

LEGISLATIVE BUDGET BOARD
Austin, Texas

FISCAL NOTE, 85TH LEGISLATIVE REGULAR SESSION

February 27, 2017

TO: Honorable Jane Nelson, Chair, Senate Committee on Finance

FROM: Ursula Parks, Director, Legislative Budget Board

IN RE: SB142 by Taylor, Van (Relating to the determination of cost of goods sold for purposes of computing the franchise tax.), **As Introduced**

Estimated Two-year Net Impact to General Revenue Related Funds for SB142, As Introduced: a negative impact of (\$840,000) through the biennium ending August 31, 2019.

Additionally, the bill will have a direct impact of a revenue loss to the Property Tax Relief Fund of (\$522,795,000) for the 2018-19 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
2018	(\$420,000)
2019	(\$420,000)
2020	(\$420,000)
2021	(\$420,000)
2022	(\$420,000)

All Funds, Five-Year Impact:

Fiscal Year	Probable (Cost) from General Revenue Fund 1	Probable Revenue (Loss) from Property Tax Relief Fund 304	Change in Number of State Employees from FY 2017
2018	(\$420,000)	(\$258,298,000)	5.0
2019	(\$420,000)	(\$264,497,000)	5.0
2020	(\$420,000)	(\$271,419,000)	5.0
2021	(\$420,000)	(\$278,062,000)	5.0
2022	(\$420,000)	(\$285,020,000)	5.0

Fiscal Analysis

The bill would amend Chapter 171 of the Tax Code, regarding the franchise tax, to add an

additional method for calculating cost of goods sold in determining taxable margin for the franchise tax. The bill would add language allowing taxable entities to use the amount entered on the cost of goods sold line on the appropriate Internal Revenue Service federal income tax form.

The bill would take effect on January 1, 2018, and only apply to reports due on or after that date.

Methodology

Under the bill's provisions, taxable entities electing to deduct cost of goods sold could choose to use either the amount determined under current law or the amount reported on an Internal Revenue Service federal income tax form. Reporting of cost of goods sold on federal returns can vary in a wide range without raising issues about the validity of the tax return. If taxable entities were to report cost of goods sold at the highest acceptable level on their federal tax returns, the franchise tax would be reduced from current levels. In addition, taxable entities currently not able to use cost of goods sold to calculate franchise tax could have a subtraction under federal tax accounting procedures. Taxable entities that have a larger cost of goods subtraction under current law than would be available under federal reporting would continue to use current law procedures.

The estimate assumes subtractions from total revenue of cost of goods sold would increase by 3 percent annually under the bill's provisions.

The cost estimate reflects the funds that would be necessary to hire five auditors to handle the anticipated increase in franchise tax refund verifications. A review or verification must be performed every time an entity amends its federal or state franchise tax filing, is audited by the IRS, or if the refund request is over \$25,000. Unlike audits which are initiated by the Comptroller's Office, refilings are initiated by the taxpayer. The bill would allow an entity to change its calculation method at any time, which would then require verification. Large companies generally file a combined report, which may include filings for hundreds or even thousands of affiliates. Any change to the combined filing would require verification by the Comptroller's Office. A cost of goods sold refund verification takes an average of 20 hours to perform. More than 78,000 taxpayers used the cost of goods sold deduction in 2016, but that figure does not capture all the affiliates included in a combined tax filing.

Local Government Impact

No fiscal implication to units of local government is anticipated.

Source Agencies: 304 Comptroller of Public Accounts

LBB Staff: UP, KK, SD