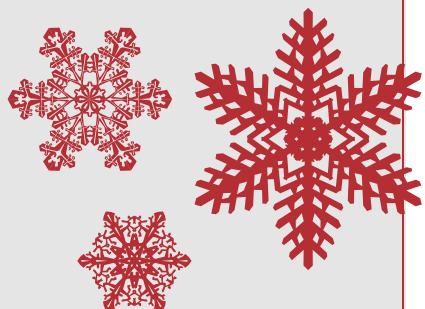


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Dear Readers,

As this newsletter arrives we will have already celebrated Thanksgiving and will be looking toward the holidays. While recent financial events may be disheartening, we look forward to 2009 with optimism and the knowledge that every event presents opportunities. We'd like to take this opportunity to wish all of our clients and friends a safe and happy holiday season and prosperous new year. Thank you for your continued readership and support.



Banks and Economic Nexus – One Step Closer

An Indiana tax court upheld the constitutionality of statutory economic nexus standards for application of the Indiana financial institutions tax (FIT). MBNA America, N.A. & Affiliates, did not maintain a place of business or have a physical presence in Indiana, yet did solicit business from Indiana customers. Therefore, the court found that the bank had economic nexus due to the presence of customers and loans in Indiana.



As part of the law, nexus standards were established to determine when financial institutions transacting business within the state would be subject to taxation. Among the activities which create nexus for financial institutions are: regularly soliciting business from potential Indiana customers and regularly engaging in transactions with customers in Indiana involving intangible property, including loans resulting in cash receipts flowing to the taxpayer from within Indiana. Regular solicitation is presumed if a financial institution engages in lending to twenty or more customers in Indiana, which MBNA had.

In making its determination, the tax court looked at two other states' decisions with identical facts. The first case, a Tennessee Court of Appeals decision, determined that U.S. Supreme Court rulings in *Bellas Hess* and *Quill* were controlling and that physical presence was required. The second ruling, involving this taxpayer (MBNA) with activities in West Virginia, found that *Quill's* physical presence test for demonstrating substantial Commerce Clause nexus applies only to sales and use taxes and not to business franchise or corporate income taxes. Although neither of these cases sets precedence, the Indiana tax court found the reasoning in the WV case to be persuasive enough and held that MBNA had established a substantial economic nexus. *MBNA America Bank, N.A. & Affiliates v. Indiana Department of State Revenue*, Cause No. 49T10-0506-TA-53, Oct. 20, 2008. ●

Speaking Out:



Conferences:

Labhart Miles attended the **California Association of Enterprise Zones (CAEZ)** conference in Long Beach October 24th and 25th. See review – page 3.

Monika Miles attended the **Joint National Conference** of the American Society of Women Accountants (ASWA) and the American Women's Society of CPAs (AWSCPA) in Dallas Texas October 27 - 30. Monika serves on ASWA's National Board as VP of Membership.

It was nice to see the many familiar faces of clients and colleagues at the 24th annual **High Technology Tax Institute**, sponsored by TEI and San Jose State University on Nov 17 & 18. Thanks to Annette Nellen and her advisory team for another great CPE filled Institute.

Associations:

Making Strides Against Breast Cancer – Monika participated in this year's Bay Area American Cancer Society events for the 11th year. Thank you to the many friends and clients that helped her raise almost \$20,000 in donations and to become the 3rd largest individual fundraiser in the Bay Area for the third year in a row.

Multi-State Tax News

Michigan – MBT & Nexus

Michigan has released Revenue Administrative Bulletin 2008-4 (October 2008) issuing guidance on the state's nexus standards under the new Michigan Business Tax ("MBT"). Taxpayers can generate nexus under two alternative scenarios:

- 1.) a taxpayer has physical presence in the state for more than one day during the tax year, or
- 2.) the person actively solicits sales in Michigan and has MI gross receipts of \$350,000 or more.

Once nexus has been established, it exists for the entire year. Further, if one member of a unitary business group has nexus in the state, all group members must be included to calculate the tax base and apportionment formula. ●

Editor's Note

More states are aggressively pursuing economic nexus standards to add taxpayers to their rolls, as evidenced by the recent MBNA cases and some recent predecessors (to include *KFC Corp vs. DOR* in Iowa – 2008 and *Lanco vs. Division of Taxation* in New Jersey – 2006). 1993's *Geoffrey* ruling in South Carolina set the stage for many of the current state court rulings which draw companies into a state for income/franchise tax purposes without physical presence. In light of the U.S. Supreme Court's denial of cert in economic nexus cases, taxpayers are left to wonder if, or when, the federal government will exercise its authority to regulate commerce among the states. Companies are looking for a bright-line test in the form of federal legislation to address the issue. Meanwhile, states are engaged in substantial lobbying efforts aimed at defeating any such bills making their way through the U.S. Congress. Until there is some relief, taxpayers must be ready to defend their activities in various states, paying particular attention in the more aggressive states of Illinois, Louisiana, Massachusetts, New Jersey, New Mexico, New York, North Carolina, South Carolina, and West Virginia.

