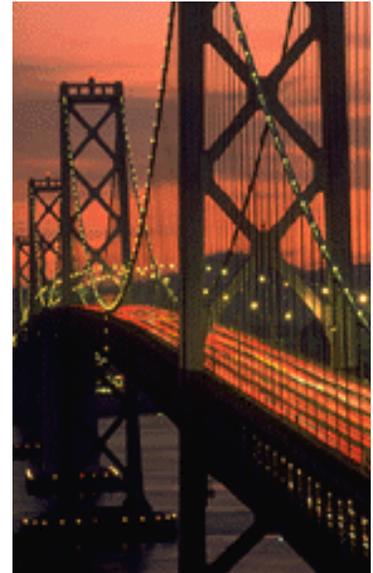




States of Affair

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MIC Scoreboard: Taxpayers 3 - FTB 0

Since February 2002, the California State Board of Equalization (“BOE”) has heard three cases on appeal from taxpayers arguing the Franchise Tax Board’s interpretation of the regulations governing California’s Manufacturers’ Investment Credit (“MIC”). And three times, deciding three different issues, the BOE unanimously ruled in favor of the taxpayer.

February 2002 – Appeal of Save Mart Supermarkets – The BOE held that a regulation was invalid as it too narrowly construed the meaning of “qualified taxpayer.” With this ruling, the BOE affirmed that the MIC statutes should be construed liberally in favor of taxpayers, as was the legislative intent. As such, Save Mart, a grocery chain, was able to claim the MIC on qualifying property used in its bakery operations. The ruling clarified that a taxpayer need not be *primarily* engaged in manufacturing activities to be eligible for the MIC.

March 2002 – Appeal of Milpitas Materials Co. and Jon and Rita Minnis – The BOE held that cement mixer trucks could be included as a qualified asset of a construction materials company. The FTB attempted to bifurcate the truck into the mixing component and the chassis, allowing the MIC only for the mixing drum portion. The BOE held that the FTB’s position was contrary to the MIC statute.

September 2002 – Appeal of Bronco Winery – The BOE held that large storage tanks used in the manufacture of wine were qualified property for the MIC despite their large size and appearance as “inherently permanent” structures. The BOE indicated that the test for qualifying property shall be whether an asset can be “reasonably moved.” Unlike its decision in Save Mart, the BOE did not invalidate regulations dealing with qualified property.
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Policing Corporate Activities - Fed & CA

On July 30, 2002, President Bush signed arguably the most significant piece of legislation affecting businesses and the accounting profession in recent history with passage of the Sarbanes-Oxley Act of 2002. Among other things, the new law establishes an accounting industry oversight board to provide for controls and more stringent penalties and disci-

plinary sanctions. The law also significantly reduces the scope of services public accounting firms can offer to attest clients and requires the company’s audit committee to approve fees for non-attest projects to be performed by the company’s audit firm.

On September 28, 2002, California’s governor signed AB55, the

“California Corporate Disclosure Act” which increases the amount of information corporations must file with regulators. Twice a year, a corporation will be required to disclose the name of its auditor, significant loans to corporate directors, annual compensation to top executives, and any individual fraud convictions of corporate executives.

Welcome to our Newsletter!

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

Look for these articles in our next issue:

- Multi-state Enterprise Zones
- CA MIC Updates



Credits may help companies offset tax during NOL suspension.

California Suspends NOLs

In early September, California Governor Gray Davis signed AB 2065 which includes a provision for a two year suspension of net operating losses (tax return years 2002 and 2003). The NOLs generated during those years will be limited to 60%. However, beginning with the year 2004, newly generated NOLs will carry forward at 100%. California net operating losses have been limited to 50% since 1987. For 2000 - 2002, the amount available for carryforward was increased to 55%.

The suspension of the NOLs in 2002 and 2003 is expected to generate

over \$1 billion over the two years. Permitting the 100% NOL carryforwards from 2004 forward is estimated to cost \$500 million annually.

AB 2065 contained other provisions of note. California will conform to the federal law for large banks, permitting only the charge-off of actual bad debts versus the reserve for bad debts. Additionally, banks, savings and loans and financial corporations will be required to add 50% of the existing reserve to their 2002 taxable income.

A further revenue acceleration measure will require withholding on "supplemental income"

such as stock options and bonus payments at 9.3% up from the current 6% rate. The teacher tax credit (a benefit of \$250 - \$1,500 per teacher) will also be suspended for 2002.

Planning Opportunity: Companies in taxable situations in 2002 and 2003 should pay special attention to statutory credits (such as the MIC, R&D and Enterprise Zone credits, if applicable) to offset franchise tax. Other strategies, such as deferral of deductions (i.e.; capitalizing certain costs rather than expensing currently) may also be a viable option.

