



# States of Affair

Volume 3, Issue 3 Summer 2005

## Ohio Tax Reform - A new "CAT" in town

On June 30, 2005, Governor Bob Taft signed into law Am. Sub. H. B. 66 and ushered in a new era in Ohio taxation. The bill follows closely the legislation originally proposed by the Governor in February 2005 (see *States of Affair*, Winter 2004/2005) and has as its centerpiece the adoption of a new Commercial Activity Tax ("CAT"). The law also phases out over 5 years the corporation franchise tax for most taxpayers and phases out over 4 years the reviled personal property tax.

The CAT is a **gross receipts tax** imposed at a rate of .26% on Ohio receipts over \$1 million. For taxpayers with receipts of \$150,000 to \$1 million, there is a minimum tax of \$150. Persons with less than \$150,000 of receipts will be excluded from the tax. The CAT is effective July 1, 2005 at a rate of .06% for receipts earned through December 31, 2005. The tax rate will continue to increase until it reaches .26% in the 2010 tax year and will be subject to periodic reviews to ensure that desired revenue levels are reached.

The CAT **applies to virtually all businesses operating in Ohio**, regardless of how they are organized, including corporations, S corporations, partnerships, limited liability companies and sole proprietorships. The CAT does not apply to financial institutions, dealers in intangibles, insurance companies and public utilities, all of which will remain subject to their current tax schemes.



Gross receipts are defined broadly as the amount realized from the sale or lease of the taxpayer's property or services and include cash, property and liabilities assumed. The only deductions permitted are for cash discounts allowed and taken, returns and allowances and bad debts from receipts upon which the CAT was paid in a prior taxable period. A number of excluded receipts are statutorily provided, including, among others, interest income (except interest on credit sales), dividends and distributions from corporations, distributive or proportionate shares of receipts and income from pass-through entities, receipts from the sale of capital assets, the proceeds of loans or capital contributions, employee compensation, proceeds from life insurance policies and tax refunds. The method of accounting for receipts is the taxpayer's method of accounting for federal income tax purposes.

Ohio gross receipts are receipts from the sale or rental of tangible personal property ultimately delivered or used in Ohio. Services are allocated to Ohio based on the proportion of the benefit that is received in Ohio. Governor Taft used his line item veto power to remove a provision of the law that would have applied the franchise tax situsing rules to the CAT, noting that since Ohio recently changed its allocation of services from cost of performance to location of benefit there is no applicable franchise tax case

*(Continued on page 5)*



Labhart Miles visit APL, Ltd. at the Los Angeles Port facility

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### Guest Articles

Labhart Miles Consulting Group, specializing in cost effective state and local tax solutions, is pleased to provide this newsletter as a resource.

This month we showcase two guest articles, contributed by Larry Evans & Inez Mello. We welcome your comments. If you know of someone who could benefit from this publication, or if you would like to contribute an article, please let us know. For more information, please contact us at:

408-266-2259 or [www.labhartmiles.com](http://www.labhartmiles.com)

Thanks to all of our clients and affiliates.

*Bill Labhart & Monika Miles*

**Bank CFO Conference a Success!** - In March 2005, Labhart Miles sponsored a booth at the 2005 Pacific Coast Bankers Bank CFO conference in Newport Beach, CA. Thank you to those who stopped by our booth or attended our technical session. And an extra special **thank you** to our new clients that found us as a result of the conference!

## **Streamlined Sales Tax Project...are you prepared for it? - Inez Mello**

*In our efforts to keep our clients up-to-date on the progress of the SSTP in various states, we have asked **Inez Mello** of Batchelor, Frechette, McCrory, Michael & Co. of Providence, Rhode Island, to provide some insight into the latest happenings on the progress being made in the program. Inez is a frequent lecturer at colleges, and is the President of the Rhode Island Chapter of the American Society of Women Accountants. She can be reached at: [imello@bfmmcpa.com](mailto:imello@bfmmcpa.com).*

### **As of Today**

You may recall the SSTP is the national level quasi-governmental organization working to simplify the sales tax system in all states. The SSTP will be activated as a voluntary sales tax system on October 1, 2005. An initial Governing Board of 18 states will hold its first meeting on October 1 in Washington D.C. The member states are AR, IN, IA, KS, KY, MI, MN, NE, NJ, NC, ND, OH, SD, TN, UT, WV, and WY.

To date, 19 states have enacted legislation conforming their state sales tax laws to the agreement. Of the 19 states, 15 (IA, IN, KS, KY, MI, MN, NE, NC, OH, OK, SD, TN, UT, WV, and WY) representing 24.1 percent of the sales tax population have legislation that is currently effective and impacting businesses. The SSTP requires 20 percent of the states tax population to be on board in order to activate the program. The other four conforming states (AR, NV, ND, and VT) have effective dates that are either July 1, 2006 or are contingent on the Agreement being in force. Texas and Washington have also enacted some conformity provisions. However, their failure to enact the Agreement's sourcing rules, among other provisions, prevented them from being included on the Conforming States Committee and should preclude them from being found in compliance with the Agreement.

Federal legislation has been introduced and supported by most states to move the system from voluntary to mandatory. This would effectively eliminate the nexus provisions that have historically protected thousands of businesses from burdensome state and local tax collection requirements.

Further evidence that the program is becoming a reality is that the Conforming States Committee has announced the appointment of Scott Peterson as the Interim Director for the SSTP. He is currently the Director of the Business Tax Division for the South Dakota Department of Revenue.

Another issue continues to be the timing of promised technology to businesses to support the system. States are changing their state sales tax statutes now in anticipation of a future, active SSTP governing board. A more user-friendly technology was to be a cornerstone to the "streamlined" design of the new system. At this time, the SSTP has not issued requests to vendors to develop the promised technology software. Additionally, states need to decide what costs they are willing to pay for. Initially, this new system was to pass no new costs on to taxpayers - this may not be the case.

### **Amnesty**

The amnesty provisions confirm that amnesty is available even for entities that have nexus in a member state. If all requirements are met, it provides a clean slate for all prior sales tax obligations forgiven. Receipt of a nexus questionnaire is not considered a notice of the commencement of an audit, thus not preventing an entity from pursuing amnesty. Amnesty continues to be an anonymous program under the system although states may choose to follow this rule. Affected taxpayers would be well advised to consult with a state tax professional before proceeding with amnesty.



### **Definitions**

Debate continues to surround standard definitions for food, bundling, and sales tax holidays. Some of the most heated debate has centered around the definition of "sales price" as it pertains to retailer buy downs. Both the states and business sector encouraged continue dialogue and amended standard definitions.

### **What Does This Mean to You?**

If a state in which your company is conducting business has conforming legislation, you should:

- Start using the new definitions, exemption provisions and sourcing rules.
- Consider whether it will make sense for your business to register under the Simplified Streamlined Sales and Use Tax Agreement.
- Follow the new due dates for sales tax returns.
- Monitor developments as the states implement the online registration, payment by automated clearinghouse, and other provisions of the SSTP.

If you have any questions regarding the SSTP, please contact us.

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## Multi-State Tax News

**Kansas** - The Kansas Department of Revenue has ruled that its auditors may adjust federal adjusted gross income to more accurately reflect that state's corporate income tax. According to Kansas revenue officials, the federal return number is only a starting point for auditors. *Kansas Revenue Department Revenue Ruling 19-2005-1.*

**South Carolina** - In a piece of legislation recently signed into law, the State assures owners and users of distribution facilities that they will be able to own or lease property at a distribution center or ship tangible property through the state without triggering that state's income tax. Additionally, the bill also states that that ownership or utilization of a distribution facility won't raise to the physical presence standard for sales and use tax either. *S.C General Assembly A157, R207, H3006 signed into law June 6, 2005.*

