



MULTISTATE TAX

Texas Comptroller adopts new regulations concerning research and development activities

Tax Alert

Overview

On July 29, 2022, the [Texas Register](#) was published adopting certain [proposed regulations](#) which implement several important updates to the Texas Research and Development (“R&D”) activities credit and sales/use tax R&D exemption.

This Tax Alert summarizes the newly adopted amendments and their effective dates, as well as offers some observations.

Adopted changes to the Texas franchise tax R&D credit and exemption

The Texas Comptroller of Public Accounts (“Comptroller”) adopted previously proposed amendments to title 34 of the Texas Administrative Code (“TAC”) §§ 3.599 and 3.340 to provide guidance regarding the franchise tax R&D credit and sales/use tax R&D exemption that modify the state’s definition of the Internal Revenue Code (“IRC”), expand the definition of Internally Used Software, and remove limitations on the credit after a change in the makeup of a combined group.

In 2016, the U.S Department of the Treasury issued final regulations addressing software developed primarily for a taxpayer’s internal use pursuant to IRC § 41, which addresses the federal research credit. Under the previous version of the Texas regulations, a federal regulation adopted after December 31, 2011, would only apply for Texas purposes if the federal regulation required a taxpayer to apply the rule to the 2011 federal income tax year. The Comptroller also noted the current version of Treasury Regulation § 1.41-4 (“Qualified research for expenditures paid or incurred in taxable years ending on or after Dec. 31, 2003”) (as adopted on during 2016) would be an example of a regulation that does not fully apply to the 2011 federal income tax year, and therefore, does not apply for Texas tax purposes.

The adopted regulations amend the definition of the IRC for purposes of the Texas credit to encompass any federal Treasury Regulations that *could have*

applied to the 2011 federal income tax year. The Treasury Regulations and examples that are now specifically enumerated in the TAC include:

- Treasury Regulation § 1.174-2, which defines research and experimental expenditures as contained in 26 C.F.R. part 1 (revised as of July 1, 2014);
- Treasury Regulation § 1.41-4, related to qualified research for expenditures paid or incurred in taxable years ending on or after December 31, 2003 as contained in 26 C.F.R. part 1 (revised as of November 3, 2016), except for paragraph (c)(6) involving Internal Use Software. For paragraph (c)(6), as provided in Treas. Reg. § 1.41-4(e), taxable entities may elect to follow either:
 - Treas. Reg. § 1.41-4(c)(6) as contained in 26 C.F.R. part 1 (revised as of April 1, 2003) and I.R.B. 2001-5; or
 - Proposed Treas. Reg. § 1.41-4(c)(6) (applicable to taxable years beginning on or after the December 31, 1985) as contained in I.R.B. 2002-4.

The adopted regulations also strike certain language pertaining to the definition of Internal Use Software for Texas tax purposes. The following provisions are now removed from the regulation:

- A taxpayer uses software internally if the software was developed for use in the operation of the business. Computer software that is developed to be commercially sold, leased, licensed, or otherwise marketed for separately stated consideration to unrelated third parties is not internal use software.
- Software developed by a taxpayer primarily for internal use by an entity that is part of an affiliated group to which the taxpayer also belongs shall be considered internal use software; and,
- The determination as to whether software is internal use software depends on the facts and circumstances existing at the beginning of the development of the software.

Specific to the franchise tax R&D activities credit, the regulations clarify that a change in the membership of a combined reporting group no longer results in the loss of the Texas R&D credit for either the remaining members of the group or the member leaving the group.

The adopted provisions apply retroactively to Texas franchise tax reports due or on after January 1, 2014, along with Texas Qualified R&D Exemption Registrations made on or after January 1, 2014.

Observations

Taxpayers that have historically claimed the R&D activities credit for Texas franchise tax reporting purposes should consult with their tax advisors to ensure activities qualify under the newly adopted provisions of 34 TAC § 3.599. Taxpayers considering applying for or holding a Texas Qualified R&D Exemption Registration permit should similarly consult with their tax advisors to analyze any potential Texas sales/use tax implications as a result of the new regulations.

Get in touch

[Robert Topp](#)

[Mary Klaasen](#)

[Grace Taylor](#)

[Jerry Lo](#)

[Scott Steinbring](#)

[Lauren Rothman](#)

[Irene Manos](#)

[Guy York](#)



[Deloitte.com](#) | [Unsubscribe](#) | [Manage email preferences](#) | [Legal](#) | [Privacy](#)

30 Rockefeller Plaza
New York, NY 10112-0015
United States

This alert contains general information only and Deloitte is not, by means of this alert, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This alert is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte shall not be responsible for any loss sustained by any person who relies on this alert.

As used in this document, "Deloitte" means Deloitte Tax LLP, a subsidiary of Deloitte LLP. Please see www.deloitte.com/us/about for a detailed description of our legal structure. Certain services may not be available to attest clients under the rules and regulations of public accounting.

Copyright © 2022 Deloitte Development LLC. All rights reserved.