.014, Government Code.

SECTION 3. FRANCHISE TAX CREDIT. Chapter 171, Tax Code, is amended by adding Subchapter M to read as follows:

SUBCHAPTER M. TAX CREDIT FOR

13.115.284

CERTAIN RESEARCH AND DEVELOPMENT ACTIVITIES

Sec. 171.651. DEFINITIONS. In this subchapter:

(1) "Internal Revenue Code" means the Internal Revenue Code of 1986 in effect on December 31, 2011, excluding any changes made by federal law after that date, but including any regulations adopted under that code applicable to the tax year to which the provisions of the code in effect on that date applied.

(2) "Qualified research" has the meaning assigned by Section 41, Internal Revenue Code, except that the research must be conducted in this state.

(3) "Qualified research expense" has the meaning assigned by Section 41, Internal Revenue Code, except that the expense must be for research conducted in this state.

Sec. 171.652. ELIGIBILITY FOR CREDIT.

Sec. 171.653. INELIGIBILITY FOR CREDIT FOR CERTAIN PERIODS.

Sec. 171.654. AMOUNT OF CREDIT. (a) Except as provided by Subsection (b), the credit for any report equals five percent of the difference between:

(1) the qualified research expenses incurred during the period on which the report is based, subject to Section 171.655; and

(2) 50 percent of the average amount of qualified research expenses incurred during the three tax periods preceding the period on which the report is based, subject to Section 171.655.

CERTAIN RESEARCH AND DEVELOPMENT ACTIVITIES

Sec. 171.651. DEFINITIONS. In this subchapter:

(1) "Internal Revenue Code" means the Internal Revenue Code of 1986 in effect on December 31, 2011, excluding any changes made by federal law after that date, but including any regulations adopted under that code applicable to the tax year to which the provisions of the code in effect on that date applied.

(2) "Public or private institution of higher education" means:

(A) an institution of higher education, as defined by Section 61.003, Education Code;

or
(B) a private or independent institution of higher education, as defined by Section 61.003, Education Code.

(3) "Qualified research" has the meaning assigned by Section 41, Internal Revenue Code, except that the research must be conducted in this state.

(4) "Qualified research expense" has the meaning assigned by Section 41, Internal Revenue Code, except that the expense must be for research conducted in this state.

Sec. 171.652. ELIGIBILITY FOR CREDIT.

Sec. 171.653. INELIGIBILITY FOR CREDIT FOR CERTAIN PERIODS.

Sec. 171.654. AMOUNT OF CREDIT. (a) Except as provided by Subsections (b), (c), and (d), the credit for any report equals five percent of the difference between:

(1) the qualified research expenses incurred during the period on which the report is based, subject to Section 171.655; and

(2) 50 percent of the average amount of qualified research expenses incurred during the three tax periods preceding the period on which the report is based, subject to Section 171.655.

(b) If the taxable entity contracts with one or more public or private institutions of higher education for the performance of qualified research and the taxable entity has qualified research expenses incurred in this state by the taxable entity under the contract during the period on which the report is based, the credit for the report equals 6.25

(b) If the taxable entity has no qualified research expenses in one or more of the three tax periods preceding the period on which the report is based, the credit for the period on which the report is based equals 2.5 percent of the qualified research expenses incurred during that period.

(c) Notwithstanding whether the time for claiming a credit under this subchapter has expired for any tax period used in determining the average amount of qualified research expenses under Subsection (a)(2), the determination of which research expenses are qualified research expenses for purposes of computing that average must be made in the same manner as that determination is made for purposes of Subsection (a)(1).

This subsection does not apply to a credit to which a taxable entity was entitled under Subchapter O, as that subchapter existed before January 1, 2008.

(d) The comptroller may adopt rules for determining which research expenses are qualified research expenses for purposes of Subsection (a) to prevent disparities in those determinations that may result from the taxable entity using different accounting methods for the period on which the report is based, as compared to any preceding tax periods used in determining the average amount of qualified research expenses under

percent of the difference between:

(1) all qualified research expenses incurred during the period on which the report is based, subject to Section 171.655; and

(2) 50 percent of the average amount of all qualified research expenses incurred during the three tax periods preceding the period on which the report is based, subject to Section 171.655.

(c) Except as provided by Subsection (d), if the taxable entity has no qualified research expenses in one or more of the three tax periods preceding the period on which the report is based, the credit for the period on which the report is based equals 2.5 percent of the qualified research expenses incurred during that period.

(d) If the taxable entity contracts with one or more public or private institutions of higher education for the performance of qualified research and the taxable entity has qualified research expenses incurred in this state by the taxable entity under the contract during the period on which the report is based, but has no qualified research expenses in one or more of the three tax periods preceding the period on which the report is based, the credit for the period on which the report is based equals 3.125 percent of all qualified research expenses incurred during that period.

