



States of Affair

Volume 4, Issue 1 Winter 2006

Update: California Enterprise Zone Regulations

At October's annual CA EZ conference in Yuba, California Department of Housing and Community Development ("HCD") State Program Manager, Mark Maldonado, outlined the long-anticipated proposed regulations for enterprise zone administration and issuance of vouchers. Consultants and enterprise zone coordinators alike had many comments during the 90 minute session. Written comments were accepted until December 7, 2005, on which date there was a public comment hearing in Sacramento. After several years and iterations of regulations (the regulations process was started originally in 2003 when the EZ program was still under the now defunct Technology Trade and Commerce Department), we had hoped to have some word from HCD by now on the commentaries. Having received over 134 pages of commentary, however, HCD is still considering the comments and expects to have progress by late spring. If HCD makes any changes to the proposed regulations, there will be an additional comment period during that timeframe.

Some of the highlights in the regulations include :

- Procedures for vouchering outside of

the "local zone" or "cross-vouchering" – where an employer might have qualifying employees in multiple zones and wish to voucher them all in one zone. Under the proposed regulations, such an arrangement would now require a written agreement between the enterprise zones and notification of HCD.

- Details on the required documentation for issuance of a voucher, including the types of acceptable supporting documents to support the employee's qualification
- A mechanism whereby employers would be able to provide alternative forms of supporting documentation (such as a statement signed by the employee under penalty of perjury that alternative documentation provided is true and accurate.)
- The establishment of an appeals process for vouchers denied by the vouchering agent.

The regulations focus only on the EZ Hiring Credits, and no detailed regulations are provided for other EZ benefits available to companies, including the EZ Sales/Use Tax Credit, and the EZ Net Interest Deduction for Lenders.

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Labhart Miles - New Offices! 3150 Almaden Expressway



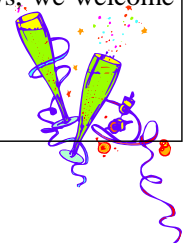
Happy Anniversary! We're pleased to announce our 4 year anniversary! As Labhart Miles Consulting Group moves into its fifth year of providing state tax services, it reminds us that we could not have reached this milestone without a great team of affiliates and most importantly, extraordinary clients.

As we start our firm's fifth year, we look forward to working with our clients on issues from the less complex "one-off" taxability question, to the more complicated "How will this enterprise zone net interest deduction or hiring credit affect my financial statements? Is our company susceptible to penalties and/or interest because we should be filing in more states?"

Since inception, we've been providing this newsletter as a resource for our clients and contacts. As always, we welcome your comments. We also invite you to come by our new office if you're in the area.

Thanks to all of our clients and affiliates!

Bill Labhart & Monika Miles



Accounting & State Taxes

For many of us that have been practicing tax consulting in public accounting and client service, the days of Intermediate Accounting I and II, studying for the CPA exam and mastering the accounting for pensions, leases, deferred taxes under FAS 96, and others, seem a long way away.

However, as Accounting for Income Taxes (“FAS 109”) has become almost as painful for tax accountants as the proverbial “tax season”, we in the state tax arena have seen more emphasis than ever on the state tax portion of the tax accounting equation. Where clients used to call on us for multi-state tax planning/minimization or to “get up to speed” on compliance or the taxability of a product or service, we are now called upon to help companies calculate their potential state tax liability so that the state tax provision is as accurate as possible. Combined with Sarbanes Oxley compliance to ensure that proper procedures are in place, in this new era of making certain that all the i’s are dotted and t’s are crossed (and dotted and crossed in just the right way), it’s been a busy time for all accountants.

What about the tax credits planning part of our practice? In cases where we assist clients in identifying a statutory tax credit that they hadn’t previously claimed, is this an uncertain tax position under FAS 109? Is it an error or a change in estimate under FAS 154? How much support is needed to prove that a state tax credit or deduction has met all the requisite accounting standards? At what point does a potential tax refund from retroactive filings become material enough to report in the tax provision? While our firm isn’t directly involved in financial statement disclosures, we’ve found that we need to be ready to discuss the underlying causes of these issues with our clients, as CFOs’ and tax directors’ accountability have become more and more important. The focus on “getting it right” – not only from a tax return perspective (and the chance on audit of losing a potentially aggressive position), but also from a financial statement perspective, has many of our tax and accounting colleagues staying up at night.

Speaking Out



Public Speaking:

Labhart Miles will again be a sponsor at this year’s Pacific Coast Bankers’ Bank Annual CFO Conference. Our theme for the three day conference will be: **“Taking Credit Where Credit is Due.”**
March 5– 8, 2006 - San Francisco

Topics: *The break-out session will feature the California Enterprise Zone Net Interest Deduction for Lenders and credit opportunities for financial institutions in other states.*



In Print:

Bill Labhart is an editor for the ***Journal of Multistate Taxation and Incentive***. If you have an article that you would like to submit for future publication, please contact Bill Labhart.

