TEXANS for Innovation

TEXAS NEEDS A NEW R&D TAX STRUCTURE TO COMPETE

SUPPORT SB 2206/HB 4393

The State of Texas must extend and improve its Research and Development (R&D) incentive program within the Texas Tax Code to (1) be competitive, (2) support a thriving Innovation Economy and (3) achieve its goal of becoming a top destination for innovation, business growth, and high-quality jobs. Currently, Texas law provides a franchise tax credit and a sales tax exemption for qualifying research activities – which expire on December 31, 2026.

SB 2206/HB 4393 Provide an Updated Tax Structure to Support Research & Development
This new structure will be easier for the State to administer and ensure that Texas remains in the hunt for these exciting projects. The State's economy, and the economic wellbeing of our citizens, will benefit from this smart tax policy, which research demonstrates will pay for itself in resulting economic gains.*

Current Texas R&D Tax Incentives Underperform and are Not Competitive

- Texas lags in R&D investment in the U.S., ranking 33rd as a percentage of GSP.*
- China offers a "super deduction" of 200% for R&D.
- The lack of R&D expenditures in Texas is directly related to inefficient and ineffective tax policy in regard to innovation for a substantial part of the last two decades.*

Texas' Competitors

- **California:** 15% of new QREs in the state, plus 24% of research payments to a public university, public university hospital, or cancer research center.
- **Michigan:** 10-15% of new QREs in the state, depending on whether the research is performed by a large or small company, plus an additional 5% for research in collaboration with a university.
- **Florida:** 10% of new QREs in the state, with a maximum credit of $9 million per year per taxpayer.

"The implication is clear. The question is not whether Texas can afford to extend the R&D tax credit, but instead whether Texas can afford not to extend the R&D tax credit."

– Dr. John Diamond, Rice University, Baker Institute, Lead Study Author

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Economic Benefits of Enhanced R&D Tax Incentives*

- Expanding and making permanent R&D tax credits could create 113,000+ jobs and $8.5 billion in wages by 2035.
- Economic benefits will offset the cost of expanding R&D tax credits. Over 20 years, Texas could see a net economic gain of $58.8 billion.

* *"The Economic Effects of R&D Tax Incentives in Texas," John W. Diamond, Ph.D., Edward A. and Hermena Hancock Kelly Senior Fellow in Public Finance | Director of the Center for Tax and Budget Policy, Baker Institute, Rice University, November 2024.*

Proposed Solution: Supporting R&D Investment in Texas

- Texas will offer a Franchise Tax credit for qualified research expenses (QRE's).
- For simplicity, the Texas credit will be tied to amounts reported on IRS Form 6765.
    - The bill offers rolling conformance to federal law, and provisions for future Form 6765 updates.
    - Taxpayers must file Form 6765 to claim the Texas credit.
- The Texas credit offered would be 8.72%, or 10.903% of new R&D in Texas.
    - The credit amount may not exceed 50% of franchise tax liability.
    - There is a 20-year carry forward.
- There is a refundable credit for businesses below the no-tax-due threshold and new veteran-owned businesses – benefiting small businesses and startups.

R&D Franchise Tax Credit Benefits Universities

- An increase in the franchise tax credit for companies partnering with higher education institutions helps universities attract funding, foster partnerships with industry, and contribute to the overall development of a robust research ecosystem in Texas.

Qualified Research Expenses

Qualified Research Expenses (QREs) for Federal R&D Tax Credits include costs associated with conducting qualified research. "Qualified research" means research to discover technological information through experimentation to develop new or improved products, processes, software, techniques, formulas or inventions. (IRC §§ 41(d)(1), (d)(2)(B).)

What's Included:

- **Wages:** Compensation paid to employees for performing qualified research (Examples: Salaries, bonuses, and stock options for employees conducting experiments, developing new processes, or solving technical problems).
- **Supplies:** Tangible materials used in the research process (Examples: Raw materials for prototypes, chemicals for experiments, and specialized equipment used directly in research).
- **Contract Research:** Payments made to third parties for conducting qualified research when maintaining substantial rights to the research performed by the contractor and bearing the economic risk of the contractor's development (Examples: Fees paid to research organizations, universities, or contractors for performing specific research tasks).
- **Computers:** Costs for using computers in the conduct of qualified research.

What's Excluded: General and administrative costs, Costs related to non-qualified research activities, Land or improvements to land, Depreciable property such as equipment, buildings, machinery, office furniture, and vehicles.

TEXAS MUST STEP UP TO COMPETE FOR ADVANCED MANUFACTURING/R&D PROJECTS.

Texans for Innovation Supporters: