

# ADOPTED RULES

Adopted rules include new rules, amendments to existing rules, and repeals of existing rules. A rule adopted by a state agency takes effect 20 days after the date on which it is filed with the Secretary of State unless a later date is required by statute or specified in the rule (Government Code, §2001.036). If a rule is adopted without change to the text of the proposed rule, then the *Texas Register* does not republish the rule text here. If a rule is adopted with change to the text of the proposed rule, then the final rule text is included here. The final rule text will appear in the Texas Administrative Code on the effective date.

## TITLE 34. PUBLIC FINANCE

### PART 1. COMPTROLLER OF PUBLIC ACCOUNTS

#### CHAPTER 3. TAX ADMINISTRATION

##### SUBCHAPTER V. FRANCHISE TAX

###### 34 TAC §3.588

The Comptroller of Public Accounts adopts an amendment to §3.588, concerning margin: cost of goods sold, with changes to the proposed text as published in the March 15, 2013, issue of the *Texas Register* (38 TexReg 1840).

Subsection (b) is amended to add new paragraph (9), which defines the term "service costs." The following paragraphs are renumbered accordingly.

Comments were received from the State Tax Committee of the Texas Society of Certified Public Accountants (TSCPA) and the Section of Taxation of the State Bar of Texas (SBoT) expressing concern that the proposed definition of the term "service costs" could be read to mean that indirect and administrative overhead costs other than labor costs would no longer be allowed to be included in a taxable entities' cost of goods sold calculation under Tax Code, §171.1012(f). In addition, the SBoT recommended that the specific examples of "service costs" that were proposed to be provided in subsections (b)(9) and (f)(1) should instead be provided in a single place in the rule. Accordingly, subsection (b)(9) has been amended to define service costs as "indirect costs and administrative overhead costs that can be identified specifically with a service department or function or that directly benefit or are incurred by reason of a service department or function." In addition, the examples of types of allowable service costs that were previously provided in subsection (f)(1) have been reorganized in subsection (b)(9).

Subsection (c) is amended to correct typographical errors and to memorialize current comptroller policies. Subsection (c)(3) is amended to implement a change in the comptroller's policy regarding taxable entities filing amended franchise tax reports to change their election to use either the compensation deduction method or the cost of goods sold (COGS) method to compute margin. See STAR Accession No. 201206444L (June 12, 2012). Previously, the regulations stated that if a taxable entity made an election to compute its margin using the COGS method, the entity could not, after the due date of the original report, file an amended report to change the method of computing margin from the COGS method to the compensation deduction method. The revised regulations provide that a taxable entity that initially computed its margin using the COGS method may file an amended report to change the method of computing margin to the compensation deduction method, 70% of total revenue, or, if qualified, the E-Z computation method.

Comments were received from the SBoT expressing concern that the proposed amendment to subsection (c)(3) would only allow a taxable entity to change its election to use the COGS method by filing an amended franchise tax report. The comments emphasized that while a taxable entity under audit might seek to change its election if the auditor determined that the entity was not eligible to use the COGS method, the proposed amendments to the rule could be interpreted to preclude that change. To address these concerns, subsection (c)(3) has been amended to clarify that in addition to changing its election by filing an amended report, a taxable entity may also change its election while under audit.

In addition, comments were received from P. Harris Consulting, Corporate Tax Services, requesting that the comptroller also amend subsection (c)(2) of this section to allow taxpayers to change their election to either capitalize or expense allowable costs. The comptroller declines to amend subsection (c)(2).

