LEGISLATIVE BUDGET BOARD
Austin, Texas

FISCAL NOTE, 83RD LEGISLATIVE REGULAR SESSION

May 1, 2013

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

FROM: Ursula Parks, Director, Legislative Budget Board

IN RE: **SB859** by Deuell (Relating to a sales and use tax exemption and a franchise tax credit related to certain research and development activities.), **As Introduced**

Estimated Two-year Net Impact to General Revenue Related Funds for SB859, As Introduced: a negative impact of ($439,256,000) through the biennium ending August 31, 2015.

Additionally, the bill will have a direct impact of a revenue loss to the Property Tax Relief Fund of ($15,700,000) for the 2014-15 biennium. Any loss to the Property Tax Relief Fund must be made up with an equal amount of General Revenue to fund the Foundation School Program.

General Revenue-Related Funds, Five-Year Impact:

Fiscal Year	Probable Net Positive/(Negative) Impact to General Revenue Related Funds
2014	($213,266,000)
2015	($225,990,000)
2016	($230,390,000)
2017	($234,990,000)
2018	($239,590,000)

All Funds, Five-Year Impact:

Fiscal Year	Probable (Cost) from *General Revenue Fund* 1	Probable Revenue (Loss) from *General Revenue Fund* 1	Probable Revenue (Loss) from *Property Tax Relief Fund* 304	Probable Revenue (Loss) from *Cities*
2014	($4,066,000)	($209,200,000)	$0	($38,600,000)
2015	($3,290,000)	($222,700,000)	($15,700,000)	($41,100,000)
2016	($3,290,000)	($227,100,000)	($16,200,000)	($41,900,000)
2017	($3,290,000)	($231,700,000)	($16,700,000)	($42,800,000)
2018	($3,290,000)	($236,300,000)	($17,200,000)	($43,600,000)

Fiscal Year	Probable Revenue (Loss) from *Transit Authorities*	Probable Revenue (Loss) from *Counties and Special Districts*	Change in Number of State Employees from FY 2013
2014	($13,100,000)	($6,600,000)	40.0
2015	($14,000,000)	($7,000,000)	40.0
2016	($14,200,000)	($7,100,000)	40.0
2017	($14,500,000)	($7,300,000)	40.0
2018	($14,800,000)	($7,400,000)	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 amendment to Chapter 151 would provide an exemption from the tax for tangible personal property or qualified services used or consumed in qualified research under certain conditions. The conditions are that the person be engaged in qualified research and that the person not claim a credit for research and development expenses as a taxable entity under the franchise tax, as provided in the bill, on the report for the period during which the sales tax exemption was taken.

The bill would amend Chapter 171 by adding 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 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 an exemption under the sales tax for the purchase or use of tangible personal property or taxable service used or consumed in qualified research.

The bill would provide that the credit, for a period covered by a franchise tax report of an eligible taxable entity, would equal five 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 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 until all of the credit had been claimed.

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 credit 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.

The franchise tax provision would apply only to reports due on or after January 1, 2014.

The bill would take effect October 1, 2013.

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 was used to estimate amounts of business R&D expenditures on items subject to sales and use tax, reduced by the portion expected to be exempt under other provisions of the sales tax code, extrapolated through 2018, 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 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.

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

Technology

There would be a one-time technology cost of $776,000.00 in fiscal year 2014 for programming and system support costs.

Local Government Impact

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

Source Agencies: 304 Comptroller of Public Accounts

LBB Staff: UP, RB, SD, KK