Monika Miles, who serves on the National Board of Directors of the American Society of Women Accountants, is Editor of ***“The EDGE,”*** the organization’s publication.



Organizations:

Monika Miles continues to serve on the Board of Directors of the Silicon Valley Chapter of NAWBO (National Association of Women Business Owners) as program director.

Community:

The Labhart Miles team raised over \$11,000 for the American Cancer Society’s eighth annual Making Strides Against Breast Cancer, held in San Francisco’s Golden Gate Park in October.

Please visit our newly designed website (up and running in mid-March) for helpful links, current updates on other state tax information, and previous copies of our newsletter!

Guest Article - Managing the Sales/Use Tax Function

By Roy Hui, CMI - Thompson Tax & Associates, LLC

Do you have state tax authorities knocking on your door looking for additional revenue from your business? Many states today are desperately seeking more tax to provide for various revenue needs. They may be attempting to balance their budget, address some economic or social issue or cater to the special interests of their constituents. For these reasons, the sales and use tax is a favorite target as it is a gross tax and may be passed through to the ultimate customer, thus it merely gets added to the cost of what is purchased but not normally quoted as part of the price of the product (exception, sales tax on gasoline). Because states are increasing their audits of registered businesses, proper sales and use tax compliance and documentation is becoming a more frequent issue. Additionally, the number of business activity (nexus) questionnaires received by businesses is rising as states seek to locate unregistered businesses with a taxable nexus in their state.

An unregistered company with a taxable nexus (generally defined as a physical presence in a particular state or locality) faces potential assessments for back taxes, associated interest and penalties going as far back as the date when the company first established nexus, regardless of how many years might be involved. Fortunately, an affected business can take steps to identify and mitigate any potential liability resulting from an unexpected sales and use tax liability.

Nexus Review

Companies who have never conducted a nexus review, who have had recent changes in their business operations or who don't have a procedure in place to correctly determine their filing requirements, should consider such a review to identify or revise their sales and use tax compliance footprint. It is an especially critical tool for companies which have

experienced mergers, acquisitions, divestitures, an expansion of manufacturing or distribution facilities or recent increases in their sales force.

A nexus review focuses on questionnaire responses designed to identify a company's activities or presence on a state-by-state basis reviewing activities such as independent sales representatives, inventory, owning or leasing real or tangible personal property and other similar actions. Responses are evaluated to determine where and when the business likely established nexus.

Taxability Study

The next step is a taxability study to determine whether the company needs to be registered in the affected state(s). A taxability study is simply a review of a company's revenue stream for the proper application of sales and use tax where a company has nexus. Important areas of examination include how and where products and services are provided to customers and whether such products or services are statutorily exempt from sales or use tax. Revenues from optional warranties, installation, repair, and transportation charges are also high interest areas. Taxability studies help quantify potential past liabilities as well provide guidance relative to the compliance function on a prospective basis. A taxability study should be updated periodically to reflect legislative, administrative and judicial changes to applicable statutes and regulations.

Voluntary Disclosure Agreement

A voluntary disclosure agreement is executed between a company and a state taxing authority whereby the company agrees to voluntarily register and remit uncollected past taxes in exchange for a shortened look-back period and the waiver of associated interest and/or pen-

alties. Typically, participation in voluntary disclosure programs are limited to those taxpayers who have not been contacted previously by the state for registration purposes.

Amnesty Program

From time to time, states enact legislation establishing amnesty programs that allow non-filers or under-reporters to disclose themselves and report and pay back taxes without interest or penalty. In addition, states participating in the national Streamlined Sales Tax Project have enacted amnesty provisions which provide for waivers of uncollected back taxes and associated interest and penalties in exchange for registration and prospective filing.

The Good News - An Opportunity

Accounts Payable Review

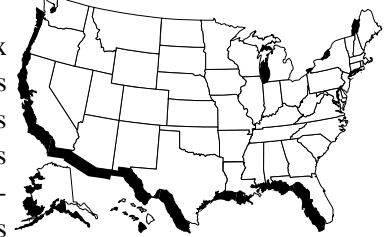
An accounts payable review identifies overpayments of tax on purchases either to a vendor or to a taxing authority that are eligible for refund. Refundable overpayments occur due to vendor error, changes in accounts payable personnel, centralized and decentralized accounts payable centers, changes in statutes and regulations and system errors. An accounts payable review is also valuable during the course of a routine audit to identify overpayments that can offset potential underpayments.