Subsection (d) is amended to improve readability, correct typographical errors, and clarify which expenses qualify as direct costs of acquiring or producing goods under Tax Code, §171.1012(c). Subsection (d), which was named "Cost of goods sold," is renamed "Direct costs." Subsection (d)(1), concerning labor costs, is amended to memorialize the comptroller's revised policy, which is based in part on federal income tax requirements, regarding the labor expenses that may be included in a taxpayer's COGS calculation under Tax Code, §171.1012(c)(1). Internal Revenue Code (IRC), §263A identifies costs that would otherwise be deductible as ordinary and necessary business expenses for federal income tax purposes but must instead be capitalized into inventory. Under IRC, §263A, taxpayers must capitalize both direct labor and material costs and indirect costs that directly benefit, or are incurred by reason of, the

performance of production activities. Many of the indirect costs that are required to be capitalized for federal purposes are specifically referenced in Tax Code, §171.1012(c) as part of "all direct costs of acquiring or producing goods." Based upon this, the comptroller has concluded that Tax Code, §171.1012(c)(1) allows taxable entities to include in their cost of goods sold calculation both direct labor costs and those indirect labor costs, other than service costs, that are subject to capitalization under the Treasury Regulations interpreting IRC, §263A. The proposed amendments reflect this policy determination.

The comptroller is aware that many taxpayers fall under the regulations related to IRC, §460, rather than IRC, §263A. The amendments in this subsection include a reference to the federal regulations interpreting IRC, §460, which apply the rules set forth in the relevant portions of the §263A regulations. In addition, the amendments make clear that the expenses described in subsection (d)(1) are expenses of the type that are subject to capitalization under IRC, §263A, without regard to whether a taxable entity actually capitalized those expenses on its federal return.

The SBoT submitted comments suggesting that the comptroller's position, as expressed in subsection (d)(1), might prevent certain small resellers, agricultural and timber businesses, and oil and gas exploration companies from deducting all of their costs. Consequently, subsection (d)(1) is amended to state as follows: "Labor costs. A taxable entity may include in its cost of goods sold calculation labor costs, other than service costs, that are properly allocable to the acquisition or production of goods and are of the type subject to capitalization or allocation under Treasury Regulation Sections 1.263A-1(e) or 1.460-5 as direct labor costs, indirect labor costs, employee benefit expenses, or pension and other related costs, without regard to whether the taxable entity is required to or actually capitalizes such costs for federal income tax purposes."

Both the TSCPA and the SBoT submitted comments expressing concern about the wording of subsection (d)(1)(A). To address those concerns, the subsection is amended to change the term "1099 wages" to "1099 payments for labor," and the phrase "such as" to "including, but not limited to." The revised subsection now reads as follows: "For purposes of this section, labor costs include W-2 wages, IRS Form 1099 payments for labor, temporary labor expenses, payroll taxes, pension contributions, and employee benefits expenses, including, but not limited to, health insurance and per diem reimbursements for travel expenses."

Subsection (d)(3), concerning consumable materials, is amended to add the word "ordinary" to the phrase "course of performing production activities." This term is added to conform the rule language to the language of the statute. Specifically, Tax Code, §171.1012(c)(3) states that the cost of goods sold includes the "cost of materials that are consumed in the ordinary course of performing production activities."

Comments received from the TSCPA expressed concern that the addition of the word "ordinary" to subsection (d)(3) "may create confusion or limit the deduction to only routine expenditures" and requested that the term be removed. Because the term appears in the statute, the comptroller declines to delete it from the rule.

The TSCPA also requested clarification that subsection (d)(11) (relating to taxes) allows property taxes paid on buildings and equipment used in the manufacturing process or in the acquisition or storage of goods to be included in a taxable entity's COGS calculation. The comptroller has amended this subsection to provide the requested clarification.

Subsection (f) is amended to correct typographical errors and to explain the comptroller's existing policy more clearly. Tax Code, §171.1012(f) places a four percent cap on a taxpayer's deduction for "indirect or administrative overhead costs, including all mixed service costs... that... are allocable to the acquisition or production of goods." The indirect or administrative overhead costs identified under Tax Code, §171.1012(f) that are allocable to the acquisition or production of goods are analogous to "service costs" in the federal regulations interpreting IRC, §263A. These "service costs" are defined as "a type of indirect costs (e.g., general and administrative costs) that can be identified specifically with a service department or function or that directly benefit or are incurred by reason of a service department or function." The federal regulations differentiate between deductible service costs, service costs that must be capitalized, and mixed service costs. Tax Code, §171.1012(f), however, applies to all service costs that the taxpayer can demonstrate are allocable to the acquisition or production of goods because the legislature specifically included examples of both deductible service costs and service costs that must be capitalized for federal purposes. Under the plain language of the statute, indirect or administrative overhead costs that are not allocable to the production or acquisition of goods cannot be included in a taxable entity's COGS calculation.

