Labhart Miles Consulting Group, Inc.

States of Affair

Volume 1, Issue 3 Spring 2003

California MIC - Legislators Offer Hope

"*States of Affair*" reported last quarter on the sunset provision of the California Manufacturers' Investment Credit ("MIC"). Unless legislation is passed, the MIC will sunset as of 12/31/03, meaning that qualifying assets placed in service after this date will not be eligible for the credit regardless of a company's year end. In response to this portion of the statute, several legislators have drafted bills calling for extension of the credit, and in some cases, some interesting changes. Those bills originating in the Senate are expected to be heard on April 30. The Assembly bills have various dates of discussion, with most to be heard in May. Following is a brief summary and sponsor information:

- SB's 2 and 47 strike the entire sunset language (Poochigian & Ackerman)
- SB 137 strikes the sunset language and increases the credit from 6% to 8% (Morrow)
- SB 454 extends the sunset date indefinitely and strikes the requirement to maintain jobs (Vasconcellos)
- AB 122 extends the sunset date to 2006 (Calderon)
- AB 651 adds a requirement that companies claiming the credit must also become participants in the Career Technical Education Campaign (Corbett)
- AB 1270 expands the definition of qualified taxpayers to include those engaged in electric power generation under SIC code 4911 (Dutton)
- AB's 1665 and 1674 would expand the list of qualified property to include that used primarily for telecommunications, and strikes the current SIC code restrictions. (Runner & Dutra)

For a complete copy of any of these bills, log on to California's bill tracker at www.leginfo.ca.gov. Also, you may link to this website from the Labhart Miles website!

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.

For a recap of another recent MIC case decided by the CA BOE, see page 5.

Possible California Jobs Credit?

Assembly Member Frommer has introduced a general statewide jobs tax credit (AB 1601) applicable to tax years beginning on or after January 1, 2004. The credit would be based on the amount of wages paid in excess of the state's average weekly wage and would be front-loaded, i.e., 100% of qualifying wages paid the first year, 80% the second year, 60% the third year, 40% the fourth year and 20% the fifth year of employment. As written, the credit would apply to both the individual and corporate taxes. California currently has in place the Enterprise Zone Hiring Credit, benefiting only taxpayers with locations in one of the state's 39 zones.

Inside this issue:

Join us in celebrating our one year anniversary. And thanks for your support!

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

We welcome your comments. For more information, please contact us at 408-266-2259 or www.labhartmiles.com

Bill Labhart & Monika Miles

States "Gone Fishing" for Taxpayers

With the economy still sluggish and more states faced with budget deficits, many state legislatures are proposing **tax amnesty programs** to help fill the gaps. These programs allow taxpayers that have been operating in a state but have failed to file tax returns and pay taxes to come forward and benefit from limited penalties and interest. That's generally good news. The bad news is that once these programs have come and gone, states are much less lenient in allowing companies to voluntarily limit outstanding years or to waive penalties. Some states increase the rates of penalties after an amnesty period has expired. Most amnesty programs do not cover liabilities for which a taxpayer has already been assessed or where a taxpayer has acted fraudulently.

Among the latest states following the trend of reeling in delinquent taxpayers are:

Signed into Law:

Colorado – Signed into law by Colorado's governor, the amnesty period will be June 2003 only and will cover income taxes, sales/use taxes, estate taxes, and others for which returns were due before 12/31/02. Penalties and 50% of the interest on past due taxes will be waived upon payment of the full liabilities owed.

Virginia – Signed into law by Virginia's governor, the upcoming program will establish a 60 to 75 day tax amnesty period for individuals and companies who have failed to file returns or pay the appropriate tax. Penalties will be waived for those coming forward, as will 50% of interest. No exact date has been set, but the program is expected in fall 2003.

Proposed:

Georgia – Under proposed House legislation, a tax amnesty period would be October – December 2003, and would apply to all taxpayers owing taxes, penalties or interest for periods ending on or before 12/31/01. The program would waive all penalties, but not interest.

Illinois – Senators in Illinois have introduced an amnesty program for October – November, 2003 for taxes owed before 7/1/02. The program would waive penalties and interest. A similar measure proposed last year failed to win approval.

