

By: Taylor

H.B. No. 900

A BILL TO BE ENTITLED

AN ACT

relating to the determination of cost of goods sold for purposes of computing the franchise tax.

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

SECTION 1. Section 171.1012, Tax Code, is amended to read as follows:

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~~

1 ~~mass-distributed by the creator or any one or more third parties in~~  
2 ~~a form that is not substantially altered, and~~

3 ~~[(iii) a computer program, as defined by~~  
4 ~~Section 151.0031.~~

5 ~~[(B) "Tangible personal property" does not~~  
6 ~~include:~~

7 ~~[(i) intangible property, or~~

8 ~~[(ii) services.~~

9 ~~[(b)]~~ Subject to Section 171.1014, a taxable entity that  
10 elects to subtract cost of goods sold for the purpose of computing  
11 its taxable margin shall determine the amount of that cost of goods  
12 sold as follows:

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

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

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

25 (4) for any other taxable entity, the cost of goods  
26 sold is an amount determined in a manner substantially equivalent  
27 to the amount for Subdivision (1), (2), or (3) determined by rules

1 the comptroller shall adopt [~~as provided by this section~~].

2 [~~(c) The cost of goods sold includes all direct costs of~~  
3 ~~acquiring or producing the goods, including:~~

4 [~~(1) labor costs,~~

5 [~~(2) cost of materials that are an integral part of~~  
6 ~~specific property produced,~~

7 [~~(3) cost of materials that are consumed in the~~  
8 ~~ordinary course of performing production activities,~~

9 [~~(4) handling costs, including costs attributable to~~  
10 ~~processing, assembling, repackaging, and inbound transportation~~  
11 ~~costs,~~

12 [~~(5) storage costs, including the costs of carrying,~~  
13 ~~storing, or warehousing property, subject to Subsection (c),~~

14 [~~(6) depreciation, depletion, and~~  
15 ~~amortization, reported on the federal income tax return on which~~  
16 ~~the report under this chapter is based, to the extent associated~~  
17 ~~with and necessary for the production of goods, including recovery~~  
18 ~~described by Section 197, Internal Revenue Code,~~

19 [~~(7) the cost of renting or leasing equipment,~~  
20 ~~facilities, or real property directly used for the production of~~  
21 ~~the goods, including pollution control equipment and intangible~~  
22 ~~drilling and dry hole costs,~~

23 [~~(8) the cost of repairing and maintaining equipment,~~  
24 ~~facilities, or real property directly used for the production of~~  
25 ~~the goods, including pollution control devices,~~

26 [~~(9) costs attributable to research, experimental,~~  
27 ~~engineering, and design activities directly related to the~~

1 ~~production of the goods, including all research or experimental~~  
2 ~~expenditures described by Section 174, Internal Revenue Code,~~

3 ~~[(10) geological and geophysical costs incurred to~~  
4 ~~identify and locate property that has the potential to produce~~  
5 ~~minerals;~~

6 ~~[(11) taxes paid in relation to acquiring or producing~~  
7 ~~any material, or taxes paid in relation to services that are a~~  
8 ~~direct cost of production;~~

9 ~~[(12) the cost of producing or acquiring electricity~~  
10 ~~sold; and~~

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

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

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

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

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

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

1           ~~[(5) postproduction direct costs allocable to the~~  
2 ~~property, including storage and handling costs, as provided by~~  
3 ~~Subsections (c)(4) and (c)(5),~~

4           ~~[(6) the cost of insurance on a plant or a facility,~~  
5 ~~machinery, equipment, or materials directly used in the production~~  
6 ~~of the goods,~~

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

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

10          ~~[(9) the costs of quality control, including~~  
11 ~~replacement of defective components pursuant to standard warranty~~  
12 ~~policies, inspection directly allocable to the production of the~~  
13 ~~goods, and repairs and maintenance of goods, and~~

14          ~~[(10) licensing or franchise costs, including fees~~  
15 ~~incurred in securing the contractual right to use a trademark,~~  
16 ~~corporate plan, manufacturing procedure, special recipe, or other~~  
17 ~~similar right directly associated with the goods produced.~~

18          ~~[(c) The cost of goods sold does not include the following~~  
19 ~~costs in relation to the taxable entity's goods:~~

20           ~~[(1) the cost of renting or leasing equipment,~~  
21 ~~facilities, or real property that is not used for the production of~~  
22 ~~the goods,~~

23           ~~[(2) selling costs, including employee expenses~~  
24 ~~related to sales,~~

25           ~~[(3) distribution costs, including outbound~~  
26 ~~transportation costs,~~