**Texas** - How much time an in-state resident sales representative spends in Texas proved to be critical when the Texas Third District Court held that spending 7-10 days soliciting orders in the state was **not** de minimus as the company contended. Moreover, the Court held, taxing the company on only its net taxable capital is not prohibited by P.L. 86-272, as that levy doesn't meet the standard of an income tax. The decision is expected to be appealed by the business. *INOVA Diagnostics, Inc. v. Tex. Comptroller and Attorney General, 353rd Judicial Dist. No. 03-04-00503-CV, 5/26/05.*

## Credits & Incentives Updates

### Incentive News

**Illinois** - Sara Lee is building a new corporate headquarters facility in Downers Grove, IL, which will create an additional 400 new jobs. The incentives include 10 year EDGE income tax credit, LBDP infrastructure grant and ETIP job training grant for a total \$5.6 million over 10 years.



**New York** - Garlock Sealing Technologies is rebuilding a manufacturing facility in Palmyra which will permit the company to retain 450 jobs. Incentives include Empire State Development Grant, Empire Opportunity Grant, state and Wayne County sales tax rebates on new construction, and a county property tax rebate. Total incentives estimated at \$8 million over 10 years.

**Michigan** - Dow Chemical, spending \$45.1 million to rehabilitate part of its manufacturing facilities in Midland, received \$4.5 million over 10 years. The benefit, a state single business tax credit for brown-fields renovation, will permit the company to retain 41 jobs and allow for future resin production at the site.

## Speaking Out

### Public Speaking:

Labhart Miles guest lectured at San Jose State University for Professor Annette Nellen's MST Program capstone class: "Business and Tax Aspects of High Tech Companies," July 28th, 2005.

**Topic:** "State and Local Hot Topics, California Enterprise Zones, and Nexus"

### Organizations:

Monika Miles has accepted a Board position with the Silicon Valley Chapter of **NAWBO (National Association of Women Business Owners)** as program director.

### In Print:

Bill Labhart is an editor for the *Journal of Multistate Taxation and Incentives*. If you have an article that you would like to submit for future publication, please contact Bill Labhart.

Monika Miles, who serves on the **National Board of Directors of the American Society of Women Accountants**, is Editor of "The EDGE," the organization's publication.

### The Community

Labhart Miles will again be sponsoring a team for the American Cancer Society's Annual "Making Strides Against Breast Cancer" to be held October 22nd in Golden Gate Park.



## Focus On: New York “The Empire State”



### About New York:

Existing as a colony of Great Britain for over a century, New York declared its independence in July 1776, becoming one of the original 13 states of the Federal Union. NY was the first state to require license plates for autos, had the first railroad which ran eleven miles from Albany to Schenectady and was home to the nation's first capital, New York City.

### Business Climate:

New York is as diverse as its population. It is one of the world's leading financial centers as well as an industry leader in printing and publishing, chemical products, and tourism.

### Taxes

New York in recent years has attempted to reduce its tax bite. Nearly all taxes in New York State have been cut, with substantial reductions in business, estate, sales, property and personal income taxes. It now enjoys one of the lowest corporate tax rates in the Northeast.

### Corporate Income/Franchise Tax

Most corporations are subject to the tax on general business corporations under Article 9-A of the Tax Law and compute the tax on four different measures: a tax measured by the entire net income base, a tax measured by the capital base, a tax measured by the minimum taxable income base, and a tax measured by a fixed dollar minimum. The corporation pays the highest computed tax, plus a

During a tour of the State's harbors, waterways and fertile interior, George Washington referred to New York as the "Seat of Empire." Hence, the State nickname as the Empire State.

tax on the subsidiary capital base, if applicable. The tax on the capital base may not apply to certain small business corporations for their first two tax years.

### Sales Tax

The sales/use tax rates: state, county and local range from approximately 7-9%.

### Credits & Incentives:

New York offers a variety of incentives to companies expanding or relocating in the State.

**Investment Tax Credit:** Businesses that create new jobs and make new investments in production property and equipment may qualify for tax credits of up to 10% of their eligible investment. New businesses may elect to receive a refund of certain credits, and all unused credits can be carried forward for 15 years.

