

States of Affair

Volume 5, Issue 1 Summer 2007

California Enterprise Zones - New (and Improved?)

As reported in previous issues of *States of Affair*, California continues to have one of the most beneficial enterprise zone programs in the country. In the last year, we have seen much activity surrounding the EZ program, including the geography of the EZs themselves.

New and Re-Designated Zones: California statutes provide for 42 enterprise zones. In the latter part of 2006, and first half of 2007, 23 of the zones expired. In November 2006, the California Department of Housing and Community Development (HCD) announced the conditional designation of 23 enterprise zones. The good news for taxpayers is that most of the existing zones re-applied and were conditionally re-designated, and in most cases, those zones became much larger. This was particularly evident in the Los Angeles metropolitan zones. And with the addition of the Compton, Southgate/Lynwood and Santa Clarita zones, Los Angeles County increased zone coverage significantly.

New Regulations: The much anticipated regulations for the EZ program,

affecting mostly the qualifying categories and vouchering processes for the EZ Hiring Credit, were finally passed in late 2006, effective 1/1/07.

New Legislation: To streamline the redesignation process and EZ benefits, the legislature passed AB 1550, which allows for those expired zones applying for and receiving re-designation to continue to offer the zone benefits, uninterrupted, for the period between expiration and final re-designation. This was important because without this “gap legislation”, the zones would have to cease benefits until their new designation was formally approved which included an additional and onerous environmental impact study. This exercise is not only extremely costly and unnecessary; in the end it has held up the final approval of most of the zones and has little relevance to economic development.

What do these changes mean to our clients? For those clients taking advantage of the **EZ hiring credit**, it's mostly good news. The minimum wage, which

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Not sitting down on the job!

Thanks to all of our clients for your support this year! Between client work, conferences, volunteer work and navigating statute changes, it's been a great first half of 2007 and we look forward to the fall!

Monika Miles & Bill Labhart



“Taking five” at the PCBB Executive Management Conf. - March 2007

Nexus & Physical Presence - Federal Intervention?

Business Activity Tax Simplification Act of 2007 Introduced in U. S. Senate - Partly in response to the U.S. Supreme Court's refusal to hear and resolve the physical presence nexus issue in the *Lanco, Inc.*, 908 A.2d 176 (2006), and *MBNA America Bank, N.A.*, 640 S.E.2d 226 (2006) petitions, in July two Senators introduced a bill to address concerns regarding the nexus standard applicable to business activity taxes. Schumer (D, NY) and Crapo (R, ID) introduced legislation that would prohibit a state from imposing a business activity tax on any taxpayer, unless the taxpayer created a physical presence in the state for 15 days or more during the year. The legislation would extend the prohibition of P.L. 86-272 to all business activity taxes, not merely net income tax. It would include in “protected activity” any solicitation for sales or any transactions approved and fulfilled outside the state, to include those involving *intangible property* and services. P.L 86-272 applies only to solicitation for sales of tangible personal property.

Multi-State Tax News

Massachusetts – Out-of-State Bank’s In-state Activity Creates Nexus

Of interest to our banking clients is a Massachusetts case, *Capital One Bank v. Commissioner of Revenue*, MA Appellate Tax Board, Nos. C262391 and C262598, June 22, 2007. The issue was whether the imposition of the Massachusetts financial institution excise tax was valid where taxpayers derive significant economic gain from the use of the state's economic markets, infrastructure and resources. Financial institutions engaged in business in Massachusetts are required to pay an excise tax measured by net income. The State determined that the taxpayer's two credit card banks' activities had exceeded certain thresholds and were thus required to file excise tax returns. The taxpayers challenged the constitutionality of this imposition because they did not have any physical presence in the state.

The Appellate Court rejected the bank's arguments that the Commerce Clause requires a corporation to have a physical presence in a state, thus requiring the imposition of the excise tax based on net income.

The Streamlined Sales Tax Stubs Its Toe but is Still Standing

In its continued attempt to bring all states into some semblance of "conformity" with respect to sales tax laws, the Streamlined Sales Tax Program marches on.

The SST Governing Board admitted Washington State to become effective 7/1/08. Washington became an associate member 7/1/07. Washington was a late-comer largely because of the impact on its local communities related to the change in how revenue would be sourced. The state has agreed to make reparations to the "losing" communities in the new sourcing scheme. Meanwhile, the Board also debated how to avoid losing its largest member, Ohio, over the issue of sourcing.

Destination sourcing continues to be one of the sticking points as states wrestle with conformity to the SST. Kansas, Ohio, Tennessee, Utah, Washington and non-member Texas have reportedly been adversely affected. Ohio proposed an amendment which would allow states with local taxes the option to permit an in-state seller to source sales on an origin basis. The proposal was narrowly approved by the State and Local Advisory Counsel as a recommendation.

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Speaking Out



Conferences: For the third consecutive year, Labhart Miles was a sponsor at the Pacific Coast Banker's Bank Executive Management Conference, held in San Francisco, March 4 - 7, 2007.

Advocacy: As the enterprise zone programs in California expand, they also get a fair amount of attention (some good, some bad) from state lawmakers wishing to leave their mark via changes to the programs through proposed legislation. Labhart Miles has joined CEON, a group that works with taxpayers utilizing the zones, to make certain that their voices are heard when changes are proposed in Sacramento.

