

MULTISTATE TAX



Texas Comptroller proposes additional provisions potentially impacting the treatment of research and development activities

Tax Alert

Overview

The Texas Comptroller of Public Accounts (“Comptroller”) recently published proposed regulatory amendments with the Office of the Texas Secretary of State to provide guidance on the franchise tax research and development (“R&D”) activities credit and the sales/use tax R&D exemption.¹ The publishing of the proposed amendments triggers a 30-day public comment period. This tax alert supplements our [tax alert](#) issued on April 22, 2021, by providing a summary of several proposed provisions impacting the Comptroller’s treatment of R&D activities.

Summary of Proposed Provisions Impacting Texas R&D Activities

Provisions applicable to both franchise tax credit and sales/use tax exemption

- The burden of proof for establishing entitlement to the R&D credit is set at a “clear and convincing” standard.
- All qualified research expenses must be supported by contemporaneous business records.
- Federal R&D regulations are applicable to the Texas R&D credit or exemption only to the extent such federal R&D regulations expressly apply to the 2011 federal tax year. The Comptroller specifically references Treas. Reg. § 1.174-2 (adopted on July 21, 2014) and Treas. Reg. § 1.41-4(c)(6) (adopted on November 3, 2016) as examples of federal regulations that would not apply when determining the Texas R&D credit or exemption.
- A design is not eligible as a business component for Texas R&D credit or exemption purposes because under the proposed regulation, a design is not a product, process, computer software, technique, formula, or invention.

Applicable to the franchise tax credit

- To the extent a sales or use tax exemption under Texas Tax Code, Chapter 151 (Limited Sales, Excise, and Use Tax) is claimed on the purchase of a taxable item and that exemption is for a use other than use in qualified research, the item is excluded from being an in-house research expense, even if the expense otherwise meets the definition of supplies.
- Any carryforward of unused R&D credits will be subject to verification by the Comptroller even if the statute of limitations for the year in which the credit was created has expired. While the verification will not result in an adjustment to tax, penalty, or interest for any report year for which the statute of limitations has expired, it may result in an adjustment to the carryforward for all periods within the unexpired statute of limitations and for all future periods in which the taxable entity may claim the carryforward.

As stated in the Deloitte tax alert as issued April 22, 2021, if the proposed amendments are ultimately adopted as a final regulation, the provisions will apply retroactively to Texas franchise tax reports due on or after January 1, 2014, along with Texas qualified R&D exemption registrations made on or after January 1, 2014.²

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Footnotes

¹ Franchise Tax Margin: Research and Development Activities Credit, 46 Tex. Reg. 2565, 2565 (proposed April 6, 2021) (to be codified at 34 Tex. Admin. Code § 3.599) (Tex. Comptroller of Pub. Accounts); Limited Sales, Excise, and Use Tax: Qualified Research, 46 Tex. Reg. 2555, 2555 (proposed April 5, 2021) (to be codified at 34 Tex. Admin. Code § 3.340) (Tex. Comptroller of Pub. Accounts). A copy of the Texas Register issue is available [here](#).

² 46 Tex. Reg. at 2564, 2568.

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