**Research and Development Tax Credit:** Investments in research and development facilities are eligible for a 9% corporate tax credit. Additional credits are available to encourage the creation and expansion of emerging technology businesses, including a three-year job creation credit of \$1,000 per employee and a capital credit for investments in emerging technologies.

**Sales Tax Exemptions:** New York State offers exemptions for purchases of production machinery and equipment, research and development property, and fuels/utilities used in manufacturing and R&D.

**Real Property Tax Abatement:** to encourage development,

expansion, and improvement of commercial property, a 10 year property tax abatement is available to offset increased assessments due to improvements to business and commercial property.

### Qualified Empire Zones:

Qualified Empire Zone Enterprises (QEZE) are eligible for a **sales tax exemption** (a ten year exemption from State sales tax on purchases of goods and services used predominantly in the zone); and a **credit for real property and business tax credits** for businesses locating and/or expanding in EZs (a refundable credit against the business tax equal to a percentage of real property taxes paid based upon increased employment in the zone).

The purpose of the Empire Zones Program is to give companies that increase employment the opportunity to operate on an almost "tax free" basis for up to 10 years in designated areas of the State, with declining benefits in years 11 through 15. The QEZEs are effective for 2001 forward and pre-certification is required.

See Bottom of page 7 for news on US Supreme Court's recent ruling regarding wine shipments to NY!



### Notable / Quotable

*"Obstacles are what you see when you take your eyes off the goal."* - Vince Lombardi - coach

*"There are many ways of going forward, but only one way of standing still."* - F.D.Roosevelt - former US President

Other famous New Yorkers: Barbara Streisand, Jonas Salk, Lucille Ball, Theodore Roosevelt, Kareem Abdul-Jabbar, John D. Rockefeller



## Ohio's CAT - continued from page 1



law on the new rule.

A potentially **controversial “bright-line” standard** provides that a person has nexus for the CAT if it: (a) has property in Ohio of at least \$50,000 (with owned property valued at original cost and rented property valued at eight times annual net rent), (b) has payroll in Ohio of at least \$50,000, (c) has gross receipts in Ohio of at least \$500,000, (d) has 25% percent of its total property, payroll or receipts in Ohio or (e) is domiciled in Ohio. Thus, a person with no property or payroll in Ohio would be subject to the tax if it ships more than \$500,000 of property to Ohio purchasers in a taxable year. This provision is expected to be challenged on constitutional grounds.

A group of two or more persons under common control may elect to be a “consolidated elected taxpayer.” An election must include all persons having at least 80% (or 50%, at the election of the taxpayer), of the value of their ownership interests owned or controlled by common owners, regardless of whether all commonly owned persons have nexus with Ohio. All foreign corporations in the group would be included or excluded at the election of the taxpayer. The election is binding for eight quarters and is automatically renewed unless the taxpayer elects out. **The major advantage of the consolidated election is that receipts from transactions between members of the group are eliminated.**

All persons with more than 50% of their value owned by common owners that are not part of a consolidated elected taxpayer will be members of a combined taxpayer and must file returns on a combined basis. Only persons with Ohio nexus are included in a combined filing but transactions between members are not eliminated.

The consolidated election must be made no later than the beginning of the first calendar quarter to which the election applies or November 15, 2005. To be effective July 1, 2005, the election must be made by November 15, 2005. Thus, taxpayers must quickly consider whether a consolidated election should be made. The decision is somewhat complicated by the expectation that the “bright-line” nexus provisions of the new law may be challenged.

**Credits for jobs creation, jobs retention and research and development will be available for tax periods beginning on or after January 1, 2008.** Such credits previously earned but

not used against the franchise tax will convert to CAT credits for periods beginning July 1, 2008.

A credit is also provided beginning in the calendar year 2010 for taxpayers with net operating loss carryforwards of more than \$50 million that would have carried forward to the 2006 franchise tax year. The credit is based on the taxpayer’s NOL carryforwards in excess of \$50 million and other deferred tax items as shown on its books and records on the last day of its taxable year ending in 2004. To be eligible for the credit, taxpayers must file a report by June 30, 2006 with the tax commissioner that sets forth the taxpayer’s calculation of the credit and any other information the tax commissioner requires. Taxpayers who file the report will not be permitted to claim NOL carryforwards or other deferred tax items used to calculate the credit in franchise tax years after 2005.