Relief...Tax Amnesty Programs

States occasionally legislate amnesty programs in an attempt to identify non-filers and get them "on the rolls". The amnesty periods are generally short and require companies to come forward as soon as possible. Companies that have not been in compliance with a state's tax laws can come forward, pay taxes owed, and often waive penalties and sometimes interest. It's generally a win-win situation for taxpayers and states. The following states have amnesty programs underway or planned for the near future:

- Connecticut (9/1/02 thru 11/30/02)
- Missouri (8/1/02 thru 10/31/02)
- Oklahoma (8/15/02 thru 11/15/02)
- New York - has announced upcoming amnesty
- Massachusetts - has authorized amnesty, expected in early 2003

Opportunities: Now is a good time to review your company's activities in these and other states to determine if you should take advantage of these programs. As the economy continues to lag, more states are likely to look to programs like this to increase revenue. But once the amnesty programs are over, it becomes more difficult to ask the state for abatements.

Several states offer relief from penalties for companies that come forward.

California Helps Companies Fund Training

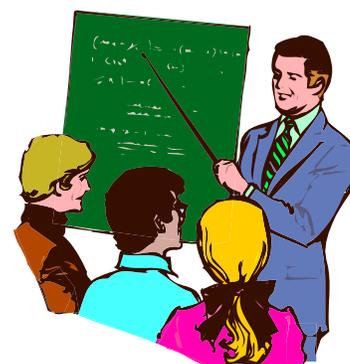
Is your company training employees in California? You may be eligible to receive funding to offset most of the cost of that training.

Many states offer training credits and grants to companies training employees. However, California has arguably the best program in the country, with funding generally in excess of \$70 million per year to disburse to qualifying taxpayers.

California's Employment Training Panel (ETP) meets monthly to award funding to companies training California employees. Funded training includes classroom, computer based training, and structured on-site training ("SOST"). However, SOST has been temporarily suspended until February 2003 (see article below). The program requires employees to receive a minimum 40 hours of qualified training

over a contract period (up to 2 years). Funding is calculated based upon the number of hours of training completed, multiplied by \$13 per hour for classroom/lab and \$8 for computer based training.

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.



Ideas for Companies Training Employees!

CA Training Program—Updates

The following are recent updates to the ETP program:

Moratorium on SOST As a result of a recent study prepared by CSU Northridge, indicating that the current structured on-site training ("SOST") is not achieving the ETP's objectives for training California workers, the Panel has placed a moratorium on SOST and will not approve SOST in any contracts through February 2003. An advisory group will suggest changes to this aspect of the ETP program. Observers expect to see a "new and improved" SOST early next year.

Planning opportunities: Companies may consider accelerating classroom or computer based training

in the near future.

Small business initiative In an attempt to reach out to small businesses, the Panel approved the Small Business Pilot Project (SBPP), which will earmark up to \$500,000 of the ETP's budget to target small business applicants who employ 100 or fewer employees. The maximum contract awarded under the program will be \$25,000 with less cumbersome paperwork requirements.

Given the current inherent limitations of small businesses to participate in the ETP, coupled with the fact that 95% of Californians are employed by small businesses, this Pilot Project is a step in the right direction for the ETP.

Planning opportunities: Start-ups and other companies should consider applying for funding under the SBPP to defray the cost of training employees.

95% of Californians are employed by small businesses employing fewer than 100 people.

MIC Scoreboard

(Continued from page 1)

This ruling is likely to affect many companies placing larger assets in service which may appear permanent in nature, but which can be moved and therefore qualify for the credit.

Since 1994, manufacturers have been able to claim a credit against California franchise tax equal to 6% of the cost of qualified manufacturing and research and development property purchased or leased and placed in service in California. To qualify for the credit, a company or a segment of the company must be engaged in manufacturing or software development as described under the 1987 SIC Manual. Qualified property includes tangible personal property defined under IRC Section 1245, special purpose buildings for certain companies, pre-written computer software, or certain directly allocable capitalized labor costs. California sales or use tax must have been paid upon purchase of the asset. Property not eligible for the credit includes furniture, inventory, and property used in administration, management or marketing. If the credit cannot be utilized, it may be carried forward for 8 years.

Preview of things to come: Appeals in late fall 2002 are expected to focus on third-party contract and capitalized labor, and the extent to which cost should be eligible for the MIC. This is a hot issue, as many taxpayers include these costs in their MIC calculation. It will also be interesting to see if the newly elected BOE (from November elections) will be as taxpayer friendly.

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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.

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Speaking Out



Labhart Miles Consulting Group is on the speaking circuit!

On **July, 11 2002**, Labhart Miles gave a presentation to the local chapter of the California Society of CPAs.

Topic: State income /franchise and sales/use tax nexus (www.calcpa.org)

On **October 15**, Labhart Miles will present to CMAC (Construction Materials Association of California) in Watsonville.

Topic: California Enterprise Zones.

On **October 18**, Labhart Miles will team with Beth Henricks of CIC Industries, and Steven Dill of PricewaterhouseCoopers to discuss investment credits, jobs credits and research and development credits, respectively at the Associated Industries of Missouri (AIM) 2002 Missouri tax conference. (www.aimo.com)

October 23 – 25 – Labhart Miles will be a sponsor for the annual CAEZ conference to be held in Santa Ana. (www.caez.org)

In **June 2003**, Labhart Miles will speak to the Silicon Valley Chapter of the American Society of Women Accountants.

Topic: Sales/use tax issues faced by companies today. (www.aswa.org)

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

It is updated regularly.