



States of Affair

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CA MIC - Latest Cases Provide “Clarification”

In the latest CA Manufacturers’ Investment Credit appeals to the Board of Equalization, a taxpayer appeal that at first appeared to be a home run was reviewed by the umpires and later scored as only a single. So it seemed with *Baxter Healthcare*. We’re still counting this one in the taxpayer victory column overall, but arguably the FTB came up with a save in the bottom of the ninth inning. However, score an interesting run for the taxpayers in the *Trend* case.

States of Affair has been reporting on the MIC cases heard by the BOE. Following are this quarter’s developments.

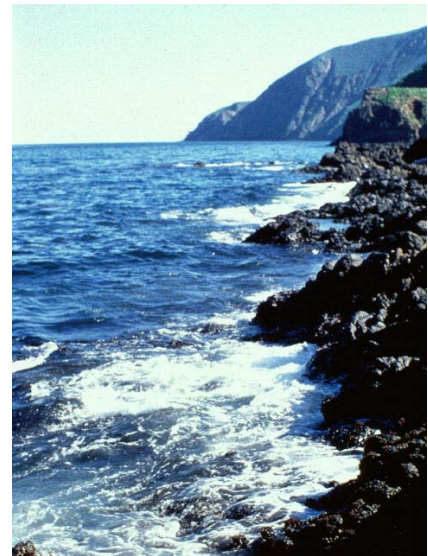
CA Steel Industries As originally decided in December 2002, the BOE ruled 3 to 1 in favor of the taxpayer that indirect labor costs paid to third party contractors are “directly allocable” to qualified property and therefore qualify for the MIC in their entirety. In an FTB request for re-

hearing, the BOE clarified on July 9 in an opinion that may be cited as precedent that all labor costs (including overhead and profit attributable to rendered services) are qualified costs. Non-labor costs (ex. materials, small tools) may not be included as qualified labor. But they may qualify under the general rules if sales tax was paid on the items.

Appeal of Baxter Healthcare Corp.
(Initially decided in February 2003, finalized May 2003)

In its ruling in February, the BOE allowed costs for capitalized labor and special purpose buildings. The BOE declined to decide on the qualification of several assets, directing Baxter to provide “adequate documents” to show that the assets meet the definition of tangible personal property as required. In May 2003, the case was finalized.

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Amnesty - Expect a Busy Autumn



In a quest to increase state coffers, many states continue to enact amnesty periods to bring companies into compliance. Following are this quarter’s updates. As always, the balance in an amnesty situation is to come forward quickly, so as to take advantage of the program, but also to be as accurate as possible, so as not to misstate any taxes owed. Also, as each program varies, it is important for companies to fully review the conditions for coming forward under such a program.

Please contact us for questions or assistance in taking advantage of any of the amnesty programs summarized below, or to assist in nexus determination.

Arizona (September 1 – October 31, 2003) Applies to sales, luxury and income tax liabilities covering periods from January 1983 to December 2001 for most taxpayers; benefits include lower interest rates and reduction or waiver of penalties.

Florida (July 1 – October 31, 2003) Applies to all taxes except unemployment taxes, and covers periods before 6/30/03; allows for lower interest and waiver of penalties.

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Newsletters Now

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We’ve updated our website to include copies of our current and prior newsletters.

We welcome your comments. For more information, please contact us at

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Bill Labhart & Monika Miles

Credits & Incentives —Some Taxpayers Still Nabbing Their Share

Some Giveth...



Even in this age of belt-tightening, several states are still putting their money where their mouths are with respect to economic development in pursuit of manufacturers. In recent developments in both **Georgia** and **Washington**, incentives are being offered to lure businesses to expand in these states. In **Georgia**, the object of desire is a Daimler-

Chrysler light van manufacturing facility, for which the state would enact significant jobs and investment credits. In **Washington**, a Boeing jet plant is eyed, as the state offers \$3 billion in potential incentives to the company over a 20 year period for expanding in Washington. **Minnesota** is offering Jobs Creation credits for biotech companies. **Michigan** is hoping to encourage retention or an increase in jobs in the pharmaceutical arena (focusing on the purchase of Pharmacia by Pfizer, Inc.) by expanding its MEGA credits and exemption of personal property taxes for pharmaceutical companies that meet certain criteria. And in **Massachusetts**, the governor signed a 5 year extension of the state's investment tax credit, citing a commitment to creating jobs and getting the state's economy back on track.