All taxpayers must register by November 15, 2005 or within 30 days after having receipts in excess of \$150,000 in a calendar year. The registration fee is \$15 if done electronically or \$20 if done otherwise.

Penalties are provided for failure to timely file returns or pay the CAT (the greater of \$50 or 10% of tax due), for tax deficiencies (up to 15% of the deficiency) and for failing to file returns or pay the tax electronically if required to do so by the tax commissioner (5% for the first two quarters after notification and 10% thereafter). The statute of limitations on the CAT is four years and audits may be conducted using samples that must be established in accordance with a yet to be issued administrative rule. Pre-assessment interest applies to all deficiencies and deficiencies may be protested using the same procedures used for other taxes.

Taxpayers with over \$1 million of gross receipts are required to file returns and remit the CAT within forty days of the end of each calendar quarter. The return for the fourth quarter is the annual return and must reflect any adjustments required to the gross receipts reported in the first three quarters.

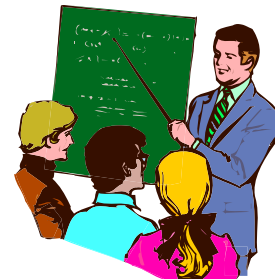
*Lawrence Evans, CPA, L.J. Evans & Company, Pepper Pike, Ohio, provides multi-state tax planning, consulting, and controversy assistance. As a strategic alliance partner of Labhart Miles, he has contributed to States of Affair in the past.*

### Is Labhart Miles Moving to Ohio?

No. We’re just fine here in sunny California, thank you! But, if you’re wondering about the focus on Ohio in the last few newsletters (regarding CAT and also the *Cuno vs. Daimler Chrysler* decision regarding credits), it’s simply because the state is making some interesting waves lately. Whenever a state changes its entire taxing scheme, we think it’s a newsworthy event. We appreciate the detailed review provided by Larry Evans. Much of our strength as a company is in having great clients and great strategic alliances. Thanks, Larry!



## California BOE - Sales Tax Tutorial



*In an effort to provide a basic understanding of the State's sales and use tax laws and to show new business owners how to avoid common mistakes, the BOE has created an online tutorial. Test your sales tax knowledge at: [www.boe.ca.gov/sutax/basic\\_SUT\\_tutorial.pdf](http://www.boe.ca.gov/sutax/basic_SUT_tutorial.pdf), or take a quick sneak peek at a sample of the questions below. We expect 100% from some of you!*

1. Which one of the following is tangible personal property?

- a)  Furniture
- b)  Toys
- c)  Giftware
- d)  Clothing
- e)  All of the above

2. The sales and use tax return must be filed and tax paid within one month following the end of the reporting period. **True  or False**

3. Under the Revenue and Taxation Code § 6596, a person

- a)  may request advice in writing, fully describing the specific facts and circumstance of the activity or transaction in question.
- b)  will receive a written response from the board stating whether or not the activity or transaction is subject to tax, or the conditions under which tax applies.
- c)  Both a and b.
- d)  None of the above.

4. As a retailer, you may need to pay both Sales and Use Tax. **True  or False**

5. One of the presumptions, specified by the Sales and Use Tax Law, is that sales and purchases are subject to tax. **True  or False**

6. What certificate(s) do people conducting business in California commonly use?

- a)  Resale Certificate.
- b)  Exemption Certificate.
- c)  Not Taxable Certificate.
- d)  Both a and b.
- e)  None of the above.

7. Which one of the following is **not** an essential element of a Resale Certificate?

- a)  Purchaser's name, address, and valid seller's permit number.
- b)  Description of the property to be purchased.
- c)  Statement that the property described is purchased "exempt."
- d)  Date resale certificate is signed.
- e)  Signature of the purchaser.