27           ~~[(4) advertising costs,~~

- 1           ~~[(5) idle facility expense,~~  
2           ~~[(6) rehandling costs,~~  
3           ~~[(7) bidding costs, which are the costs incurred in~~  
4 ~~the solicitation of contracts ultimately awarded to the taxable~~  
5 ~~entity,~~  
6           ~~[(8) unsuccessful bidding costs, which are the costs~~  
7 ~~incurred in the solicitation of contracts not awarded to the~~  
8 ~~taxable entity,~~  
9           ~~[(9) interest, including interest on debt incurred or~~  
10 ~~continued during the production period to finance the production of~~  
11 ~~the goods,~~  
12           ~~[(10) income taxes, including local, state, federal,~~  
13 ~~and foreign income taxes, and franchise taxes that are assessed on~~  
14 ~~the taxable entity based on income,~~  
15           ~~[(11) strike expenses, including costs associated~~  
16 ~~with hiring employees to replace striking personnel, but not~~  
17 ~~including the wages of the replacement personnel, costs of~~  
18 ~~security, and legal fees associated with settling strikes,~~  
19           ~~[(12) officers' compensation,~~  
20           ~~[(13) costs of operation of a facility that is:~~  
21                 ~~[(A) located on property owned or leased by the~~  
22 ~~federal government, and~~  
23                 ~~[(B) managed or operated primarily to house~~  
24 ~~members of the armed forces of the United States, and~~  
25           ~~[(14) any compensation paid to an undocumented worker~~  
26 ~~used for the production of goods. As used in this subdivision:~~  
27                 ~~[(A) "undocumented worker" means a person who is~~

1 ~~not lawfully entitled to be present and employed in the United~~  
2 ~~States; and~~

3 ~~[(B) "goods" includes the husbandry of animals,~~  
4 ~~the growing and harvesting of crops, and the severance of timber~~  
5 ~~from realty.~~

6 ~~[(f) A taxable entity may subtract as a cost of goods sold~~  
7 ~~indirect or administrative overhead costs, including all mixed~~  
8 ~~service costs, such as security services, legal services, data~~  
9 ~~processing services, accounting services, personnel operations,~~  
10 ~~and general financial planning and financial management costs, that~~  
11 ~~it can demonstrate are allocable to the acquisition or production~~  
12 ~~of goods, except that the amount subtracted may not exceed four~~  
13 ~~percent of the taxable entity's total indirect or administrative~~  
14 ~~overhead costs, including all mixed service costs. Any costs~~  
15 ~~excluded under Subsection (e) may not be subtracted under this~~  
16 ~~subsection.~~

17 ~~[(g) A taxable entity that is allowed a subtraction by this~~  
18 ~~section for a cost of goods sold and that is subject to Section~~  
19 ~~263A, 460, or 471, Internal Revenue Code, may capitalize that cost~~  
20 ~~in the same manner and to the same extent that the taxable entity~~  
21 ~~capitalized that cost on its federal income tax return or may~~  
22 ~~expense those costs, except for costs excluded under Subsection~~  
23 ~~(e), or in accordance with Subsections (c), (d), and (f). If the~~  
24 ~~taxable entity elects to capitalize costs, it must capitalize each~~  
25 ~~cost allowed under this section that it capitalized on its federal~~  
26 ~~income tax return. If the taxable entity later elects to begin~~  
27 ~~expensing a cost that may be allowed under this section as a cost of~~

1 ~~goods sold, the entity may not deduct any cost in ending inventory~~  
2 ~~from a previous report. If the taxable entity elects to expense a~~  
3 ~~cost of goods sold that may be allowed under this section, a cost~~  
4 ~~incurred before the first day of the period on which the report is~~  
5 ~~based may not be subtracted as a cost of goods sold. If the taxable~~  
6 ~~entity elects to expense a cost of goods sold and later elects to~~  
7 ~~capitalize that cost of goods sold, a cost expensed on a previous~~  
8 ~~report may not be capitalized.~~

9 ~~[(h) A taxable entity shall determine its cost of goods~~  
10 ~~sold, except as otherwise provided by this section, in accordance~~  
11 ~~with the methods used on the federal income tax return on which the~~  
12 ~~report under this chapter is based. This subsection does not~~  
13 ~~affect the type or category of cost of goods sold that may be~~  
14 ~~subtracted under this section.~~