.... And Some Taketh Away....

As reported previously, the **California** MIC is set to sunset on 12/31/03 unless the legislature and governor extend the credit. As of press time, the proposed budget does not call for an extension though it had been supported by both Democrats and Republicans during recent months. Given the other current CA issues (for instance, a potential recall of our governor and that pesky \$38 billion deficit), we'll continue our MIC-watch into early next year and hope that an extension makes its way into legislators' New Year's resolutions. **North Carolina** has voted to limit the William S. Lee credits that were enacted several years ago to stimulate the economy. And in an interesting turn, **Indiana** is suing United Airlines (through the bankruptcy court) in an attempt to recover some of the \$300 million in incentives that it granted the company in the early 1990's to locate a facility in the state. Indiana claims that United did not hire the required number of employees, and it is therefore pursuing clawback of the incentives.



High Tech Tid-Bytes

WA – The Governor has approved SB 5725 which provides benefits for semiconductor manufacturers expanding into the state. The benefits include reduction in the B&O tax rate, property and sales tax breaks, and exemption from the B&O tax for nine years. The benefits do not become effective until at least one semiconductor manufacturer commits to locating a plant in the state with an investment of at least \$1 billion. Once such a company commits, other companies can benefit from the tax breaks.

CA – SB 103 would clarify California's nexus standard to require certain "dot.com" affiliates of instate retailers to collect sales tax if they sell similar products or cross promote each other's products. The bill stalled on June 30 in tie vote, but was granted reconsideration by the committee. There is stiff opposition from the AeA and firms such as Barnes & Noble.



TX – In a letter ruling issued in May, the TX Comptroller's office clarified the rules of taxability of computer related services, including consulting, support and training. Consulting services unrelated to the sale of computers are generally not taxable. Activities such as setting up computers, configuring hardware systems, and installing software are taxable assembly charges, and custom application development is also taxable. Training and support are not taxable, except for trouble-shooting hotline services provided from a Texas location.

Streamlined Sales Tax Project ("SSTP")

The SSTP continues to generate support in state legislatures, as several voted to approve the measure this quarter. The agreement, aimed at simplifying sales/use collection and administration, goes into effect when 10 states, comprising at least 20 percent of the population of states imposing a sales tax, have adopted the measure.

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CA Employment Training Panel (“ETP”) Program:

California’s ETP meets monthly to award funding to companies training California employees. Funded training includes classroom and computer based training. The general program requires employees to receive a minimum 40 hours of qualified training over a contract period, and funding is calculated based upon the number of hours of training completed. Before receiving funding, a company must be certified eligible, complete an application, and be approved by the 8 member Panel. Once approved, funds are distributed as training is completed.

- The current anticipated budget for the program for the fiscal year ending 6/30/04 is at funding levels similar to prior years (\$60 to \$80 million).
- For FYE 6/30/03, the panel approved 264 contracts for a total value of \$119 million. The entire \$82 million budget was encumbered.

- The Small Business Pilot Program (SBPP) has been extended for another year. The program, approved in August 2002, makes it easier for business with fewer than 100 employees to apply for funding. Contracts are approved for qualified training of between 8 and 39 hours per trainee, and are limited to \$25,000.

- ETP recently approved revised regulations to the “out of state competition” requirement, including adoption of the NAICS industry codes, addition of new qualifying industry codes, and clarification of requirements pertaining to service industry eligibility, corporate HQ and support facilities.

Training: Small Business Program receives funding of \$500,000 for 6/30/04.

Update for CA Enterprise Zone Hiring Credit Junkies Only:

The CA EZ Hiring Credit, a substantial tax credit available to zone employers hiring qualified individuals, may be another program under scrutiny in California’s current economic climate. The state agency regulating the zones, the Technology Trade & Commerce Agency (TTCA), has been eliminated in the latest proposed budget. During a July 25 meeting of the CA Association of Enterprise Zones (CAEZ) in San Jose, this an-

nouncement was met with a plea to companies and consultants to “do the right thing” in terms of acting now to embrace the spirit of proposed regulations limiting cross jurisdictional vouchering and “maintaining the integrity” of the program. TTCA representatives at the meeting indicated that the latest version of the proposed regulations are expected to be issued for public comment in early August.

This will be followed by another public comment period.