Kansas – The House Taxation Committee has approved legislation for tax amnesty from October – November, 2003 for income and privilege taxes owed for periods ending on or before 12/31/01, and for all other taxes for periods ending on or before 12/31/02. The program, which is supported by the governor, will forgive penalties and interest.

Maine – The governor of Maine has expressed support for an amnesty program to run September – October 2003, for taxes owed prior to 4/16/03. The program would waive penalties and 50% of interest and would include those taxpayers under audit or with pending administrative or judicial proceedings.

Montana – The Montana Senate approved a bill to provide for an amnesty period from August 1 – Sept 30, 2004. The program would waive all penalties and half the interest.

Oklahoma – The state announces an extension through 6/30/03 on the limited amnesty program for unclaimed property. The amnesty program allows the state to waive interest and penalties.

Planning: In addition to the programs mentioned above, many states also allow delinquent taxpayers to come forward and identify themselves through a third party, using voluntary disclosure agreements (VDAs). VDAs most often permit businesses to reduce penalties and negotiate other items, such as interest and number of look-back years. We recommend that clients review their current filing positions in these and other states to determine if they have a filing requirement. Many times during such a review, businesses also find that they are filing unnecessary returns, and can reduce some filings. Companies might also uncover simple techniques to increase their competitive edge.

Big fish take heed: **Connecticut** baited its hooks and reeled in over $109 Million with its 2002 amnesty program!

Streamlined Sales Tax Project Update

The Streamlined Sales Tax Project is an effort created by state governments, with input from local governments and the private sector to simplify and modernize sales and use tax collection and administration. The simplified system reduces the number of sales tax rates, brings uniformity to definitions within tax laws, and significantly reduces paperwork burdens on retailers.

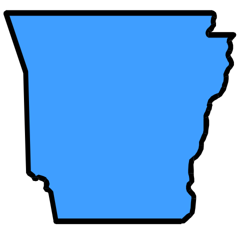
Many state legislatures are voting to approve the concept which is designed to ease compliance and definitional issues within sales tax laws. Legislatures all over the country are in various stages of approval. The agreement goes into effect when 10 states, comprising at least 20 percent of the population of states imposing a sales tax, have adopted the measure.

Recent discussions in California indicate that the state will not yet become a full voting member, but agrees to participate in SSTP meetings as an observer.

For updates and status for all states, contact the project's website at www.streamlinedsalestax.org.

California agrees to become an "observer."

Arkansas - New Credits & Incentives



With the signing into law of the Consolidated Incentives Act of 2003, Arkansas addresses credits and incentives with a bang. The Act provides credits for companies that create jobs, make capital investments, or engage in certain research and development activities in the state. The state will require companies to meet eligibility requirements and to sign a financial incentive agreement with the Department of Economic Development to qualify for the benefits.

As in other states (e.g., North Carolina and Georgia), Arkansas has drafted the Act to base the amount of benefits eligible to companies upon the county in which the expansions are made. The program will categorize Arkansas' counties into four tiers, with Tier One representing the areas least in need and Tier Four representing those areas in greatest need of investment and new jobs. The benefits are highest in those counties that need them the most.

Credits will include the following:

Job creation tax credit – **Tier 1**: 1% of payroll for new full-time employees hired for each of the first 60 months and payroll for such new employees must be at least $200,000 per year; **Tier 2**: 2% of payroll and annual payroll of at least $150,000; **Tier 3**: 3%, and payroll of at least $125,000; and **Tier 4**: 4% of payroll, and annual payroll of at least $100,000.

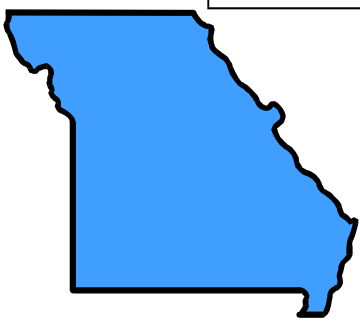
Investment tax credit – 10% of the total investment in land, buildings and equipment on an approved project. For Tier 1 counties, business must invest at least $5 million and have an annual payroll for new employees exceeding $2 million, Tier 2 counties require investment of $4 million and annual new payroll of at least $1.5 million; Tier 3 counties require investment of at least $3 million and annual new payroll of at least $1.25 million; Tier 4 counties require investment of $2 million and new employee payroll in excess of $1 million.

