



SALT Alert! 2026-04: Texas Comptroller Proposes Amendments to Franchise Tax Rule on Cost of Goods Sold

The Texas Comptroller of Public Accounts has proposed amendments to the administrative rule governing computation of the Cost of Goods Sold (COGS) deduction for the Texas Franchise Tax. The amendments are intended to reflect the Comptroller's determination that certain elements of the franchise tax, including the COGS deduction, can be based on the current version of the Internal Revenue Code (IRC) as opposed to that in effect on January 1, 2007. 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. The description and comments below are based on a courtesy copy of the draft amendments provided to certain parties.

Background

Historically, the Texas Franchise Tax has been tied to the IRC as in effect for the tax year beginning on January 1, 2007, and those aspects of the franchise tax report that were taken from the federal income tax return were required to reflect what those return amounts would be when computed under the IRC as of January 1, 2007. In December 2025, the Comptroller conducted a new statutory review of the franchise tax conformity to the IRC and determined that certain aspects of the franchise tax reports could be based on the "then-current" federal tax law, rather than the IRC of 2007.

As detailed in a [Policy Memo](#) issued in December 2025 and updated in March 2026—beginning with the 2026 franchise tax reports originally due on or after January 1, 2026—a taxable entity will determine amounts taken from the federal tax return under the federal tax law in effect for that federal tax year, unless the franchise tax statute or rule specifically references the IRC. When the statute or rule references the IRC, those amounts must be determined under the IRC in effect as of January 1, 2007. The Policy Memo discussed the general impact of the policy change on three areas of the franchise tax: Total Revenue, COGS, and Apportionment. It indicated that the Comptroller would be amending the franchise tax rules governing Total Revenue and COGS to reflect the change. The Comptroller adopted amendments to the Total Revenue rule (Rule 3.587) in February 2026, and the proposed COGS rule is discussed here.

Proposed Amendments

The draft amendments to the COGS rule (Rule 3.588. Margin: Cost of Goods Sold) outline the procedure for computing the “depreciation, depletion, and amortization” that a taxable entity may include in its COGS deduction. Throughout the rule, allowable depreciation, depletion, and amortization that may be deducted is “only to the extent associated with and necessary for the production of the goods.”

Specifically, the proposed rule provides that beginning with the 2026 franchise tax report, a taxable entity shall use the then-current federal tax law instead of the IRC as of 2007 when determining the includible depreciation from the federal tax return on which the report is based, including amounts for which the taxable entity elected to expense certain depreciable business assets. The IRC of 2007 applies only when the statute and rule specifically reference the IRC.

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 the statute authorizing such recovery specifically references the IRC (as opposed to more generally referencing the ‘federal tax return’). The proposed amendment also deletes a reference to IRC section 179 in the current rule because the franchise tax statute contained no reference specifically to IRC section 179. As a result, any depreciation under IRC section 179 that is claimed on the 2026 report will be based on current federal rules and not tied to 2007.

The proposed rule allows a “one-time net depreciation adjustment” on the entity’s 2026 report for each “qualifying asset,” which is defined as an 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 before the first day of that period.¹ The adjustment for each qualifying asset for any given year is the difference between the depreciation claimed on the federal tax return and that claimed for franchise tax purposes, which may be a negative amount. If a taxpayer did not claim depreciation in its COGS deduction in any year, the net adjustment for that year is zero. A depreciation adjustment is not available for recovery under IRC section 197, as that provision remains tied to the IRC as of 2007. The total adjustment to be taken on the 2026 report is the sum of all the adjustments for each piece of qualifying property, but the total net depreciation adjustment may not be less than zero and may not reduce the taxable margin for the entity below zero. Any unused adjustment may be carried forward to successive years and claimed as an adjustment to COGS in those years until fully utilized.

The proposed rule also includes a definition for “Internal Revenue Code” that is defined to mean the IRC of 1986 “in effect for the federal tax year beginning on January 1, 2007, not including any changes made by federal law after that date, and any regulation under that code applicable to that period.” The rule further clarifies that this definition applies unless the context clearly indicates that the current version of the IRC is intended or the rule expressly refers to “current federal tax law.” It further contains amendments to provisions involving television or radio broadcasting, movie theaters, and motion pictures.

Other Franchise Tax Provisions

As noted, the Policy Memo also indicated that certain aspects of the computation of Total Revenue and Apportionment for franchise tax purposes are affected by the

policy change. The Comptroller promulgated a new rule for the computation of Total Revenue (Rule 3.587) in February 2026. As put forth in the rule, a taxable entity computes its total revenue by adding specific line items from the federal tax return and then adding or subtracting certain categories of income and expense. The IRC is not specifically referenced in identifying the line items with which to begin the calculation, and those line items will be based on current federal law. Some income and expense categories do, however, specifically reference the IRC and will be tied to the IRC as of January 1, 2007.

Of particular note, there is a subtraction for foreign royalties and dividends as determined under IRC section 78 and IRC sections 951-964, meaning that computation of those items will be based on the IRC in effect on January 1, 2007. The revised rule notes specifically that the exclusion under this section will not include amounts for foreign derived intangible income (FDII) or global intangible low-taxed income (GILTI) as defined in the Tax Cuts and Jobs Act of 2017 (P.L. 115-97); neither will it include their successors of foreign-derived deduction eligible income (FDDEI) or net controlled foreign corporation tested income (NCTI) as defined by the One Big Beautiful Bill Act (P.L. 119-21). The amended rule also provides that FDII, GILTI, FDDEI, and NCTI are not considered dividends and are not allowable as a part of the allowable exclusions from Total Revenue for amounts on Form 1120, Schedule C, to the extent the related dividend income is included in total revenue. The revised Rule 3.587 is effective for franchise tax reports due on or after January 1, 2026.

With respect to apportionment, the Policy Memo and the Preamble to the amended Rule 3.587 indicates that taxable margin is apportioned to Texas based a single gross receipts factor. Beginning with reports due on or after January 1, 2026, the apportionment factor will be based on total revenue determined under the current federal tax law, except in instances in which the IRC is specifically mentioned as outlined above.

Conclusion and Next Steps

Taken together, the Comptroller's new approach in dealing with the conformity to the Internal Revenue Code is based on two principles:

1. Amounts that are defined by reference to line items "as reported on the federal income tax return," which will generally follow current federal law for the tax year involved; and
2. Amounts for which the franchise tax statutes or rules explicitly reference the IRC (e.g., IRC sections 78 and 951–964 or section 197), which will continue to be determined using the IRC as in effect for the federal tax year beginning January 1, 2007.

Please bear in mind that the proposed COGS rule discussion is based on a draft of the proposed amendments provided only to certain parties. The rule will be open for public comment until May 3, 2026, after which there may also be changes made by the Comptroller prior to final adoption. For further information, please contact [Jeffrey Benson](#) or [Karey Barton](#).

Footnote

¹ Current federal depreciation provisions as set forth in the One Big Beautiful Bill Act (P.L. 119-21) apply to assets placed in service on or after January 19, 2025.