Comments received from the TSCPA and the SBoT emphasized that service costs, as defined by the comptroller's proposed rule, are only one category of indirect or administrative overhead costs. Tax Code, §171.1012(f) allows taxable entities to include all indirect or administrative overhead costs in determining the underlying amount to which the four percent limitation is applied. As proposed, this section would have required taxpayers to apply the four percent limitation to service costs only, not to all indirect or administrative overhead costs. In response to these concerns, the final sentence of subsection (f) of this section is amended to state, "The amount subtracted may not exceed 4.0% of total indirect and administrative overhead costs."

In addition, both the TSCPA and the SBoT submitted comments requesting clarification regarding the proposed use of the word "properly" before the term "allocable" in the proposed rule. The TSCPA expressed concern that the word "properly" lacked specific meaning. The SBoT requested that the term "properly" be deleted or, in the alternative, that subsection (f) be amended to state that costs allocated by a reasonable allocation method described in Treasury Regulation Section 1.263A-1(f)(4) would be deemed to be properly allocated. To provide additional clarity and to address the concerns raised, the comptroller has deleted the word "properly" and replaced it with the word "reasonably." The comptroller intends for this provision to clarify for taxpayers that the allocation method used must be reasonable.

Comments received from the TSCPA further requested "that the Comptroller amend Rule 3.588 to state that costs allowable as direct costs under Rule 3.588(d) should not be treated as 'indirect or administrative overhead costs,' which are subject to the limitations of Rule 3.588(f)(1)." Such an amendment would be contrary to the plain language of Tax Code, §171.1012(f), which, as explained above, states that mixed service costs allocable to the production or acquisition of goods are subject to the four percent cap.

Under the comptroller's revised policy, as reflected in the amendments to subsections (b)(9), (d)(1), and (f), taxpayers may include the following labor expenses in their cost of goods sold calculation: all direct labor costs; all indirect labor costs, other

than service costs, that are capitalized under IRC, §263A; and service costs that are allocable to the acquisition or production of goods, subject to a four percent cap.

Finally, comments received from the SBoT and TSCPA also included recommendations for suggested revisions to subsection (g)(12) of this section and to §3.584 (concerning Margin: Reports and Payments) and §3.589 (concerning Margin: Compensation). The comptroller will consider these recommendations when she proposes revisions to those rules.

The amendment is adopted under Tax Code, §111.002, which provides the comptroller with the authority to prescribe, adopt, and enforce rules relating to the administration and enforcement of the provisions of Tax Code, Title 2.

The amendment implements Tax Code, §171.1012.

*§3.588. Margin: Cost of Goods Sold.*

(a) Effective Date. The provisions of this section apply to franchise tax reports originally due on or after January 1, 2008.

(b) Definitions. The following words and terms, when used in this section, shall have the following meanings, unless the context clearly indicates otherwise.

(1) Arm's length--The standard of conduct under which entities that are not related parties and that have substantially equal bargaining power, each acting in its own interest, would negotiate or carry out a particular transaction.

(2) Computer program--A series of instructions that are coded for acceptance or use by a computer system and that are designed to permit the computer system to process data and provide results and information. The series of instructions may be contained in or on magnetic tapes, printed instructions, or other tangible or electronic media.

(3) Goods--Real or tangible personal property sold in the ordinary course of business of a taxable entity. "Goods" includes:

- (A) the husbandry of animals;
- (B) the growing and harvesting of crops;
- (C) the severance of timber from realty.