We recommend that companies review their multi-state activities regularly to determine if they have potential exposure in various states. Please contact us for information on a nexus/taxability review. ●

R&D Credit Update


In early October 2008, President Bush signed the Research and Development Credit extender (HR 1424) into law. The law extends the credit for qualified research expenses incurred between 1/1/08 and 12/31/09. The bill also increases the rate of the Alternative Simplified Credit (ASC) from 12% to 14%. The question remains as to whether the R&D credit will finally be made permanent, expected to be favored by the Obama administration. Over 2 years ago the Senate Finance Committee commissioned a GAO study on the credit to explore concerns of both the IRS (aggressive taxpayer positions) and

taxpayers (burdensome recordkeeping requirements). The credit is not likely to be made permanent until these issues are resolved to the satisfaction of the Committee and the new administration.

As a reminder, California's already permanent R&D credit differs from the federal credit insofar as California does not currently conform to the ASC mentioned above and the state calculation includes only California receipts (not to include any "throwback" sales). The California R&D credit, is also subject to the new credit limitation of 50% of tax liability for years beginning between 1/1/08 and 12/31/09.

California Corner

California Enterprise Zone Conference Update



This year's California Association of Enterprise Zones' ("CAEZ") Annual Conference was held in Long Beach on the historic Queen Mary.

Craig Johnson – Long Beach Zone Coordinator – was the host and was rewarded for his efforts by being elected CAEZ President for the upcoming year.

Frank Luera, Manager of CA's Housing and Community Development Department ("HCD") responsible for the EZ program, discussed several updates. First, the next round of new EZ designations will be released soon with applica-

tions due in March/April of 2009. (Every year communities across the state vie for the EZ designations by completing an application and dozens of supporting economic data schedules.) The EZ hiring credit vouchering regulations, effective 1/1/2007, will be reviewed for possible changes, including the use of Form W-4 instead of the I-9 to verify residence under the hiring credit's "targeted employment area" category. When queried about the viability of the EZ program during the current budget crisis, Mr. Luera relayed that Governor Schwarzenegger has embraced the program with even stronger support than in the past and appears to view it as an important part of any economic stimulus.

Jeannie Harriman, FTB EZ liaison and frequent CAEZ speaker, discussed the impact of AB 1452 and SBX1 28 and their technical implications (addressed below). Ms. Harriman also reiterated the need to file IRS forms 8886 and 8918 with the FTB (see FTB Notice 2008-1), and discussed several pending FTB challenges involving the enterprise zones to be decided in the near future by the SBE. Of particular interest to our banking clients will be the Farmers & Merchants Bank case where the taxpayer argues that interest earned on loans to non-profit entities should qualify for the net interest deduction for lenders. ●



California State Budget Affects Tax Credits

As reported in our recent State Tax Brief (emailed to our clients and contacts in October), the California state budget which was signed into law in late September included various measures affecting taxpayers. The items that we felt most affected our clients and partners are:

- Increased penalties for corporations that understate their tax liability
- Suspension of net operating loss deduction utilization in 2008 and 2009
- Extension of the carry forward period for loss deductions
- "Carryback" losses allowed beginning in 2011
- Business tax credits that can be used to reduce tax liabilities in 2008 and 2009 are limited to 50% of the taxpayer's liability. Credit limitation impacts the R&D credit, the Enterprise Zone tax credits, and Low-Income Housing credits. (Taxpayers with net business income of less than \$500,000 will be exempted from this change.)
- Beginning in 2010, potential increase in credit utilization as businesses can elect to assign credits to affiliated corporations

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- *Editors of the Journal of Multistate Taxation and Incentives*
- *A wealth of experience in Big 4, Industry, and State Government*
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Insight

The 2008 Election

We all know that history was made on November 4, 2008 as Barack Obama was elected the first African-American President of the United States. Following are a few ballot items across the country you might have missed:

- Connecticut – voters approved a proposal allowing state residents to **vote in primaries at the age of 17** as long as they will be 18 before the general election. (9 other states have passed similar measures.)
- Massachusetts – voters rejected a proposal which would have eliminated the state's **personal income tax**, cutting state revenues by an estimated 40%.
- Maine – voters rejected a measure which would have **increased taxes on the beverage industry** to fund the state's health care program.
- San Francisco, CA – voters rejected a measure which would have **renamed the local sewage plant** "in honor" of President George W. Bush.

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