This Week in State Tax (TWIST)

March 30, 2026

Texas: Comptroller releases draft rule on IRC conformity and computation of COGS

The Texas Comptroller of Public Accounts has proposed amendments to the Cost of Goods Sold (COGS) deduction for the Texas Franchise Tax. The amendments reflect an earlier determination of the Comptroller that certain elements of franchise tax, including depreciation under the COGS deduction, should be based on the current version of the Internal Revenue Code (IRC). The proposed amendments are expected to be published in the Texas State Register on April 3, 2026, and the public comment period is open until May 3, 2026.

Historically, the franchise tax has been tied to the IRC as in effect for the tax year beginning on January 1, 2007, and items on the franchise tax report taken from the federal return were to be computed under the IRC of 2007. In December 2025, the Comptroller determined that certain aspects of the franchise tax reports should be based on the current federal law. As detailed in a Policy Memo, beginning with the 2026 franchise tax report, a taxable entity will determine amounts taken from the federal tax return under the current year federal tax law, unless the franchise tax statute or rule specifically references the IRC, in which case those amounts must be determined under the IRC in effect on January 1, 2007.

For franchise tax purposes, a taxable entity may include in its COGS deduction the depreciation or amortization it claims for federal tax purposes, to the extent those assets are “associated with and necessary for the production of the goods.” The proposed rule provides that beginning with the 2026 franchise tax report, a taxable entity shall use the current federal tax law instead of the IRC of 2007 when determining the includible depreciation, including amounts for depreciable assets which the taxable entity elected to expense. The draft specifically calls out that any deduction for amortization of goodwill or other intangibles under IRC section 197 must be determined under the IRC rules of 2007 as statute authorizing such recovery specifically references the IRC. The proposed amendment also deletes a reference to IRC section 179 in the current rule, meaning any depreciation under IRC section 179 on the 2026 report will be based on current rules.

The proposed rule allows a “one-time net depreciation adjustment” on the entity’s 2026 report for each asset placed in service prior to the beginning of the accounting period on which the 2026 report is based, if the asset has not been disposed of. The adjustment for each asset is the difference between the depreciation claimed on the federal return and that claimed for franchise tax purposes each year. The total adjustment allowed on the 2026 report is the sum of the annual adjustments for each property, but the adjustment may not be less than zero and may not reduce the taxable margin of the entity below zero. Any unused adjustment may be carried forward to successive years.

This discussion is based on a draft of the proposed amendments. Changes may occur before final promulgation. For further information, please contact Jeffrey Benson or Karey Barton. Also, KPMG will publish a SALT Alert on the proposed rule this week.

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