(4) Heavy construction equipment--Self-propelled, self-powered, or pull-type equipment that weighs at least 3,000 pounds and is intended to be used for construction. The term does not include a motor vehicle required to be titled and registered.

(5) Lending institution--An entity that makes loans and:

(A) is regulated by the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Commodity Futures Trading Commission, the Office of Thrift Supervision, the Texas Department of Banking, the Office of Consumer Credit Commissioner, the Credit Union Department, or any comparable regulatory body;

(B) is licensed by, registered with, or otherwise regulated by the Department of Savings and Mortgage Lending;

(C) is a "broker" or "dealer" as defined by the Securities Exchange Act of 1934 at 15 U.S.C. §78c; or

(D) provides financing to unrelated parties solely for agricultural production.

(6) Principal business activity--The activity in which a taxable entity derives the largest percentage of its "total revenue".

(7) Production--Construction, manufacture, installation occurring during the manufacturing or construction process, development, mining, extraction, improvement, creation, raising, or growth.

(8) Related party--A person, corporation, or other entity, including an entity that is treated as a pass-through or disregarded entity for purposes of federal taxation, whether the person, corporation, or entity is subject to the tax under this chapter or not, in which one person, corporation, or entity, or set of related persons, corporations, or entities, directly or indirectly owns or controls a controlling interest in another entity.

(9) Service costs--Indirect costs and administrative overhead costs that can be identified specifically with a service department or function, or that directly benefit or are incurred by reason of a service department or function. For purposes of this section, a service department includes personnel (including costs of recruiting, hiring, relocating, assigning, and maintaining personnel records or employees); accounting (including accounts payable, disbursements, and payroll functions); data processing; security; legal; general financial planning and management; and other similar departments or functions.

(10) Tangible personal property--

(A) includes:

(i) personal property that can be seen, weighed, measured, felt, or touched or that is perceptible to the senses in any other manner;

(ii) films, sound recordings, videotapes, live and prerecorded television and radio programs, books, and other similar property embodying words, ideas, concepts, images, or sound, without regard to the means or methods of distribution or the medium in which the property is embodied, for which, as costs are incurred in producing the property, it is intended or is reasonably likely that any medium in which the property is embodied will be mass-distributed by the creator or any one or more third parties in a form that is not substantially altered; and

(iii) a computer program, as defined in paragraph (2) of this subsection.

(B) does not include:

- (i) intangible property or
- (ii) services.

(11) Undocumented worker--A person who is not lawfully entitled to be present and employed in the United States.

(c) General rules for determining cost of goods sold.

(1) Affiliated entities. Notwithstanding any other provision of this section, a payment made by one member of an affiliated group to another member of that affiliated group not included in the combined group may be subtracted as a cost of goods sold only if it is a transaction made at arm's length.

(2) Capitalization or expensing of certain costs. The election to capitalize or expense allowable costs is made by filing the franchise tax report using one method or the other. The election is for the entire period on which the report is based and may not be changed after the due date or the date the report is filed, whichever is later. A taxable entity that is allowed a subtraction by this section for a cost of goods sold and that is subject to Internal Revenue Code, §§263A, 460, or 471 (including a taxable entity subject to §471 that elects to use LIFO under §472), may elect to:

(A) Capitalize those costs in the same manner and to the same extent that the taxable entity capitalized those costs on its federal



income tax return, except for those costs excluded under subsection (g) of this section, or in accordance with subsections (d), (e), and (f) of this section. A taxable entity that elects to capitalize costs on its first report due on or after January 1, 2008, may include, in beginning inventory, costs allowable for franchise tax purposes that would be in beginning inventory for federal income tax purposes.

(i) If the taxable entity elects to capitalize those costs allowed under this section as a cost of goods sold, it must capitalize each cost allowed under this section that it capitalized on its federal income tax return.