8. A tax return does not have to be filed when no sales are made during a given period.

**True  or False**

9. A preprinted resale certificate is the only way you can document sales for resale.

**True  or False**

10. You need to maintain shipping documents or export documents as support for you sales in interstate and foreign commerce.

**True  or False**

11. Delivery charges are generally not subject to tax, if you shipped the items directly to the purchaser by common carrier and ...

- a)  charge the customer the actual cost.
- b)  the charges are separately stated on the invoice.
- c)  include handling charges in the invoice.
- d)  Both a and b.
- e)  All of the above.

Answers: 1.E; 2.True; 3.C; 4.True; 5.True; 6.D; 7.C; 8.False; 9.False; 10.True; 11.D.

We thought the tutorial would be fun for both our seasoned state tax clients and those that don't deal with this area every day.

**Surprised by any of the answers?**

**Give us a call to discuss!**

**L. A. City Business Tax Changes** - Effective 1/1/05, corporate taxpayers could calculate their gross receipts for L.A. city tax purposes on either a cash or accrual basis, with a deduction for bad debts. Previously, taxpayers were required to use the accrual basis with no deduction for bad debts. Effective 7/1/05, the small business exemption threshold rises to \$50,000 from \$5,000, and on 7/1/06, it

increases to \$100,000. Taxpayers that fail to file their renewal notice timely are considered delinquent and will not qualify for the small business exemption. Also included in the change is a creative artist exemption of \$300,000, only for individuals when performing creative activities for entertainment or aesthetic purposes. Other types of income which the person creates is excluded from the exemption.

## California FTB - Told to Butt Out of Taxpayer's Business

A California Superior Court concluded that American General Corp. of Houston, in filing its California combined return, could deduct interest expense from debt incurred to conduct its consumer finance and real estate businesses. The FTB, using state regulations, argued it was proper to infer that if a company had other fungible assets, that the company must have taken on debt specifically to generate non-taxable dividend income. Further, the FTB argued, the parent non-insurance businesses could have sold stock in their insurance subsidiaries rather than borrow funds. *American General Realty Investment Group Corp. v. FTB, CA Sup. Ct. of San Francisco, No. CGC03425690*



## Three New Enterprise Zones Designated

The California Department of Housing and Community Development announced that three communities are finalists for designation as CA EZs - the statewide program geared toward creating more jobs and more economic opportunity in California. Director Lucretia Dunn stated that, "California Enterprise Zones give communities a chance to unleash their economic potential, improve their quality of life and contribute to the California comeback."

The three finalists; **Barstow, Brawley, and Stanislaus County**, were chosen from a pool of nine applicants. Com-

munities are evaluated and ranked relative to their comparative need and the local jurisdiction's capacity to undertake a long-term economic development initiative. Designation of the three new enterprise zones is contingent upon completion of a final application and an environmental impact report. If designated, the three communities will join the 39 existing zones in California - each zone is in effect for 15 years.

Individual enterprise zone administration is funded and managed by the local city or county that has been designated as an enterprise zone. Enterprise zone

managers, employed by the city or county, are responsible for marketing the area to new businesses, working with existing businesses to prevent closures, and assisting firms in expanding. The program was designed to play a key role in linking newly created jobs with individuals in the community who are either under or unemployed.

If you would like more information about the enterprise zone program, please contact Labhart Miles about our process for obtaining these benefits for your company.

## Sneaking some space in California's Corner....New York...and Wine



Wine drinkers (and of course, wine purchasers and sellers) anxiously awaited the U.S. Supreme Court's recent ruling in *Granholm v. Heald*, U.S. Supreme Court, Dkt. No. 03-1116, 05/16/2005. In response to this decision, striking down a New York law that barred out-of-state wineries from making direct shipments of wine into the state, the New York Legislature has passed, and Governor George E. Pataki has signed into law, legislation that establishes reciprocal wine shipping privileges between New York and other states and requires out-of-state wineries to register for sales and use tax and excise tax purposes before shipping wine into the state. The legislation is effective August 12, 2005.



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Please visit our website for helpful links, current updates on other state tax information, and previous copies of our newsletter!