Other potential credits include a ***sales tax investment credit*** (also based on minimum amounts of investments), a ***payroll rebate***, ***research and development credits***, and special incentives for targeted businesses. As with incentives programs, there are also certain restrictions.

Bottom line: For businesses looking to expand in Arkansas, many credits will become available, however, as always in the credits and incentives arena, clients should make sure that all T's are crossed and I's are dotted for maximum benefits.

Please contact Labhart Miles for questions and assistance.

Focus On: "Show Me" Missouri



Business Climate:

Missouri's Governor, in summarizing the state of the state, said the most important priority for the future can be summed up in one word, "**jobs**." Creating and maintaining good, higher paying jobs can only be accomplished by readying the Missouri workforce for the new **"knowledge-based" economy**. And in creating the necessary jobs, education of a skilled workforce is considered the program of choice.

This approach, however well-intentioned, appears to do little to relieve the short term job creation picture. Instead, the state has developed a longer range plan, the **Research Alliance of Missouri**, designed to strengthen the relationship between Missouri's businesses and higher education. The Alliance is made up of industry and higher education representatives and is aimed at pooling their resources, exchanging life science research ideas and turning research into commercial opportunities.

However, the state does offer myriad state tax credits to encourage businesses to locate and operate within its borders. **Additionally, Missouri permits businesses to transfer and/or sell many of its tax credits**.

Taxes:

The Missouri tax picture consists of corporate and individual income, corporate franchise, sales/use and property taxes. Missouri corporations are permitted to elect either a modified single sales factor or a standard three factor formula with a corporate income tax rate of 6.25%.

Credits & Incentives:

Missouri currently offers over 50 different tax credit programs, of which, at least 28 are "transferable" tax credits. Six are transferable contribution programs and 22 are transferable investment credit programs. However, as in many states, these programs are in jeopardy because of the current economic situation. Some credits also require a pre-certification.

Enterprise Zones

Missouri provides an enterprise zone program which includes both jobs and investment components. The jobs component of the enterprise zone program provides a cumulative hiring credit: $400 for each new job created, $400 if the new employee is a zone resident, $400 if the new employee was receiving public assistance and $400 if the employee is trained and a zone resident or previously unemployed. The investment credit is 2% of the new capital investment over $100,000. These amounts are available for a ten year period if employment levels do not decrease.

New Business Facility

The state provides a general (non-EZ) tax credit for new jobs and investment throughout Missouri. The credits are provided for each tax year for up to ten years after the project commences operations. Amounts range from $75-$100 for each new employee and each $100K of investment.

Research and Development

An R&D credit for qualified research is available up to 6 1/2 %. The research expenses for the current year must exceed the average amount of qualified research expenses (QRE). The amount of QRE for which tax credits shall apply, may not exceed 200% of the average QRE incurred during the immediate prior three-year period. The total funding limit, however, is $9.7 million in any taxable year.

Contact Labhart Miles for more information concerning Missouri credit opportunities.

Preparing for the Knowledge-Based Economy

"This work (Research Alliance of Missouri) in advancing the life sciences could prove to be very lucrative for Missouri, according to a study conducted by the Battelle Memorial Institute. Battelle researchers determined that the life sciences industry over the next decade could create more than 22,000 high paying jobs and more than a billion dollars in investment."

- *Missouri Enterprise* - January - February 2003

"I have found the best way to give advice to your children is to find out what they want and then advise them to do it." 5/27/55

"Whenever you have efficient government, you have a dictatorship." 4/28/59

Harry Truman - 33rd President of the United States, and native son of Missouri

CA Credits & Incentive Updates

CA Enterprise Zone Credits:

California's Technology, Trade and Commerce Agency (TTCA), which oversees the enterprise zones, has drafted regulations related to policies and procedures in an attempt to standardize the EZ program among the various jurisdictions.

