

BILL ANALYSIS

Senate Research Center
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S.B. 859
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AUTHOR'S / SPONSOR'S STATEMENT OF INTENT

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, and they cite a recent study placing the cost of the lack of a research and development tax credit in Texas at more than \$3 billion annually and more than 20,000 jobs.

S.B. 859 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.

As proposed, S.B. 859 amends current law relating to a sales and use tax exemption and a franchise tax credit related to certain research and development activities.

RULEMAKING AUTHORITY

Rulemaking authority is expressly granted to comptroller of public accounts of the State of Texas in SECTION 3 (Sections 171.654 and 171.662, Tax Code) of this bill.

SECTION BY SECTION ANALYSIS

SECTION 1. LEGISLATIVE FINDINGS AND PURPOSES. (a) Provides that the legislature finds that:

- (1) Texas economic activity accounts for 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) Provides that, 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. Amends Subchapter H, Chapter 151, Tax Code, by adding Section 151.3182, as follows:

Sec. 151.3182. CERTAIN PROPERTY AND SERVICES USED IN RESEARCH AND DEVELOPMENT ACTIVITIES. (a) Defines "Internal Revenue Code" and "qualified research" and "qualified service" in this section.

(b) Provides that 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 (Definition of Taxable Entity) or as a member of a combined group that is a taxable entity, claim a credit under Subchapter M, Chapter 171 (Franchise Tax), on a franchise tax report for the period during which the sale, storage, use, or other consumption occurs.

SECTION 3. FRANCHISE TAX CREDIT. Amends Chapter 171, Tax Code, by adding Subchapter M, as follows:

SUBCHAPTER M. TAX CREDIT FOR CERTAIN RESEARCH AND DEVELOPMENT ACTIVITIES

Sec. 171.651. DEFINITIONS. Defines "Internal Revenue Code," "qualified research," and "qualified research expense" in this subchapter.

Sec. 171.652. ELIGIBILITY FOR CREDIT. 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.

Sec. 171.653. INELIGIBILITY FOR CREDIT FOR CERTAIN PERIODS. (a) Provides that a taxable entity is not eligible for a credit on a report against the tax imposed under this chapter for qualified research expenses incurred during the period on which the report is based if the taxable entity, or a member of the combined group if the taxable entity is a combined group, received an exemption under Section 151.3182 during that period.

(b) Provides that a taxable entity's ineligibility under this section for a credit on a report for the period on which the report is based does not affect the taxable entity's eligibility to claim a carryforward of unused credit under Section 171.659 on that report.

Sec. 171.654. AMOUNT OF CREDIT. (a) Provides that, 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.

(b) Provides that 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) Requires that the determination of which research expenses are qualified research expenses for purposes of computing that average, 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), be made in the same manner as that determination is made for purposes of Subsection (a)(1). Provides that this subsection does not apply to a credit to which a taxable entity was entitled under Subchapter O (Tax Credit for Certain Research and Development Activities), as that subchapter existed before January 1, 2008.

(d) Authorizes the comptroller of public accounts of the State of Texas (comptroller) to 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 Subsection (a)(2).

Sec. 171.655. **ATTRIBUTION OF EXPENSES FOLLOWING TRANSFER OF CONTROLLING INTEREST.** (a) Provides that if a 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 credit under this subchapter, the amount of the acquiring taxable entity's qualified research expenses equals the sum of:

- (1) the amount of qualified research expenses incurred by the acquiring taxable entity during the period on which the report is based; and
- (2) subject to Subsection (d), the amount of qualified research expenses incurred by the acquired taxable entity or unit during the portion of the period on which the report is based that precedes the date of the acquisition.

(b) Prohibits a taxable entity that sells or otherwise transfers to another taxable entity a controlling interest in another taxable entity or in a separate unit of a taxable entity during a period on which a report is based from claiming a credit under this subchapter for qualified research expenses incurred by the transferred taxable entity or unit during the period if the taxable entity is ineligible for the credit under Section 171.653 or if the acquiring taxable entity claims a credit under this subchapter for the corresponding period.

(c) Provides that if during any of the three tax periods following the tax period in which a sale or other transfer described by Subsection (b) occurs, the taxable entity that sold or otherwise transferred the controlling interest reimburses the acquiring taxable entity for research activities conducted on behalf of the taxable entity that made the sale or other transfer, the amount of the reimbursement is:

(1) subject to Subsection (e), included as qualified research expenses incurred by the taxable entity that made the sale or other transfer for the tax period during which the reimbursement was paid; and

(2) excluded from the qualified research expenses incurred by the acquiring taxable entity for the tax period during which the reimbursement was paid.

(d) Prohibits an acquiring taxable entity from including on a report the amount of qualified research expenses otherwise authorized by Subsection (a)(2) to be included if the taxable entity that made the sale or other transfer described by Subsection (b) received an exemption under Section 151.3182 during the portion of the period on which the acquiring taxable entity's report is based that precedes the date of the acquisition.

(e) Prohibits a taxable entity that makes a sale or other transfer described by Subsection (b) from including on a report the amount of reimbursement otherwise authorized by Subsection (c)(1) to be included if the reimbursement is for research activities that occurred during a tax period under this chapter during which that taxable entity received an exemption under Section 151.3182.

Sec. 171.656. **COMBINED REPORTING.** (a) Requires that a credit under this subchapter for qualified research expenses incurred by a member of a combined group be claimed on the combined report required by Section 171.1014 (Combined Reporting; Affiliated Group Engaged in Unitary Business) for the group.

(b) Authorizes 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 (Reporting for Certain Partnerships in Tiered Partnership Arrangement) to 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.** Provides that the burden of establishing entitlement to and the value of the credit is on the taxable entity.

Sec. 171.658. **LIMITATIONS.** Prohibits the total credit claimed under this subchapter for a report, including the amount of any carryforward credit under Section 171.659, from exceeding 50 percent of the amount of franchise tax due for the report before any other applicable tax credits.

Sec. 171.659. **CARRYFORWARD.** Authorizes a taxable entity, if the taxable entity is eligible for a credit that exceeds the limitation under Section 171.658, to carry the unused credit forward until all of the credit has been claimed. Provides that credits and credit carryforwards are considered to be used in the following order:

(1) a credit carryforward from a previous report; and

(2) a current year credit.

Sec. 171.660. **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. 171.661. **APPLICATION FOR CREDIT.** Requires a taxable entity to apply for a credit under this subchapter on or with the tax report for the period for which the credit is claimed.

Sec. 171.662. RULES. Requires the comptroller to adopt rules and forms necessary to implement this subchapter.

SECTION 4. TRANSITION PROVISION. Makes application of Section 151.3182, Tax Code, as added by this Act, prospective.

SECTION 5. APPLICABILITY. Provides that 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. EFFECTIVE DATE. Effective date: October 1, 2013.