Organizations: Monika Miles has accepted the position of Treasurer of the National Board of Directors with the American Society of Women Accountants ("ASWA"). Monika has served on the national board since 2003, and has been a member of the organization since 1990.

Community: The Labhart Miles team raised over \$17,000 for the American Cancer Society's Making Strides Against Breast Cancer, held in San Francisco in October 2006. We will once again be sponsoring a team this year, and our goal is to raise \$20,000. Note: Monika personally was the 3rd largest individual fundraiser for the 2006 event in all of the Bay Area! Please visit our website in the upcoming weeks for links to Monika's ACS Fundraising page. We'd be honored to count our many friends and clients among our supporters.

In Print: Bill Labhart is an editor for the *Journal of Multistate Taxation and Incentives*. He has served in this capacity for over 6 years.

Monika Miles has contributed another article published in the ASWA Magazine, *The EDGE*, entitled "Are you an Entrepreneur?" See it on our website under the "In the News" tab.



California Franchise Tax Board (FTB) Tidbits



In its June issue of Tax Notes, the FTB discusses various topics which affect individual and corporate income and franchise tax filers. Some of these are detailed as follows.

Notification Requirements Following Federal Adjustments

Taxpayers are reminded by the FTB of the requirements for notification upon conclusion of an IRS audit and emphasizes the following: mark "yes" under "federal audit"; do not submit duplicate amended returns; write tax year and identification number on a check; include pertinent IRS documentation and a complete explanation; use correct starting amounts; apply correct phase-outs; and include penalties.

S Corporation Indebtedness – Shareholders of an S corporation, unlike partners in a partnership, may acquire basis in the S corporation indebtedness only to the extent of their loans made directly to the corporation. Proper reporting of S corporation indebtedness on the S corporation balance sheet is recommended in order to avoid unnecessary examination. S corporations must report all loans received directly from shareholders.

Research Credit Documentation – In addition to a list of the types of research and business documents it typically relies upon to support the research credit, the FTB notes that credible oral testimony from individuals with personal knowledge of the issues may be used in supporting the taxpayer's contemporaneous documentation. By itself, however, oral or written testimony will not substitute for the documentation. While there is some flexibility in substantiating the credit, the taxpayer is responsible for maintaining and providing adequate records.

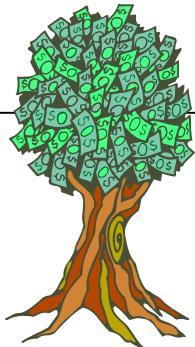
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is used to calculate the limitation for each employee, is increasing. On 1/1/07 the minimum wage increased to \$7.25/hour and beginning 1/1/08 the amount increases to \$8.00/hour. This will increase the potential benefit for a full time qualified employee who remains with the taxpayer for five years, from approximately **\$31,000 to \$37,000**. The other news relates to the new regulations, mentioned above. Although the regulations take some of the uncertainty out of the documentation necessary to qualify an employee they also remove much of the discretion out of the hands of the local enterprise zone vouchering managers to approve a qualified employee. Also, taxpayers must now contend with the recent California SBE *Deluxe* decision which held that the Franchise Tax Board can review the documentation behind an approved voucher. (See *States of Affair*, Winter 2006) Hopefully, the new regulations will deter the FTB from creating another unnecessary layer of approval.

The gap legislation discussed above also affects the **EZ sales/use tax credit**. Those businesses purchasing qualifying equipment during the gap period should not lose those benefits. Otherwise, for purposes of this benefit there are no material affects to the zones receiving re-designation.

The **net interest deduction for lenders** gave us a moment for pause during this process as FTB representatives discussed an "unofficial position" holding that lenders making loans into expiring/re-designated zones would not be able carry over those loans which had qualified during the old zone period. However, after some gentle nudging by Labhart Miles and other interested parties, the FTB determined that the gap legislation also applied to the NID. So, previously qualified loans **DO** continue to qualify as long as the address qualifies under the re-designated zone. Note that interest earned from loans into those zones that did NOT receive re-designation ceases to qualify for the deduction on the date of the zone expiration.

If you have any questions about the discussion above or any other California EZ items, please do not hesitate to contact Labhart Miles. We recommend that all companies and banks review their facility or branch addresses to determine if they now qualify for additional benefits. Also, visit our website for an updated EZ map and list of all the new zones.



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Experience: Over 45 years combined in Big 4, Industry, and State Government

References: Impeccable!



Please keep an eye out for our fall newsletter, which will showcase a new look! As always, we welcome your comments and suggestions!



Multi-state Tax News.... continued from page 2

tion. However, at the urging of its President, the Board approved appointment of a 15 member focus group to examine the sourcing issue. Stay tuned.

Michigan - SBT replaced by MBT

The new Michigan Business Tax was enacted effective 1/1/08. The MBT replaces the Single Business Tax which is repealed after 12/31/07. Some new features of the MBT include an addition to taxable income for related party expenses, a single sales factor apportionment formula, combined filing for unitary business groups, and a franchise tax for financial institutions. The bill also enacts several tax credits, including credits for compensation, investment and R&D.