15 ~~[(i) A taxable entity may make a subtraction under this~~  
16 ~~section in relation to the cost of goods sold only if that entity~~  
17 ~~owns the goods. The determination of whether a taxable entity is~~  
18 ~~an owner is based on all of the facts and circumstances, including~~  
19 ~~the various benefits and burdens of ownership vested with the~~  
20 ~~taxable entity. A taxable entity furnishing labor or materials to~~  
21 ~~a project for the construction, improvement, remodeling, repair, or~~  
22 ~~industrial maintenance (as the term "maintenance" is defined in 34~~  
23 ~~T.A.C. Section 3.357) of real property is considered to be an owner~~  
24 ~~of that labor or materials and may include the costs, as allowed by~~  
25 ~~this section, in the computation of cost of goods sold. Solely for~~  
26 ~~purposes of this section, a taxable entity shall be treated as the~~  
27 ~~owner of goods being manufactured or produced by the entity under a~~



1 ~~contract with the federal government, including any subcontracts~~  
2 ~~that support a contract with the federal government,~~  
3 ~~notwithstanding that the Federal Acquisition Regulation may~~  
4 ~~require that title or risk of loss with respect to those goods be~~  
5 ~~transferred to the federal government before the manufacture or~~  
6 ~~production of those goods is complete.~~

7 ~~[(j) A taxable entity may not make a subtraction under this~~  
8 ~~section for cost of goods sold to the extent the cost of goods sold~~  
9 ~~was funded by partner contributions and deducted under Subsection~~  
10 ~~(c)(13).~~

11 ~~[(k) Notwithstanding any other provision of this section,~~  
12 ~~if the taxable entity is a lending institution that offers loans to~~  
13 ~~the public and elects to subtract cost of goods sold, the entity,~~  
14 ~~other than an entity primarily engaged in an activity described by~~  
15 ~~category 5932 of the 1987 Standard Industrial Classification Manual~~  
16 ~~published by the federal Office of Management and Budget, may~~  
17 ~~subtract as a cost of goods sold an amount equal to interest~~  
18 ~~expense. For purposes of this subsection, an entity engaged in~~  
19 ~~lending to unrelated parties solely for agricultural production~~  
20 ~~offers loans to the public.~~

21 ~~[(k-1) Notwithstanding any other provision of this section,~~  
22 ~~the following taxable entities may subtract as a cost of goods sold~~  
23 ~~the costs otherwise allowed by this section in relation to tangible~~  
24 ~~personal property that the entity rents or leases in the ordinary~~  
25 ~~course of business of the entity:~~

26 ~~[(1) a motor vehicle rental or leasing company that~~  
27 ~~remits a tax on gross receipts imposed under Section 152.026,~~

1           ~~[(2) a heavy construction equipment rental or leasing~~  
2 ~~company; and~~

3           ~~[(3) a railcar rolling stock rental or leasing~~  
4 ~~company.~~

5           ~~[(1) Notwithstanding any other provision of this section, a~~  
6 ~~payment made by one member of an affiliated group to another member~~  
7 ~~of that affiliated group not included in the combined group may be~~  
8 ~~subtracted as a cost of goods sold only if it is a transaction made~~  
9 ~~at arm's length.~~

10           ~~[(m) In this section, "arm's length" means the standard of~~  
11 ~~conduct under which entities that are not related parties and that~~  
12 ~~have substantially equal bargaining power, each acting in its own~~  
13 ~~interest, would negotiate or carry out a particular transaction.~~

14           ~~[(n) In this section, "related party" means a person,~~  
15 ~~corporation, or other entity, including an entity that is treated~~  
16 ~~as a pass-through or disregarded entity for purposes of federal~~  
17 ~~taxation, whether the person, corporation, or entity is subject to~~  
18 ~~the tax under this chapter or not, in which one person, corporation,~~  
19 ~~or entity, or set of related persons, corporations, or entities,~~  
20 ~~directly or indirectly owns or controls a controlling interest in~~  
21 ~~another entity.~~

22           ~~[(o) If a taxable entity, including a taxable entity with~~  
23 ~~respect to which cost of goods sold is determined pursuant to~~  
24 ~~Section 171.1014(c)(1), whose principal business activity is film~~  
25 ~~or television production or broadcasting or the distribution of~~  
26 ~~tangible personal property described by Subsection (a)(3)(A)(ii),~~  
27 ~~or any combination of these activities, elects to subtract cost of~~

1 ~~goods sold, the cost of goods sold for the taxable entity shall be~~  
2 ~~the costs described in this section in relation to the property and~~  
3 ~~include depreciation, amortization, and other expenses directly~~  
4 ~~related to the acquisition, production, or use of the property,~~  
5 ~~including expenses for the right to broadcast or use the property.]~~

6 SECTION 2. This Act applies only to a report originally due  
7 on or after the effective date of this Act.

8 SECTION 3. This Act takes effect January 1, 2014.