(ii) If the taxable entity later elects to begin expensing those costs allowed under this section as a cost of goods sold, the entity may not deduct any cost incurred before the first day of the period on which the report is based, including any ending inventory from a previous report.

(B) Expense those costs, except for those costs excluded under subsection (g) of this section, or in accordance with subsections (d), (e), and (f) of this section.

(i) If the taxable entity elects to expense those costs allowed under this section as a cost of goods sold, costs incurred before the first day of the period on which the report is based may not be subtracted as a cost of goods sold.

(ii) If the taxable entity later elects to begin capitalizing those costs allowed under this section as a cost of goods sold, costs incurred prior to the accounting period on which the report is based may not be capitalized.

(3) Election to subtract cost of goods sold. A taxable entity, if eligible, must make an annual election to subtract cost of goods sold in computing margin by the due date, or at the time the report is filed, whichever is later. The election to subtract cost of goods sold is made by filing the franchise tax report using the cost of goods sold method. An amended report may be filed within the time allowed by Tax Code, §111.107 to change the method of computing margin to the cost of goods sold deduction method or from the cost of goods sold deduction method to the compensation deduction method, 70% of total revenue, or, if otherwise qualified, the E-Z computation method. An election may also be changed as part of an audit. See §3.584 of this title (relating to Margin: Reports and Payments).

(4) Exclusions from total revenue. Any expense excluded from total revenue (see §3.587 of this title (relating to Margin: Total Revenue)) may not be included in the determination of cost of goods sold.

(5) Film and broadcasting. A taxable entity whose principal business activity is film or television production or broadcasting or the sale of broadcast rights or the distribution of tangible personal property described by subsection (b)(10)(A)(ii) of this section, or any combination of these activities, and who elects to use cost of goods sold to determine margin, may include as cost of goods sold:

(A) the costs described in this section in relation to the property;

(B) depreciation, amortization, and other expenses directly related to the acquisition, production, or use of the property, including

(C) expenses for the right to broadcast or use the property.

(6) Lending institutions. Notwithstanding any other provision of this section, if the taxable entity is a lending institution that offers loans to the public and elects to subtract cost of goods sold, the

entity may subtract as a cost of goods sold an amount equal to interest expense.

(A) This paragraph does not apply to entities primarily engaged in an activity described by category 5932 of the 1987 Standard Industrial Classification Manual published by the federal Office of Management and Budget.

(B) For purposes of this subsection, an entity engaged in lending to unrelated parties solely for agricultural production offers loans to the public.

(7) Mixed transactions. If a transaction contains elements of both a sale of tangible personal property and a service, a taxable entity may only subtract as cost of goods sold the costs otherwise allowed by this section in relation to the tangible personal property sold.

(8) Owner of goods. A taxable entity may make a subtraction under this section in relation to the cost of goods sold only if that entity owns the goods. The determination of whether a taxable entity is an owner is based on all of the facts and circumstances, including the various benefits and burdens of ownership vested with the taxable entity.

(A) A taxable entity furnishing labor or materials to a project for the construction, improvement, remodeling, repair, or industrial maintenance (as the term "maintenance" is defined in §3.357 of this title (relating to Nonresidential Real Property Repair, Remodeling, and Restoration; Real Property Maintenance)), of real property is considered to be an owner of the labor or materials and may include the costs, as allowed by this section, in the computation of the cost of goods sold.

(B) Solely for the purposes of this section, a taxable entity shall be treated as the owner of goods being manufactured or produced by the entity under a contract with the federal government, including any subcontracts that support a contract with the federal government, notwithstanding that the Federal Acquisition Regulations may require that title or risk of loss with respect to those goods be transferred to the federal government before the manufacture or production of those goods is complete.

(9) Rentals and leases. Notwithstanding any other provision of this section, the following taxable entities may subtract as cost of goods sold the costs otherwise allowed by this section in relation to tangible personal property that the entity rents or leases in the ordinary course of business of the entity:

(A) a motor vehicle rental company that remits a tax on gross receipts imposed under Tax Code, §152.026 or a motor vehicle leasing company;

(B) a heavy construction equipment rental or leasing company; and

(C) a railcar rolling stock rental or leasing company.

