
Texas - Legislature passes bill adopting research and development tax credit and sales and use tax exemption

May 24, 2013

In brief

UPDATE: Governor signed H.B. 800 on June 14, 2013

On May 21, 2013, the Texas Senate passed [H.B. 800](#), which would provide a sales and use tax exemption and a franchise tax credit relating to qualified research and development (R&D) activities in Texas. The bill now moves to the governor's desk since the bill was passed by the House earlier in the month. With Governor Perry's expected signature, Texas would join nearly 40 other states that have an R&D tax credit.

In detail

Background

Prior to the revised Texas franchise tax regime, which became effective January 1, 2008, the primary R&D incentive in Texas had been an R&D credit applicable to both qualified research expenses and basic research payments. Under the revised franchise (or 'margin') tax, all credits, inclusive of the R&D credit, were cancelled, although carryovers from prior periods remained effective.

H.B. 800 would provide entities performing qualified research and development activities in Texas the option of taking either a sales tax exemption or a

franchise tax credit relating to qualified property. The bill would use the definitions for 'research' and 'qualified research' that appear in federal tax law, except that the bill would apply only to research conducted in Texas.

Sales tax exemption

The bill would exempt from Texas sales and use tax the sale, storage, or use of depreciable tangible personal property used in qualified research if the property was sold to, stored, or in some way used by a person engaged in qualified research. 'Depreciable tangible personal property' would be defined as personal property with a useful life greater than one year and

that can be depreciated according to generally accepted accounting principles or under IRC secs. 167 or 168. The person taking the exemption would not be able to claim a franchise tax credit for research and development activities.

Franchise tax credit

The bill would provide a franchise tax credit to entities performing qualified research. Taxable entities claiming a sales tax credit would not be able to claim a franchise tax credit for the same tax period.

With some exceptions, the franchise tax credit would equal 5 percent of the difference between an entity's qualified

research expenses during the period on which the tax report was based and 50 percent of the average amount of qualified research expenses over the three previous tax reporting periods. A separate franchise tax credit would be available to taxable entities that contract with a public or private higher education institution to perform qualified research.

Taxpayers must apply for the credit on or with the tax report for the period the credit is claimed. The credit may not exceed 50 percent of franchise tax due before any other applicable tax credits. If the taxable entity is eligible for a credit that exceeds this limitation, the taxable entity may

carry forward the unused credit for 20 years.

Effective date

The sales tax exemption would be effective January 1, 2014. The franchise tax credit would apply to reports originally due on or after January 1, 2014. Both the sales tax exemption and franchise tax credit would sunset on December 31, 2026.

The takeaway

With the expected passage of H.B. 800, now is the time for businesses to evaluate their Texas activities in order to determine eligibility under the proposed Texas R&D franchise credit and sales and use tax exemption.

Because the Texas R&D tax credit has been dormant for more than five years, the adoption and implementation of the credit and exemption may be overlooked. Additionally, under the prior Texas tax regime, R&D tax credits were often ignored by many business owners who assumed they must have laboratories or breakthrough research to claim the credit. Many businesses that employ engineers, develop software, or outsource product testing should explore whether they qualify for R&D benefits under H.B. 800 should it be enacted.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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