

- SUBJECT:** Expanding eligible cost-of-goods sold deductions for the margins tax
- COMMITTEE:** Ways and Means — favorable, without amendment
- VOTE:** 11 ayes — Oliveira, Otto, Bohac, Hartnett, Hilderbran, C. Howard, P. King, Paxton, Peña, Taylor, Villarreal
- 0 nays — None
- WITNESSES:** For — Bob Owen, Donna Rutter, Texas Society of CPAs
- Against — None
- BACKGROUND:** Under Tax Code, sec. 171.101, a business may deduct the cost of goods sold when computing its taxable margin. Under sec. 171.1014, a taxable entity that is part of an affiliated group engaged in a unitary business must file a combined report based on the combined group’s business activity. Under sec. 171. 171.0001(1), an affiliated group is a group of one or more entities in which a controlling interest is owned by a common owner or owners, either corporate or non-corporate, or by one or more of the member entities.
- Under sec. 171.1012(l), a payment made by one member of an affiliated group to another member of that affiliated group that is not included in the combined group may be subtracted as a cost of goods sold only if it is a transaction made at arm’s length. “Arm’s length” is defined in sec. 171.1012(m) as the standard of conduct under which entities that are not related parties and that have substantially equal bargaining power, each acting in its own interest, negotiate or carry out a particular transaction.
- DIGEST:** HB 4270 would amend sec. 171.1012(1) to allow a purchasing member of an affiliated group of businesses to deduct as a cost of goods sold an amount that did not exceed the market value of the transaction, if the related-party transaction was not made at arm’s length. The selling member of the affiliated group of businesses could include in its gross receipts an amount that did not exceed the market value of the transaction for purposes of computing margins tax liability.

The bill would take effect January 1, 2010, and would apply only to taxes originally due after that date.

**SUPPORTERS  
SAY:**

HB 4270 would provide a deduction for cost of goods sold that more clearly reflected market reality for combined and affiliated businesses. One of the most difficult accounting requirements for businesses under the margins tax is the combined reporting requirement. Under current law, a payment made by one member of an affiliated group to another member of that affiliated group that is not included in the combined group may not be subtracted as a cost of goods sold if the transaction is not at arm's length. This has been interpreted to mean that any transaction between these groups that is not made at market value may not be subtracted as a cost of goods sold. Because many transactions between affiliated businesses are not done at arm's length, they cannot be claimed as proper cost-of-goods sold deductions. HB 4270 would remedy this by allowing for transactions not done at arm's length to be counted as part of the cost of goods sold, up to the market value of the transaction.

HB 4270 also would prevent abuse of this exemption by not allowing the cost of goods sold deduction to exceed the market value of the transaction. This market value ceiling also would keep this expanded deduction in line with the original statute that was designed to provide a deduction for and promote arm's length transactions.

**OPPONENTS  
SAY:**

HB 4270 could result in a loss of revenue to the Property Tax Relief Fund. According the LBB, HB 4270 would cause an indeterminate revenue loss. The loss would depend upon the extent of the use of transactions that were not made at arm's length among affiliated businesses. The Legislature cannot afford to make cuts to the Property Tax Relief Fund as any loss would have to be made up with general revenue, and the next biennium is expected to have even less available revenue than the current one.