LEGISLATIVE BUDGET BOARD
Austin, Texas

FISCAL NOTE, 83RD LEGISLATIVE REGULAR SESSION

May 8, 2013

TO: Honorable Tommy Williams, Chair, Senate Committee on Finance

FROM: Ursula Parks, Director, Legislative Budget Board

IN RE: **HB800** by Murphy (Relating to a sales and use tax exemption and a franchise tax credit related to certain research and development activities.), **As Engrossed**

Estimated Two-year Net Impact to General Revenue Related Funds for HB800, As Engrossed: a negative impact of ($239,156,000) through the biennium ending August 31, 2015.

General Revenue-Related Funds, Five-Year Impact:

Fiscal Year	Probable Net Positive/(Negative) Impact to General Revenue Related Funds
2014	($91,666,000)
2015	($147,490,000)
2016	($150,990,000)
2017	($153,590,000)
2018	($157,190,000)

All Funds, Five-Year Impact:

Fiscal Year	Probable Revenue (Loss) from *General Revenue Fund* 1	Probable (Cost) from *General Revenue Fund* 1	Probable Revenue (Loss) from *Cities*	Probable Revenue (Loss) from *Transit Authorities*
2014	($87,600,000)	($4,066,000)	($16,200,000)	($5,500,000)
2015	($126,200,000)	($21,290,000)	($23,300,000)	($7,900,000)
2016	($128,700,000)	($22,290,000)	($23,700,000)	($8,000,000)
2017	($131,300,000)	($22,290,000)	($24,300,000)	($8,200,000)
2018	($133,900,000)	($23,290,000)	($24,700,000)	($8,400,000)

Fiscal Year	Probable Revenue (Loss) from *Counties and Special Districts*	Change in Number of State Employees from FY 2013
2014	($2,800,000)	40.0
2015	($4,000,000)	40.0
2016	($4,000,000)	40.0
2017	($4,100,000)	40.0
2018	($4,200,000)	40.0

Fiscal Analysis

This bill would amend Chapter 151, Tax Code, regarding the limited sales and use tax, and Chapter 171, Tax Code, regarding the franchise tax.

The bill would amend Chapter 151 to add new Section 151.3182 to provide an exemption from tax for depreciable tangible personal property directly used in qualified research under certain conditions. The conditions are that the person be engaged in qualified research and that the person not claim as a taxable entity under the franchise tax a credit for research and development expenses, as provided in the bill, on the report for the period during which the sales tax exemption was taken. The new section also would provide that the Comptroller make a biennial report to the Legislature and Governor regarding the exemption. This new section would expire December 31, 2026.

The bill would amend Chapter 171 to add new Subchapter M to provide for a tax credit for certain research and development activities. The bill would define "qualified research" and "qualified research expense" by reference to the Internal Revenue Code with the qualification that the research and expenses must occur in this state. The bill would provide that a taxable entity is not eligible for a credit for a qualified research expense on a report covering a period in which the entity or a member of a combined group that includes that entity received a sales tax exemption under the new Section 151.3182.

The bill would provide that the credit, for a period covered by a franchise tax report of an eligible taxable entity, would equal 5 percent (or in the case of an entity that contracts for the performance of qualified research with an institution of higher education, 6.25 percent) of the difference between the qualified research expenses incurred during the period and 50 percent of the average amount of qualified research expenses during the three preceding periods. If during any of the three preceding periods the taxable entity had no qualified research expenses the credit would equal 2.5 percent (or in the case of an entity that contracts for the performance of qualified research with an institution of higher education, 3.125 percent) of the qualified research expenses incurred during the period. The bill would limit the amount of credit claimed, including credit carried forward from prior reports, to 50 percent of the franchise tax due before any other applicable credits. Credits that could not be used on a report due to the limitation could be carried forward for not more than 20 consecutive reports.

The bill would specify how qualified research expenses would be calculated for taxable entities that acquire or dispose of other taxable entities that have qualified research expenses. A taxable entity could not transfer credits to another entity unless all of the assets of the taxable entity are transferred.

The Comptroller would be required to adopt rules and forms necessary to implement the credit, and also would be required to make a biennial report to the Legislature and Governor regarding the credit. The Comptroller also would be required to deposit for each fiscal year an amount from franchise tax revenues to the Property Tax Relief Fund sufficient to offset any decrease attributable to the credits under the new subchapter.

The franchise tax provisions would apply only to reports due on or after January 1, 2014. The new Subchapter M would expire December 31, 2026.

The bill would take effect January 1, 2014.

Methodology

Data from the National Science Foundation on funds spent for business research and development (R&D) by companies in Texas and on the distribution of such expenditures by type were used to estimate amounts of business R&D expenditures on items of depreciable tangible personal property (namely, software and equipment with a useful life in excess of one year) currently subject to sales and use tax, reduced by the portion expected to be exempt under other provisions of the Tax Code, extrapolated through 2018, adjusted for the effective date, and multiplied by the state sales tax rate to estimate the probable effects on sales tax collections. Effects on units of local government were estimated proportionately.

The estimated impact of the franchise tax provisions is based on data on the prior research and development credit that existed from 2000 to 2007. The estimate was modified to account for the differences between the franchise tax as it now exists and the tax that applied during the earlier period, and of the interaction of the bill's sales tax and franchise tax provisions. Because of the much larger impact arising from the sales tax exemption, the franchise tax fiscal impact reflects estimated franchise tax credits available to taxable entities with low sales tax liability, in many cases because of contracts with the federal government.

Due to hold harmless provisions for the Property Tax Relief Fund provided by new Section 171.664, the effect of the franchise tax credits is shown as a cost to the General Revenue Fund rather than a revenue loss to the Property Tax Relief Fund. The effect on certification of the general appropriations bill does not change.

This General Revenue cost estimate also reflects the funds that would be necessary for the CPA to hire 40 auditors due to anticipated significantly expanded audit coverage.

Technology

The Comptroller of Public Accounts indicates there would be a one-time technology cost of $776,000 in fiscal 2014 for programing and system support costs.

Local Government Impact

There would be a proportional loss of sales and use tax revenue to local taxing jurisdictions.

Source Agencies: 304 Comptroller of Public Accounts

LBB Staff: UP, KK, SD