

## Income/Franchise:

### Texas Comptroller Proposes Changes to Rules on Research and Development Credit and Exemption

*Proposed Amended 34 TAC §3.599*, Tex. Comptroller (4/16/21). The Texas Comptroller of Public Accounts (Comptroller) has proposed several amendments to its rule on the Texas franchise (margin) tax credit for research and development (R&D) activities, including details on the “four-part test” described in Internal Revenue Code section 41(d) that determines whether research activities constitute “qualified research” – specifically:

**URL:** <https://www.sos.state.tx.us/texreg/pdf/backview/0416/0416prop.pdf>

1. The “Section 174 Test,”
2. The “Discovering Technological Information Test,”
3. The “Business Component Test,” and
4. The “Process of Experimentation Test.”

The proposed rule changes explain that this four-part test applies separately to each business component of the taxable entity, and that if the whole business component does not meet the requirements of this four-part test, the taxable entity “may then shrink back the business component to the next most significant subset of elements of the business component” until either the four-part test is satisfied, or the most basic element of the product fails the test. The proposal also addresses how the four-part test applies to software development activities, including a list of software development activities that are likely to be considered qualified research and a list of software development activities that are unlikely to be considered qualified research.

The Comptroller additionally has proposed several corresponding amendments [see Proposed Amended 34 TAC §3.340, Tex. Comptroller (4/16/21)] to its Texas R&D sales tax exemption rule concerning the “four-part test” and what constitutes exempt “qualified research.”

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Comments on these proposed R&D administrative rule changes must be received no later than 30 days from the date of their April 16, 2021 publication in the Texas Register.

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