Labhart Miles and Thompson Tax & Associates have strategically partnered to provide many of the services discussed above. Please call us for more information and how to address these issues or implement these savings opportunities for your business.



Roy Hui, CMI, is a manager with Thompson Tax & Associates, LLC, where he specializes in multi-state sales and use tax matters. Prior to joining Thompson Tax in 2004, Roy worked for a Big 4 public accounting firm and the California State Board of Equalization. CMI is a professional achievement designation of the *Institute for Professionals in Taxation*.

Multi-State Tax News



Florida—Delivery Charges Although delivery charges are generally exempt from sales/use tax when optional and separately stated on an invoice, Florida has indicated that they are taxable when combined with taxable installation charges or set-up fees, and reflected as a single amount on the invoice. TAA, No. 05A-016, FL Dept. of Rev., March 29, 2005.

Florida – De Minimis Nexus Exception The Florida Department of Revenue concluded that a taxpayer had not established nexus for sales tax purposes because it had no property or employees, representatives or agents in the State. The taxpayer did have employees who “occasionally” visited customers in Florida. The Department carefully phrased its ruling stating that, “if the only physical contact with the State of Florida is a once a year visit to one customer, where no sales orders are taken, this would be considered “inconsequential”, and thus not create nexus.” This ruling is apparently premised upon the earlier, more liberal holding in Department of Revenue v. Share International, 676 So.2d 1362 (FL 1996). TAA 05A-045

Connecticut—State Supreme Court Affirms Ruling on Worthless Accounts A financial services company appealed a prior decision that stated they could not claim a refund of Connecticut sales and use tax remitted to the state on behalf customers that eventually defaulted on automobile loans that the taxes were collected on. The financial service company purchased the loans from auto dealers. However, under the language of Connecticut law, the auto dealers were considered to be the proper sellers of the vehicles that were sold and remitted the taxes to the state. The Court found on appeal that the dealer statute was not applicable to the financial services company. Therefore, the transaction fell outside the guidelines set in the statute for the exemption. DaimlerChrysler Services North American,

LLC v. Commissioner of Rev. Services, CT Sup. Ct. June 28, 2005.

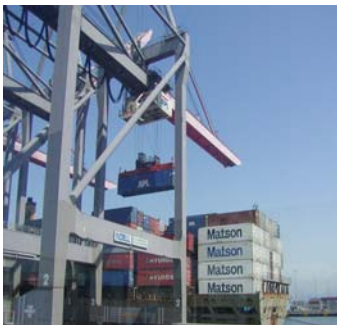
Louisiana - the state issued an emergency rule announcing which of the recently enacted federal tax credits offering relief for Hurricanes Katrina & Rita will be includ-

able in the expanded state tax deduction for federal taxes paid. Generally, if a taxpayer’s federal income tax liability is decreased by credits, the Louisiana income tax liability is increased because the Louisiana deduction for federal income tax paid decreases. However, the Hurricane relief credits are allowed to be deducted from the state taxable income. Federal credits covered by what is known as “Act 23” include certain employee retention credits, the WOTC, the employer-provided housing credit for individuals affected by Hurricane Katrina, and certain rehabilitation tax credits.

Missouri—State Supreme Court rules Local Use Tax is Constitutional The Missouri Supreme court affirmed that local use taxes are constitutional. Section 144.757, RSMo allows local jurisdictions to levy a local use tax on items bought outside the state as long as the tax does not exceed its local sales tax. The Court compared the local use tax of the jurisdiction in question with its sales tax and found that it met that requirement. Kirkwood Glass Co. v. Dir. of Rev., MO Sup. Ct., No. SC86347, June 21, 2005.

Washington—Temporary Staffing Taxable The WA Dept. of Revenue issued a special notice stating that it has always been their position that temporary staffing firms are required to collect retail sales tax on the charges. Such services include: construction, roofing electrical, excavation, carpentry and site clean-up. The services are taxable even if only the labor is provided.

Washington—Revised Advisory on Machinery and Equipment Exemption In the language of the machinery and equipment exemption, machinery and equipment is defined as “industrial fixtures, devices and support facilities.” Since the statute does not provide a definition of devices it is often questioned as to what qualifies is a device. The advisory specifically described the taxability of books and software. The Department ruled that books do not do work or perform a task and therefore, do not qualify for the exemption. If software performs a task that is used directly in the manufacturing operation, it exempt from tax. WA Dept. of Rev. Excise Tax Advisory No. 2012-4S.08.12.13601



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Focus On: Oklahoma - “The Sooner State”

About Oklahoma:

From the state flower, mistletoe, to its colorful creation from two political subdivisions, Oklahoma Territory and Indian Territory, Oklahoma, not quite 100 years old, has lived up to its state motto: “Labor conquers all things.” Oklahoma is based upon the Choctaw words for “red man.” The state was admitted into the Union on November 16, 1907, as the 47th state. On April 22, 1889, the first day homesteading was permitted, 50,000 people swarmed into the area. Those who tried to beat the noon starting gun were called “Sooners.” Oklahoma has the largest Native American population of any state with approximately 250,000 descendants from 67 tribes. It is currently the tribal headquarters for 39 tribes.



