BILL ANALYSIS

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S.B. 756
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AUTHOR'S / SPONSOR'S STATEMENT OF INTENT

Businesses can determine their taxable margin for purposes of completing the state's franchise tax by using one of three calculation methods. Those methods include determining 70 percent of the entity's total business revenues, subtracting the amount of compensation paid from the entity's total revenues, or subtracting the cost of goods sold from the entity's total revenues. Interested parties claim that the methods prescribed within Chapter 171 (Franchise Tax) of the Tax Code for determining the eligible cost of goods sold is unnecessarily complex, oftentimes requiring greater effort than determining the cost of goods sold for federal income tax purposes. Interested parties further claim that the compliance costs for determining the taxable margin on the basis of cost of goods sold sometimes equals or exceeds the amount of franchise tax due.

S.B. 756 proposes to simplify the method for businesses' determination of their taxable margin on the basis of cost of goods sold. The bill authorizes entities to use information reportable for federal income tax purposes for the purpose of determining their taxable margins using the cost of goods sold basis. Offering a simpler method for computing the cost of goods sold would help lower entities' compliance costs for determining their taxable margin using this method.

As proposed, S.B. 756 amends current law relating to the determination of cost of goods sold for purposes of computing the franchise tax.

RULEMAKING AUTHORITY

Rulemaking authority is expressly granted to the Comptroller of Public Accounts of the State of Texas in SECTION 1 (Section 171.1012, Tax Code) in this bill.

SECTION BY SECTION ANALYSIS

SECTION 1. Amends Section 171.1012, Tax Code, as follows:

Sec. 171.1012. DETERMINATION OF COST OF GOODS SOLD. Requires, subject to Section 171.1014 (Combined Reporting; Affiliated Group Engaged in Unitary Business), a taxable entity that elects to subtract costs of goods sold for the purpose of computing its taxable margin to determine the amount of that cost of goods sold as follows:

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

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

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

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

determined by rules the Comptroller of Public Accounts of the State of Texas is required to adopt.

Deletes existing Subsection (a) defining "goods," production," and "tangible personal property."

Deletes designation of Subsection (b).

Deletes existing Subsection (c) providing that the cost of goods sold includes all direct costs of acquiring or producing goods, including certain enumerated costs.

Deletes existing Subsection (d) providing that in addition to the amounts includable under Subsection (c), the cost of goods sold includes certain enumerated costs in relation to the maintenance of the taxable entity's goods.

Deletes existing Subsection (e) providing that the cost of goods sold does not include certain enumerated costs in relation to the selling of the taxable entity's goods.

Deletes existing Subsection (f) authorizing a taxable entity to subtract certain indirect or administrative overhead costs as a cost of goods sold that it can demonstrate are allocable to the acquisition or production of goods and prohibiting costs excluded under Subsection (e) from being subtracted.

Deletes existing Subsection (g) providing that a taxable entity that is allowed a subtraction for a cost of goods sold subject to certain legislation is authorized to capitalize that cost in the same manner and to the same extent that the taxable entity capitalized that cost on its federal income tax return or is authorized to expense those costs, except for certain costs. Deletes existing text requiring that if the taxable entity elects to capitalize costs, it is required to capitalize each cost allowed under this section that it capitalized on its federal income tax return. Deletes existing text related to the expensing of costs in relation to previous reports.

Deletes existing Subsection (h) requiring a taxable entity to determine its cost of goods sold in accordance with the methods used on the federal income tax return on which the report under this chapter is based.

Deletes existing Subsection (i) authorizing a taxable entity to make a subtraction under this section in relation to the cost of goods sold only if that entity owns the goods. Deletes existing text providing that a taxable entity is to be treated as the owner of goods being manufactured or produced by the entity under a contract with the federal government.

Deletes existing Subsection (j) prohibiting a taxable entity from making a subtraction under this section for cost of goods sold to the extent the cost of goods sold was funded by partner contributions and deducted under Subsection (c)(13).

Deletes existing Subsection (k) providing that if the taxable entity is a lending institution that offers loans to the public and elects to subtract cost of goods sold, the entity, other than an entity primarily engaged in an activity described by category 5932 of the 1987 Standard Industrial Classification Manual published by the federal Office of Management and Budget, is authorized to subtract as a cost of goods sold an amount equal to interest expense.

Deletes existing Subsection (k-1) authorizing certain taxable entities to subtract as a cost of goods sold the costs otherwise allowed by this section in relation to tangible personal property that the entity rents or leases in the ordinary course of business of the entity.

Deletes existing Subsection (k-2) providing that this subsection applies only to a pipeline entity that falls under certain specifications. Deletes existing text providing that a pipeline entity providing services for others related to the product that the pipeline does not own and to which this subsection applies is authorized to subtract as a cost of goods sold its depreciation, operations, and maintenance costs allowed by this section related to the services provided.

Deletes existing Subsection (k-3) defining "processing."

Deletes existing Subsection (l) authorizing a payment made by one member of an affiliated group to another member of that affiliated group not included in the combined group to be subtracted as a cost of goods sold only if it is a transaction made at arm's length.

Deletes existing Subsection (m) defining "arm's length."

Deletes existing Subsection (n) defining "related party."

Deletes existing Subsection (o) providing that if a taxable entity whose principal business activity is film or television production or broadcasting or the distribution of tangible personal property, or any combination of these activities, elects to subtract cost of goods sold, the cost of goods sold for the taxable entity is required to be the costs described in this section in relation to the property and include depreciation, amortization, and other expenses directly related to the acquisition, production or use of the property, including expenses for the right to broadcast or use the property.

Deletes existing Subsection (t) providing that if a taxable entity that is a movie theater elects to subtract cost of goods sold, the cost of goods sold for the taxable entity is required to be the costs described by this section in relation to the acquisition, production exhibition, or use of a film or motion picture, including expenses for the right to use the film or motion picture.

SECTION 2. Amends Section 171.1011(v), Tax Code, to make a conforming change relating to the deletion of Section 171.1012(e)(3).

SECTION 3. Makes application of this Act prospective.

SECTION 4. Effective date: January 1, 2016.