

By: Zedler

H.B. No. 2347

A BILL TO BE ENTITLED

AN ACT

relating to the franchise tax.

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

SECTION 1. Section 171.0003(a), Tax Code, is amended to read as follows:

(a) An entity is a passive entity only if:

(1) the entity is a general or limited partnership or a trust, other than a business trust;

(2) during the period on which margin is based, the entity's federal gross income consists of at least 90 percent of the following income:

(A) dividends, interest, foreign currency exchange gain, periodic and nonperiodic payments with respect to notional principal contracts, option premiums, cash settlement or termination payments with respect to a financial instrument, and income from a limited liability company;

(B) distributive shares of partnership income to the extent that those distributive shares of income are greater than zero;

(C) net capital gain [~~capital gains~~] from the sale of real property, gains from the sale of commodities traded on a commodities exchange, and gains from the sale of securities; and

(D) royalties, bonuses, or delay rental income from mineral properties and income from other nonoperating mineral

1 interests; and

2 (3) the entity does not receive more than 10 percent of
3 its federal gross income from conducting an active trade or
4 business.

5 SECTION 2. Section 171.1012, Tax Code, is amended to read as
6 follows:

7 Sec. 171.1012. DETERMINATION OF COST OF GOODS SOLD. [~~(a)~~
8 ~~In this section:~~

9 [~~(1) "Goods" means real or tangible personal property
10 sold in the ordinary course of business of a taxable entity.~~

11 [~~(2) "Production" includes construction,
12 installation, manufacture, development, mining, extraction,
13 improvement, creation, raising, or growth.~~

14 [~~(3)(A) "Tangible personal property" means:~~

15 [~~(i) personal property that can be seen,
16 weighed, measured, felt, or touched or that is perceptible to the
17 senses in any other manner,~~

18 [~~(ii) films, sound recordings, videotapes,
19 live and prerecorded television and radio programs, books, and
20 other similar property embodying words, ideas, concepts, images, or
21 sound, without regard to the means or methods of distribution or the
22 medium in which the property is embodied, for which, as costs are
23 incurred in producing the property, it is intended or is reasonably
24 likely that any medium in which the property is embodied will be
25 mass-distributed by the creator or any one or more third parties in
26 a form that is not substantially altered, and~~

27 [~~(iii) a computer program, as defined by~~

1 ~~Section 151.0031.~~

2 [~~(B)~~ ~~"Tangible personal property"~~ ~~does not~~
3 ~~include:~~

4 [~~(i)~~ ~~intangible property; or~~

5 [~~(ii)~~ ~~services.~~

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

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

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

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

22 (4) for any other taxable entity, the cost of goods
23 sold is an amount determined in a manner substantially equivalent
24 to the amount for Subdivision (1), (2), or (3) determined by rules
25 the comptroller shall adopt [as provided by this section].

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

- 1 ~~[(1) labor costs,~~
- 2 ~~[(2) cost of materials that are an integral part of~~
- 3 ~~specific property produced,~~
- 4 ~~[(3) cost of materials that are consumed in the~~
- 5 ~~ordinary course of performing production activities,~~
- 6 ~~[(4) handling costs, including costs attributable to~~
- 7 ~~processing, assembling, repackaging, and inbound transportation~~
- 8 ~~costs,~~
- 9 ~~[(5) storage costs, including the costs of carrying,~~
- 10 ~~storing, or warehousing property, subject to Subsection (e),~~
- 11 ~~[(6) depreciation, _____ depletion, _____ and~~
- 12 ~~amortization, reported on the federal income tax return on which~~
- 13 ~~the report under this chapter is based, to the extent associated~~
- 14 ~~with and necessary for the production of goods, including recovery~~
- 15 ~~described by Section 197, Internal Revenue Code,~~
- 16 ~~[(7) the cost of renting or leasing equipment,~~
- 17 ~~facilities, or real property directly used for the production of~~
- 18 ~~the goods, including pollution control equipment and intangible~~
- 19 ~~drilling and dry hole costs,~~
- 20 ~~[(8) the cost of repairing and maintaining equipment,~~
- 21 ~~facilities, or real property directly used for the production of~~
- 22 ~~the goods, including pollution control devices,~~
- 23 ~~[(9) costs attributable to research, experimental,~~
- 24 ~~engineering, and design activities directly related to the~~
- 25 ~~production of the goods, including all research or experimental~~
- 26 ~~expenditures described by Section 174, Internal Revenue Code,~~
- 27 ~~[(10) geological and geophysical costs incurred to~~