Labhart Miles works with many different zone coordinators in vouchering employees for companies, and continues its commitment to doing so in anticipation of the upcoming regulations. Please contact us for additional information about the proposed regulations, vouchering, or calculating your company’s hiring credit.

CAEZ’s message: Continue to “do the right thing” on vouchering

Amnesty Programs.....Continued from page 1



Illinois (October 1 – November 15, 2003) Applies to any tax attributable to periods between 6/30/83 and 7/1/02; abates all penalties and interest. However, as written it appears that taxpayers must act quickly and thoroughly. If companies owe taxes and do not come forward during the amnesty period, future penalties and interest will be much higher, and the state promises little or no leniency.

Kansas (October 1 – November 30, 2003) Applies to income and privilege taxes for liabilities for tax periods ending on or before 12/31/01, and for all other taxes for periods ending

before 12/31/02. Amnesty would forgive penalties and interest.

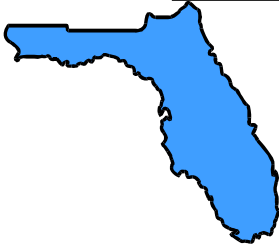
Maine (Sept 1—October 31, 2003) Applies to all taxes or returns filed on or before 8/31/03.

Missouri (Aug 1– October 31, 2003) Applies to all taxes due on or before 12/31/02.

Virginia (upcoming program; dates not yet set) State warns that penalties will be at least 20% for companies identified after amnesty period ends.



Focus On: Florida –The Sunshine State



Business Climate:

Florida is the 4th most populous state and the 7th largest producer of exported goods. Florida is one of the leaders in technological advances. From the birth of the nation's space program in the 1950s in Cape Canaveral, to work with early laser technology during the 1960s in Central Florida, to the development of the personal computer in Boca Raton in the early 1980s, Florida has played a strong historical role in pushing the technology envelope.

Florida's strengths lie in the following key sectors:

- Information Technology (including IT products/services; software development; modeling simulation & training; photonics; microelectronics; telecommunications)
- Life Sciences
- Aviation / Aerospace
- Homeland Security / Defense
- Financial / Professional Services

To keep business costs at a manageable level, Florida offers one of the

more cost efficient alternative to other competitive high-tech states. Property, high-tech talent, and the on-going costs of doing business are more affordable than in many other comparative states.

Taxes:

Florida has a **corporate income tax** but does not tax limited partnerships or Sub S corporations. Nor does it have a corporate net worth tax or state level property tax. It also does not impose an individual income tax. Florida does impose an **intangibles tax** on individuals and businesses at the rate of .1%. The state also offers several business related sales/use tax exemptions.

Credits & Incentives:

The state offers an assortment of tax incentives to businesses that choose to create employment within any of the state's **51 Enterprise Zones**. The zones are specific geographic areas which have been targeted for economic revitalization. Benefits include a sales and use tax credit, tax refund for business machinery and equipment used in an enterprise zone, sales tax refund for building materials used in

an enterprise zone, and a sales tax exemption for electrical energy used in an enterprise zone.

The **Jobs Tax Credit (Sales Tax)** allows a business to take a sales/use tax credit on wages paid to new employees who live in a zone. To be eligible, a business must create at least one new job. The Sales Tax Credit, however, cannot be used in conjunction with the Corporate Income Tax Jobs Credit. The credit percentages range from 20 to 45 percent of wages paid, depending upon whether the taxpayer is located in a rural or urban zone.

The **Jobs Tax Credit (Corporate Income Tax)** is essentially the same credit with the same requirements and benefits except it is claimed against the corporate income tax.

The **Business Equipment Sales Tax Refund** is available for sales taxes paid on the purchase of certain business property, which is used exclusively in an urban or rural enterprise zone. The **Building Materials Sales Tax Refund** is available for sales taxes paid on the purchase of building materials used to rehabilitate real property located in an urban or rural enterprise zone.



Employment news: Florida is proud to report that just over 89,000 new jobs were created during the 12-month period ending June 30, continuing 15 straight months of positive job growth. The new job figures also show the state's unemployment rate holding steady and below the national average.

Statewide Incentive Opportunities

New or expanded businesses located within an enterprise zone are allowed a credit against Florida corporate income tax equal to 96 percent of **ad valorem taxes** paid on the new or improved property.

