SUBJECT: Allowing certain aerospace costs to be deducted under the franchise tax

COMMITTEE: Ways and Means — committee substitute recommended

VOTE: 7 ayes — Burrows, Martinez Fischer, Murphy, Noble, E. Rodriguez, Sanford, Wray

0 nays

4 absent — Guillen, Bohac, Cole, Shaheen

WITNESSES: For — Aimee Gilroy, Raytheon Company; Richard A. (Tony) Bennett, Texas Association of Manufacturers; Dale Craymer, Texas Taxpayers and Research Association; (*Registered, but did not testify*: Dana Harris, Austin Chamber of Commerce; Jake Posey, Bell; Priscilla Camacho, Dallas Regional Chamber; Rebecca Young-Montgomery, Fort Worth Chamber of Commerce; Jay Barksdale, Irving-Las Colinas Chamber of Commerce; Trent Townsend, L3 Technologies; Becky Redman, Lockheed Martin Aeronautics; Holli Davies, North Texas Commission; Juan Antonio Flores, Port San Antonio; Leticia Van de Putte, San Antonio Chamber of Commerce; James Hines, Texas Association of Business; Justin Yancy, Texas Business Leadership Council; Carlton Schwab, Texas Economic Development Council; Tyler Schroeder, The Boeing Company)

Against — (*Registered, but did not testify*: Dick Lavine, Center for Public Policy Priorities)

On —Tom Currah, Comptroller of Public Accounts; Jon Hockenyos

BACKGROUND: Tax Code ch. 171 imposes an annual franchise tax on each taxable entity that does business in the state or that is chartered or organized in the state. The tax is imposed on a taxable entity's taxable margin, which can be computed by determining an entity's total revenue from its entire business and subtracting the greater of $1 million or an amount equal to, at the entity's election, either the cost of goods sold or compensation.

Some have suggested that certain aerospace and defense companies selling both goods and services to the federal government do not receive the full benefits that could be available to them because they must choose to deduct either the cost of goods sold or compensation, but not both, from their total revenue to determine the state franchise tax they must pay. The current franchise tax deductions place Texas at a competitive disadvantage in attracting these companies compared to other states that allow companies to deduct expenses associated with both the cost of goods sold and compensation when determining their state tax liability.

DIGEST:

CSHB 1607 would allow taxable entities incurring certain federally contracted aerospace costs to subtract a percentage of these costs beyond what was included in cost of goods sold or compensation in computing their taxable margins under the franchise tax.

Aerospace costs. The bill would define "aerospace costs" as certain costs attributable to the sale of goods or services to the federal government that were incurred by a taxable entity in the aerospace industry engaged in certain activities described by the North American Industry Classification System and specified in the bill.

Such costs could not already have been subtracted from the entity's taxable margin, and they would have to have been allocated and incurred under the Federal Acquisition Regulations System and subject to the requirements of the Defense Acquisition Regulations System or the National Aeronautics and Space Administration for contracts or for supporting subcontracts for such goods and services.

Annual percentages. Taxable entities would be able to subtract aerospace costs in computing their taxable margins on each year's franchise tax report in the following percentages:

- 20 percent of aerospace costs for franchise tax reports originally due between January 1, 2020, and January 1, 2021;
- 40 percent of aerospace costs for franchise tax reports originally due between January 1, 2021, and January 1, 2022;

- 60 percent of aerospace costs, for franchise tax reports originally due between January 1, 2022, and January 1, 2023;
- 80 percent of aerospace costs, for franchise tax reports originally due between January 1, 2023, and January 1, 2024; and
- 100 percent of aerospace costs, for franchise tax reports originally due on or after January 1, 2024.

The bill would take effect January 1, 2020.

NOTES:

According to the Legislative Budget Board, while the bill would have no fiscal impact on general revenue related funds through fiscal 2020-21, the bill would result in a revenue loss to the Property Tax Relief Fund of $12.7 million for the 2020-21 biennium. Any loss to the Property Tax Relief Fund would have to be made up with an equal amount of general revenue to fund the Foundation School Program.