(10) Reporting methods. A taxable entity shall determine its cost of goods sold, except as otherwise provided by this section, in accordance with the methods used on the federal income tax return on which the report under this chapter is based. This subsection does not affect the type or category of cost of goods sold that may be subtracted under this section.

(11) Restaurants and bars. Entities engaged in activities described in Major Group 58 (Eating and Drinking Places) of the Standard Industrial Classification Manual may deduct for cost of goods sold only those expenses allowed under subsections (d), (e) and (f) of this section, that relate to the acquisition and production of food and beverages. Any costs related to both the production of food and beverages

and to other activities must be allocated to production on a reasonable basis.

(d) Direct costs. The cost of goods sold includes all direct costs of acquiring or producing the goods. Direct costs include:

(1) Labor costs. A taxable entity may include in its cost of goods sold calculation labor costs, other than service costs, that are properly allocable to the acquisition or production of goods and are of the type subject to capitalization or allocation under Treasury Regulation Sections 1.263A-1(e) or 1.460-5 as direct labor costs, indirect labor costs, employee benefit expenses, or pension and other related costs, without regard to whether the taxable entity is required to or actually capitalizes such costs for federal income tax purposes.

(A) For purposes of this section, labor costs include W-2 wages, IRS Form 1099 payments for labor, temporary labor expenses, payroll taxes, pension contributions, and employee benefits expenses, including, but not limited to, health insurance and per diem reimbursements for travel expenses, to the extent deductible for federal tax purposes.

(B) Labor costs under this paragraph shall not include any type of costs includable in subsection (f) or excluded in subsection (g) of this section. Costs for labor that do not meet the requirements set forth in this paragraph may still be subtracted as a cost of goods sold if the cost is allowed under another provision of this section. For example, service costs may be included in a taxable entity's cost of goods sold calculation to the extent provided by subsection (f) of this section.

(2) Incorporated materials. A taxable entity may include in its cost of goods sold calculation the cost of materials that are an integral part of specific property produced.

(3) Consumable materials. A taxable entity may include in its cost of goods sold calculation the cost of materials that are consumed in the ordinary course of performing production activities.

(4) Handling costs. A taxable entity may include in its cost of goods sold calculation handling costs, including costs attributable to processing, assembling, repackaging, and inbound transportation.

(5) Storage costs. A taxable entity may include in its cost of goods sold calculation storage costs, including the costs of carrying, storing, or warehousing property, subject to subsection (g) of this section, concerning excluded costs.

(6) Depreciation, depletion, and amortization. A taxable entity may include in its cost of goods sold calculation depreciation, depletion, and amortization reported on the federal income tax return on which the report under this chapter is based, to the extent associated with and necessary for the production of goods, including recovery described by Internal Revenue Code, §197, and property described in Internal Revenue Code, §179.

(7) Rentals and leases. A taxable entity may include in its cost of goods sold calculation the cost of renting or leasing equipment, facilities, or real property directly used for the production of the goods, including pollution control equipment and intangible drilling and dry hole costs.

(8) Repair and maintenance. A taxable entity may include in its cost of goods sold calculation the cost of repairing and maintaining equipment, facilities, or real property directly used for the production of the goods, including pollution control devices.

(9) Research and development. A taxable entity may include in its cost of goods sold calculation the costs attributable to research, experimental, engineering, and design activities directly related

to the production of the goods, including all research or experimental expenditures described by Internal Revenue Code, §174.

(10) Mineral production. A taxable entity may include in its cost of goods sold calculation geological and geophysical costs incurred to identify and locate property that has the potential to produce minerals.

(11) Taxes. A taxable entity may include in its cost of goods sold calculation taxes paid in relation to acquiring or producing any material, including property taxes paid on buildings and equipment, and taxes paid in relation to services that are a direct cost of production.