The **Capital Investment Tax Credit**, available to companies who pre-qualify, is an annual credit against a "Project's" Florida corporate income tax for up to 20 years. Eligible projects are those in designated, high-impact sectors (currently silicon technology, certain transportation equipment manufacturing, certain information technology, or biomedical technology) that create at least 100 jobs and invest at least \$25 million in eligible capital costs. Eligible capital costs include all expenses incurred in the acquisition, construction, installation and equipping of a project from the beginning of construction to the commencement of operations. The level of investment and the project's Florida corporate income tax liability for the 20 years following commencement of operations determine the amount of the annual credit.

States of Affair regularly reports on MIC updates. Following is a brief recap of the public activity and guidance surrounding the credit in the last few years. For more detail on each SBE decision, please visit our website.

FTB Rulings

Legal Ruling 98-1 (February 2, 1998): Capitalized Costs of Labor for Engineering & Design Costs

Legal Ruling 2001-1 (June 1, 2000): Capitalized Costs under Third Party Contracts

Legal Ruling 2001-4 (August 16, 2001): Ready Mixed Concrete and Cement Trucks (Note: Ruling Withdrawn, Subject to **FTB Notice 2003-3** (April 29, 2003), as a result of *Milpitas Materials* case.)

FTB Notice 2001-6 (Oct. 23, 2001): Audit Policy Regarding use of Board of Equalization Sales and Use Tax Audit Results

FTB Notice 2002-1 (Feb 4, 2002): MIC Alternative Computation of Capitalized Direct Labor Costs Under Third Party Contracts

SBE Decisions

Appeal of Save Mart Supermarkets (February 2002)

Appeal of Milpitas Materials (March 2002)

Appeal of Bronco Winery (September 2002)

Appeal of CA Steel Industries (December 2002, reaffirmed July 2003)

Appeal of Baxter Healthcare Corp. (February 2003, finalized May 2003)

Appeal of Trend Offset Printing (July 2003)



The MIC is scheduled to sunset on 12/31/03. As of press time, no extension has been granted by the CA Legislature.



“There is one difference between a tax collector and a taxidermist...the taxidermist leaves the hide.” Mortimer Caplan, *Time*, Feb. 3, 1963.

MIC “Clarification”: (continued from page 1)

The taxpayer was denied the credit for assets relating to the heating, ventilation and HVAC systems, and electrical system improvements related to clean rooms, as BOE determined that the systems are structural components and not tangible personal property. Despite the ruling, we recommend that companies placing into service specialty HVAC equipment and process piping take an objective look at their additions in these areas to make certain that the costs are indeed of the type that would be disallowed. This case is by no means a ruling arbitrarily limiting all such materials, as each company’s facts are likely to be different.

Trend Offset Printing: Oral arguments were heard on May 28, and voting resulted in a tie (2 – 2). A final decision was rendered on July 9, 2003 in favor of the taxpayer by a vote of 4 - 1. At issue was whether gain realized by the taxpayer on the receipt of insurance proceeds for equipment losses and deferred under IRC Section 1033 is “properly chargeable” to Trend’s capital account for such equipment and thus constitutes a “qualified cost” for purposes of claiming the MIC. The BOE ruled that the Section 1033 gain constituted qualified costs for purposes of the MIC. The decision will stand unless the FTB or the taxpayer requests a rehearing.

Since 1994, manufacturers have been able to claim a credit against California franchise tax equal to 6% of the cost of qualified manufacturing and R&D property purchased or leased and placed in service in California. Qualified property includes tangible personal property defined under IRC Section 1245, special purpose buildings for certain companies, and pre-written computer software. Capitalized labor costs associated with construction or modification of the property also qualify for the credit.

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Cost Effective State Tax Solutions

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To provide our clients with the highest quality, value-added state and local tax consulting services; to make our client, not the fee arrangement, the focus of our every effort.

Speaking Out



Public Speaking:

On **June 24, 2003**, Labhart Miles gave a presentation to the Silicon Valley Chapter of the American Society of Women Accountants at the Biltmore Hotel in Santa Clara

Topic: *State tax issues faced by companies today.*
(www.aswa.org)

On **July 17, 2003**, Labhart Miles had the opportunity to speak to the San Francisco Area Women Tax Lawyers' monthly lunch meeting

Topic: "*California Tax Credits & Incentives*"

On **August 5**, Labhart Miles has been invited to guest lecture for SJSU Professor Annette Nellen's MST High Technology Capstone class.

Topic: *State & Local Hot Topics*

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