As reported in our last newsletter, until now, there has been no mandated guidance and standardization among the zones with respect to some of the details of the program including approval of applications for vouchers, retroactive vouchering (whereby a company can go back to open tax years), cross jurisdictional vouchering (where one zone administrator can approve a voucher for an employee in a different zone), and an appeal process for voucher denials.

Proposed regulations 5631 through 5636 address these and other issues. In developing these regulations, the TTCA met with both enterprise zone administrators and consultants to draft something that was the best answer for the companies that claim these credits and their employees.

A public hearing is scheduled for ***April 11*** in Sacramento to discuss the regulations.

*A summary of the proceedings was not available at press-time, but updates and breaking news will be reported on our website at **www.labhartmiles.com.***

Also, for a copy of our CA EZ Hiring Credit or EZ Sales/Use Tax Credit Process, please contact us.

CA Employment Training Panel ("ETP") Updates:

California's ETP meets monthly to award funding to companies training California employees in various industries, but with a focus on the manufacturing sector. Funded training currently includes classroom/lab and computer based training. The program used to allow "Structured On-Site Training" ("SOST"), which was an on-the-job training component of the program. However, in fall of 2002, the panel placed a moratorium on SOST until February 2003. At its February meeting, the panel ruled to continue the moratorium and will likely address it again in the new fiscal year, beginning July 2003. All California companies pay into the pool of ETP funds through a line item on their unemployment tax returns, and distribution of those funds (generally $60 - 80 million per year) is determined by the 8 member employment training panel. Members are appointed by the governor. Note that there are currently seven seated members, with one panel member position currently vacant.

> Panel members' decision to continue the moratorium on SOST is disappointing and not in the original spirit of the ETP.

MIC Scoreboard: Taxpayers 5 - FTB 0:

Since we last reported, there has been one additional MIC case settled in favor of the taxpayer (added to four others favorably decided since February 2002). The latest case, *Appeal of Baxter Healthcare Corp.* was decided in early February 2003 by a 3 member Board of Equalization (BOE). Three issues were discussed:

Capitalized labor – BOE ruled in favor of the taxpayer that capitalized payments to third party independent contractors which are directly allocable to the construction of qualified property qualify for the credit. This is consistent with the Board's December 2002 decision in *Appeal of California Steel Industries*. As part of this issue, the Board denied Baxter's request for the inclusion of certain reimbursable costs such as travel, meals and shipping in MIC qualifying costs.

Special purpose buildings – BOE ruled that portions of buildings could qualify for treatment as "special purpose buildings" as defined by statute and regulation, even though they are not clean rooms. FTB had argued that legislative intent of the special purpose building provision was to cover cleans rooms used in silicon wafer fabrication.

Documentation – Taxpayer argued that rules for substantiation of qualifying assets are too cumbersome for retroactive credit claims. BOE declined to decide this issue, directing Baxter to provide "adequate documents" to show that the assets meet the definition of tangible personal property as required. Both sides will have additional time to provide information, and a final decision is expected in May 2003.

For a complete listing and discussion of all MIC appeals decided by the BOE to date, please visit our website at ***www.labhartmiles.com*** under the page "News-CA".

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Cost Effective State Tax Solutions

Our Mission:
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

Labhart Miles Consulting Group stays involved in current events:

Public Speaking:

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

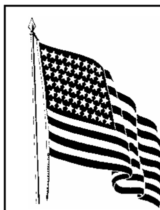
Topic: ***State tax issues faced by companies today.*** (*www.aswa.org)*

Ask About our Customized State Tax Training for your Business

Current Events:

Labhart Miles is keeping tabs on current legislative updates on selected credits. Special thanks to Chris Micheli of Carpenter Snodgrass and Associates for assistance with updates from Sacramento.

Please visit our website for helpful links and current updates on other state tax information!



Labhart Miles would like to take this opportunity to recognize our readers who are veterans or whose family members are serving in the armed forces. Our thoughts are with all those serving our country.