(12) Electricity. A taxable entity may include in its cost of goods sold calculation the cost of producing or acquiring electricity sold.

(13) A taxable entity may include in its cost of goods sold calculation a contribution to a partnership in which the taxable entity owns an interest that is used to fund activities, the costs of which would otherwise be treated as cost of goods sold of the partnership, but only to the extent that those costs are related to goods distributed to the contributing taxable entity as goods-in-kind in the ordinary course of production activities rather than being sold by the partnership.

(e) Additional costs. In addition to the amounts includable under subsection (d) of this section, the cost of goods sold includes the following costs in relation to the taxable entity's goods:

- (1) deterioration of the goods;
- (2) obsolescence of the goods;
- (3) spoilage and abandonment, including the costs of rework, reclamation, and scrap;
- (4) if the property is held for future production, preproduction direct costs allocable to the property, including storage and handling costs, as provided by subsection (d)(4) and (5) of this section;
- (5) postproduction direct costs allocable to the property, including storage and handling costs, as provided by subsection (d)(4) and (5) of this section;
- (6) the cost of insurance on a plant or a facility, machinery, equipment, or materials directly used in the production of the goods;
- (7) the cost of insurance on the produced goods;
- (8) the cost of utilities, including electricity, gas, and water, directly used in the production of the goods;
- (9) the costs of quality control, including replacement of defective components pursuant to standard warranty policies, inspection directly allocable to the production of the goods, and repairs and maintenance of goods; and
- (10) licensing or franchise costs, including fees incurred in securing the contractual right to use a trademark, corporate plan, manufacturing procedure, special recipe, or other similar right directly associated with the goods produced.

(f) Indirect or administrative overhead costs. A taxable entity may subtract as a cost of goods sold service costs, as defined in subsection (b)(9) of this section, that it can demonstrate are reasonably allocable to the acquisition or production of goods. The amount subtracted may not exceed 4.0% of total indirect and administrative overhead costs.

(1) Any costs already subtracted under subsections (d) or (e) of this section may not be subtracted under this subsection.

(2) Any costs excluded under subsection (g) of this section may not be subtracted under this subsection.

(g) Costs not included. The cost of goods sold does not include the following costs in relation to the taxable entity's goods:

(1) the cost of renting or leasing equipment, facilities, or real property that is not used for the production of the goods;

(2) selling costs, including employee expenses related to sales;

(3) distribution costs, including outbound transportation costs;

(4) advertising costs;

(5) idle facility expenses;

(6) rehandling costs;

(7) bidding costs, which are the costs incurred in the solicitation of contracts ultimately awarded to the taxable entity;

(8) unsuccessful bidding costs, which are the costs incurred in the solicitation of contracts not awarded to the taxable entity;

(9) interest, including interest on debt incurred or continued during the production period to finance the production of the goods;

(10) income taxes, including local, state, federal, and foreign income taxes, and franchise taxes that are assessed on the taxable entity based on income;

(11) strike expenses, including costs associated with hiring employees to replace striking personnel, but not including the wages of the replacement personnel, costs of security, and legal fees associated with settling strikes;

(12) officers' compensation;

(13) costs of operation of a facility that is:

(A) located on property owned or leased by the federal government; and

(B) managed or operated primarily to house members of the armed forces of the United States;

(14) any compensation paid to an undocumented worker used for the production of goods; and

(15) costs funded by a partnership contribution, to the extent that the contributing taxable entity made the cost of goods sold deduction under subsection (d)(13) of this section.

This agency hereby certifies that the adoption has been reviewed by legal counsel and found to be a valid exercise of the agency's legal authority.

Filed with the Office of the Secretary of State on May 16, 2013.

TRD-201301989

Ashley Harden

General Counsel

Comptroller of Public Accounts

Effective date: June 5, 2013

Proposal publication date: March 15, 2013

For further information, please call: (512) 475-0387

◆ ◆ ◆