1 ~~identify and locate property that has the potential to produce~~
2 ~~minerals;~~

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

6 ~~[(12) the cost of producing or acquiring electricity~~
7 ~~sold; and~~

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

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

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

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

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

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

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

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

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

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

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

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

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

17 ~~[(1) the cost of renting or leasing equipment,~~
18 ~~facilities, or real property that is not used for the production of~~
19 ~~the goods;~~

20 ~~[(2) selling costs, including employee expenses~~
21 ~~related to sales;~~

22 ~~[(3) distribution costs, including outbound~~
23 ~~transportation costs;~~

24 ~~[(4) advertising costs;~~

25 ~~[(5) idle facility expense;~~

26 ~~[(6) rehandling costs;~~

27 ~~[(7) bidding costs, which are the costs incurred in~~

1 ~~the solicitation of contracts ultimately awarded to the taxable~~
2 ~~entity;~~

3 ~~[(8) unsuccessful bidding costs, which are the costs~~
4 ~~incurred in the solicitation of contracts not awarded to the~~
5 ~~taxable entity;~~

6 ~~[(9) interest, including interest on debt incurred or~~
7 ~~continued during the production period to finance the production of~~
8 ~~the goods;~~

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

12 ~~[(11) strike expenses, including costs associated~~
13 ~~with hiring employees to replace striking personnel, but not~~
14 ~~including the wages of the replacement personnel, costs of~~
15 ~~security, and legal fees associated with settling strikes;~~

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

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

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

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

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

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

27 ~~[(B) "goods" includes the husbandry of animals,~~

1 ~~the growing and harvesting of crops, and the severance of timber~~
2 ~~from realty.~~

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

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

1 ~~incurred before the first day of the period on which the report is~~
2 ~~based may not be subtracted as a cost of goods sold. If the taxable~~
3 ~~entity elects to expense a cost of goods sold and later elects to~~
4 ~~capitalize that cost of goods sold, a cost expensed on a previous~~
5 ~~report may not be capitalized.~~

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

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

1 ~~require that title or risk of loss with respect to those goods be~~
2 ~~transferred to the federal government before the manufacture or~~
3 ~~production of those goods is complete.~~

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

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

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

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

25 ~~[(2) a heavy construction equipment rental or leasing~~
26 ~~company, and~~

27 ~~[(3) a railcar rolling stock rental or leasing~~

1 company.

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

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

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

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

1 ~~related to the acquisition, production, or use of the property,~~
2 ~~including expenses for the right to broadcast or use the property.]~~

3 SECTION 3. Section 171.1013, Tax Code, is amended by
4 amending Subsection (a) and adding Subsection (i) to read as
5 follows:

6 (a) Except as otherwise provided by this section, "wages and
7 cash compensation" means the amount entered in the Medicare wages
8 and tips box of Internal Revenue Service Form W-2 or any subsequent
9 form with a different number or designation that substantially
10 provides the same information. The term also includes, to the
11 extent not included above:

12 (1) a person's net distributive income from a taxable
13 entity treated as a partnership for federal income tax purposes,
14 but only if the person [~~receiving the distribution~~] is a natural
15 person, a professional association owned entirely by natural
16 persons, or a professional corporation owned entirely by natural
17 persons, and only if the amount is positive;

18 (2) a person's net distributive income from limited
19 liability companies and corporations treated as S corporations for
20 federal income tax purposes, but only if the person [~~receiving the~~
21 ~~distribution~~] is a natural person and only if the amount is
22 positive;

23 (3) stock awards and stock options deducted for
24 federal income tax purposes; ~~and~~

25 (4) a person's net distributive income from a limited
26 liability company treated as a sole proprietorship for federal
27 income tax purposes, but only if the person [~~receiving the~~

1 ~~distribution]~~ is a natural person and only if the amount is
2 positive; and

3 (5) payroll taxes paid by a taxable entity in
4 connection with the employment of an officer, director, owner,
5 partner, or employee.

6 (i) Subject to Section 171.1014 and the limitation in
7 Subsection (c), a taxable entity that elects to subtract
8 compensation for the purpose of computing its taxable margin under
9 Section 171.101 may include as wages and cash compensation any
10 nonemployee compensation paid to an independent contractor as
11 reported on Internal Revenue Service Form 1099 or any subsequent
12 form with a different number or designation that substantially
13 provides the same information.

14 SECTION 4. Sections 171.103(c) and (d), Tax Code, are
15 repealed.

16 SECTION 5. This Act applies only to a report originally due
17 on or after the effective date of this Act.

18 SECTION 6. This Act takes effect January 1, 2014.