

AN ALERT FROM THE BDO STATE AND LOCAL TAX PRACTICE

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► SUBJECT

TEXAS REINTRODUces THE RESEARCH AND DEVELOPMENT TAX CREDIT

► SUMMARY

On June 14, 2013, Governor Rick Perry signed Texas HB 800 into law. Effective for expenses paid or incurred between January 1, 2014, and December 31, 2026, to attempt to develop or improve products, manufacturing processes, and software, the law reinstates the Texas Franchise Tax Credit for Certain R&D Activities and allows taxpayers to take either the credit or a sales tax exemption for purchased property used in R&D activity.

► DETAILS

R&D Tax Credit

Finding that Texas economic activity accounts for more than 8% of United States economic activity but only 5% of United States R&D spending and that R&D creates high-paying jobs that provide substantial economic benefits, the Texas legislature passed this legislation to try to make Texas more economically competitive in the field of R&D and to encourage new investments in Texas.

In general, the law provides a tax credit equal to five percent of the excess (if any) of:

- the qualified research expenses ("QREs") incurred in the state of Texas during the period on which the tax report is based ("reporting period"); over
- 50% of the average amount of QREs in the state of Texas during the three tax periods preceding the reporting period.

If the taxable entity has no QREs in one or more of the three tax periods preceding the reporting period, the credit for the reporting period equals 2.5% of the QREs incurred during that period.

CONTACT:

JONATHAN FORMAN

Principal
New York
212-515-5441
jforman@bdo.com

CHRIS BARD

National Leader
Los Angeles / New York
310-557-7525 / 212-515-5421
cbard@bdo.com

The percentages above—5% and 2.5%—are increased by 25%—to 6.25% and 3.125%—if:

- the taxable entity contracts with one or more public or private institutions of higher education for the performance of qualified research; and
- the taxable entity has QREs incurred in Texas by the taxable entity under the contract during the reporting period.

The otherwise allowable R&D credit is limited to 50% of the franchise tax due for the reporting period. Any credit in excess of this limitation can be carried forward for up to 20 succeeding years, subject to the same limitation in the carryforward year, after taking into account both the current credit for the carryforward year and the credits carried forward from prior years. This credit is not transferable, and must be reported on or with the tax report for the reporting period.

Special rules exist for taxable entities that acquire or dispose of another taxable entity or a separate unit of another taxable entity during a tax period and that are members of a controlled group or group under common control.

Sales Tax Exemption - The law also provides a sales tax exemption for certain depreciable tangible personal property used directly in R&D activities, namely, tangible personal property that has a useful life that exceeds one year and is subject to depreciation under generally accepted accounting principles or Internal Revenue Code section 167 or 168. The property must be sold, leased, or rented to—or stored or used by—the person who is engaged in qualified R&D activity. Taxpayers can apply this exemption beginning January 1, 2014.

► INSIGHTS

Because taxpayers can report only one of these benefits, both should be calculated to determine which puts them in the better position.

Modeled on federal law, the Texas R&D Tax Credit is also available to businesses in virtually every industry. Corporations in the industries and manufacturing subsectors listed below reported federal credits in 2009, the latest year for which the Internal Revenue Service has published such data. Businesses in these industries should consider also the Texas opportunities this new law and credit establish.

If you have any questions or believe that you can benefit from or have issues with these new rules, please contact your BDO advisor.

Industry (money amounts in 000s)	Credit	No. of Returns	Average Credit
Manufacturing	\$ 5,394,673	5,197	\$ 1,038
Information	854,675	887	964
Professional, scientific, technical services	733,531	3,913	187
Wholesale and retail trade	424,531	1,003	423
Finance and insurance	149,219	293	509
Utilities	52,168	81	644
Various services *	58,182	384	111
Management/holding companies	47,877	242	198
Administrative/ support and waste management services	26,847	252	107
Mining	19,841	41	484
Construction	11,060	124	89
Transportation and warehousing	10,838	56	194
Real estate, rental, and leasing	10,312	57	181
Agriculture, forestry, fishing, hunting	7,072	81	87
Total or Average	7,773,979	12,359	629

* includes services such as administrative, support, waste management, educational, health care, social assistance, arts, entertainment, recreation, accommodation, and food.

Manufacturing Subsector (money amounts in 000s)	Credit	No. of Returns	Average Credit
Computer and electronic product	\$ 1,584,938	1,178	\$ 1,345
Chemical	1,439,465	715	2,013
Transportation equipment	1,071,484	315	3,402
Miscellaneous	291,715	560	521
Machinery	275,046	640	430
Elec. equipment, appliance, component	254,081	494	514
Petroleum and coal products	160,916	43	3,742
Food	74,767	171	437
Fabricated metal product	65,946	450	147
Paper	62,408	58	1,076
Plastics and rubber	27,751	233	119
Primary metal	24,947	103	242
Nonmetallic mineral product	17,022	59	289
Beverage and tobacco product	11,471	17	675
Furniture and related product	10,178	42	242
Apparel	5,862	25	234
Printing and related support activities	5,746	55	104
Textile mills and textile product mills	4,919	17	289
Wood product	4,814	14	344
Leather and allied product	1,199	7	171
Total	\$ 5,394,675	5,196	1,038

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