(e) Notwithstanding whether the time for claiming a credit under this subchapter has expired for any tax period used in determining the average amount of qualified research expenses under Subsection (a)(2) or (b)(2), the determination of which research expenses are qualified research expenses for purposes of computing that average must be made in the same manner as that determination is made for purposes of Subsection (a)(1) or (b)(1).

This subsection does not apply to a credit to which a taxable entity was entitled under Subchapter O, as that subchapter existed before January 1, 2008.

(f) The comptroller may adopt rules for determining which research expenses are qualified research expenses for purposes of Subsection (a) or (b) to prevent disparities in those determinations that may result from the taxable entity using different accounting methods for the period on which the report is based, as compared to any preceding tax periods used in determining the average amount of qualified research expenses under

Subsection (a)(2).

Sec. 171.655. ATTRIBUTION OF EXPENSES FOLLOWING TRANSFER OF CONTROLLING INTEREST.

Sec. 171.656. COMBINED REPORTING.

(a) A credit under this subchapter for qualified research expenses incurred by a member of a combined group must be claimed on the combined report required by Section 171.1014 for the group.

(b) An upper tier entity that includes the total revenue of a lower tier entity for purposes of computing its taxable margin as authorized by Section 171.1015 may claim the credit under this subchapter for qualified research expenses incurred by the lower tier entity to the extent of the upper tier entity's ownership interest in the lower tier entity.

Sec. 171.657. BURDEN OF ESTABLISHING CREDIT.

Sec. 171.658. LIMITATIONS.

Sec. 171.659. CARRYFORWARD.

Sec. 171.660. ASSIGNMENT PROHIBITED.

Sec. 171.661. APPLICATION FOR CREDIT.

Sec. 171.662. RULES.

No equivalent provision.

Subsection (a)(2) or (b)(2).

Sec. 171.655. ATTRIBUTION OF EXPENSES FOLLOWING TRANSFER OF CONTROLLING INTEREST.

Sec. 171.656. COMBINED REPORTING.

(a) A credit under this subchapter for qualified research expenses incurred by a member of a combined group must be claimed on the combined report required by Section 171.1014 for the group, and the combined group is the taxable entity for purposes of this subchapter.

(b) An upper tier entity that includes the total revenue of a lower tier entity for purposes of computing its taxable margin as authorized by Section 171.1015 may claim the credit under this subchapter for qualified research expenses incurred by the lower tier entity to the extent of the upper tier entity's ownership interest in the lower tier entity.

Sec. 171.657. BURDEN OF ESTABLISHING CREDIT.

Sec. 171.658. LIMITATIONS.

Sec. 171.659. CARRYFORWARD.

Sec. 171.660. ASSIGNMENT PROHIBITED.

Sec. 171.661. APPLICATION FOR CREDIT.

Sec. 171.662. RULES.

Sec. 171.663. REPORTING OF ESTIMATES AND COLLECTION OF INFORMATION. (a) Before the beginning of each regular session of the legislature, the comptroller shall submit to the legislature and the governor estimates of:

- (1) the total number of taxable entities that applied credits under this subchapter against the tax imposed under this chapter;
- (2) the total amount of those credits; and
- (3) the total amount of unused credits carried forward.

(b) The comptroller may require a taxable entity that claims a credit under this subchapter to complete a form to provide the information necessary for the comptroller to make the evaluations required by Section 151.3182. The

information provided on the form is confidential and not subject to disclosure under Chapter 552, Government Code.

(c) The comptroller shall provide the estimates required by this section as part of the report required by Section 403.014, Government Code.

No equivalent provision.

SECTION 4. INITIAL REPORTING OF INFORMATION. The comptroller of public accounts shall submit the initial estimates required by Sections 151.3182(c)(1) and 171.663, Tax Code, as added by this Act, before the 84th Regular Legislative Session commences in January 2015. Notwithstanding Section 151.3182(c)(2), Tax Code, as added by this Act, the comptroller is not required to submit the initial evaluation required by that section until January 2017, but shall submit that evaluation before the 85th Regular Legislative Session commences.

SECTION 4. TRANSITION PROVISION. Section 151.3182, Tax Code, as added by this Act, does not affect tax liability accruing before the effective date of this Act. That liability continues in effect as if this Act had not been enacted, and the former law is continued in effect for the collection of taxes due and for civil and criminal enforcement of the liability for those taxes.

SECTION 5. Same as introduced version.

SECTION 5. APPLICABILITY. Subchapter M, Chapter 171, Tax Code, as added by this Act, applies only to a report originally due on or after January 1, 2014.

SECTION 6. APPLICABILITY. Subchapter M, Chapter 171, Tax Code, as added by this Act, applies only to a report originally due on or after the effective date of this Act.

SECTION 6. EFFECTIVE DATE. This Act takes effect October 1, 2013.

SECTION 7. EFFECTIVE DATE. This Act takes effect January 1, 2014.