

SUBJECT: Franchise tax law clarifications

COMMITTEE: Ways and Means — favorable, without amendment

VOTE: 6 ayes — Craddick, Ramsay, Heflin, Holzheuser, Horn, Thompson
0 nays
5 absent — Grusendorf, Oliveira, Stiles, Telford, Williamson

SENATE VOTE: On final passage, Local and Uncontested Calendar, April 3 — 31-0

WITNESSES: None

BACKGROUND : The corporate franchise tax, the state's major business tax, is calculated on either taxable capital or “earned surplus.” Earned surplus is a firm's federal taxable income, before any net operating loss deductions, with officer and director compensation added back into the base. Taxpayers pay the higher of \$2.50 per \$1,000 of taxable capital or 4.5 percent of earned surplus.

In apportioning franchise tax liability, multi-state corporations divide their total tax base into portions that represent business conducted in individual states. The apportionment computation results in a fraction that represents the state's share of a firm's total business. The fraction is applied to the firm's total tax base to compute the Texas tax base against which the tax rate is applied. Texas law requires using the firm's gross receipts to calculate this apportionment fraction. The numerator of the fraction represents receipts in Texas; the denominator represents all receipts of the company.

DIGEST: SB 861 would make a number of technical revisions to the franchise tax law. It would link the Texas franchise tax to the Internal Revenue Code of 1986, in effect between January 1, 1996, and December 31, 1997, and include a banking corporation in the definition of “corporation.”

In addition, the bill would require, rather than allow, charitable corporations to be exempt from franchise tax if they are exempt from federal income tax and mandate that they file certain documents with the Comptroller's Office.

It also would require that:

- Texas-apportioned taxable capital and earned surplus include the use of trademarks, franchises, or licenses and royalties from oil, gas or other mineral interests;
- taxable capital or earned surplus be apportioned to the state if the shareholders were Texas residents;
- franchise tax calculations be based solely on a corporation's own financial conditions, prohibiting consolidated reports with related corporations; and
- corporations file an amended report if their net taxable earned surplus was changed as a result of an audit or other adjustment by the Internal Revenue Service or another competent authority or if the corporation filed an amended federal income tax return that changed the corporation's net taxable surplus. Failure to comply would incur a penalty of 10 percent of the tax that should have been reported.

SB 861 would specify legislative intent that changes to the franchise tax law be considered clarifications to existing law and that existing law could not be construed as inconsistent with its provisions.

The bill would take effect January 1, 1998, except the provision related to amended reports would have immediate effect if finally approved by a two-thirds record vote of the membership in each house.