Business Climate:

With a population of over 3.5 million, its traditional industries of agriculture and mining are being expanded into communications, business services, food processing, aircraft and parts, oil and gas extraction, construction, and fabricated metals. Because of its many rivers and lakes, tourism is also a major industry in Oklahoma.

Taxes

Oklahoma has four basic business taxes: Corporate Income and Franchise, Sales/Use and Property taxes. The corporate income tax is 6% of federal taxable income earned in Oklahoma. The corporate franchise tax is levied at \$1.25 per \$1,000 of capital used, invested, or employed in the state, capped at \$20,000. The sales/use tax consists of a 4.5% rate

charged against taxable purchases or use, with the ability for cities to charge and additional 1% to 4.25% and counties 2%. Property tax is levied on both real and personal property at the county level with rates ranging from less than 1% to 1.8%.

Credits & Incentives:

Oklahoma has several credit and incentive opportunities driven primarily by the need to create and maintain jobs. These programs become increasingly important with the planned closing of one of General Motor’s assembly plants.

The long-running Quality Jobs Program offers cash payments to new and expanding businesses and the Investment and Job Creation tax credit incentive helps to offset up to 100% of the state income tax liability. Additional tax benefits, training opportunities, and custom incentive analysis are available and are designed by the State to provide bottom-line benefits.

Investment and New Jobs Tax Credit

This income tax benefit provides growing manufacturers a tax credit based on either an investment in depreciable property **or** on the addition of full-time equivalent employees engaged in manufacturing, processing, or aircraft maintenance. This benefit is a five year credit on the greater of 1% per year of investment in qualified new depreciable property **or** a credit of \$500 per year per new job, doubled in an Enterprise Zone.



Enterprise Zones

Businesses located in one of Oklahoma’s opportunity or Enterprise Zones may receive enhanced financial incentives for stimulating economic expansion in rural and disadvantaged communities.

Opportunity Zones are those census tracts in which at least 30% of the residents have an annual gross household income from all sources below the poverty guidelines established by the federal Dept. of Health and Human Services.

Enterprise Zones can be designated in disadvantaged counties, cities or portions of cities. The Oklahoma Department of Commerce designates enterprise zones and publishes lists of eligible counties, cities and census tracts. Businesses located in an Enterprise Zone are eligible to receive double the Investment/new Jobs Tax Credit. Additionally, companies obtaining ad valorem exemptions from local taxing entities may be exempted for up to six years, rather than five.

Notable / Quotable Oklahomans

Diplomacy is the art of saying “nice doggie” until you can find a bigger rock.

Will Rodgers

In times like these it helps to recall that there have always been times like these.

Paul Harvey

If I knew I was going to live this long, I’d have taken better care of myself.

Mickey Mantle

Thank you for this award and for this occasion. I don’t deserve either, but as George Burns said, “I have arthritis and I don’t deserve that either.”

Bill Moyers



***Deluxe Corp.* - SBE Decides that FTB Can “Audit Behind The Voucher” for Enterprise Zone Hiring Credits**

On January 31, 2006, in a case of first impression (Letter Decision, *Appeal of Deluxe Corp.*, No. 297128), the California State Board of Equalization held that the Franchise Tax Board (FTB) has the authority to request substantiation supporting enterprise zone hiring credit vouchers submitted by a taxpayer claiming the EZ hiring credit against corporation franchise and income taxes.

The taxpayer argued that the FTB did not have the authority to determine the validity of the hiring credit vouchers because the statutes governing the enterprise zone program granted sole authority to review the vouchers to the California Department of Housing and Community Development (HCD), (formerly Technology Trade & Commerce Agency – TTCA) and the local enterprise zone administrative agencies. However, the FTB successfully argued that given its overall responsibility to determine a taxpayer's correct tax liability, it may request substantiation to verify the validity of the vouchers in order to determine whether the taxpayer qualified for the credit.

The vouchers at issue in this case were submitted to the Oakland EZ, which had previously been audited by the TTCA. The TTCA's audit had concluded that the vouchering agent maintained inadequate records that were insufficiently documented or missing, failed to independently verify supporting source documents, and erroneously issued vouchers to ineligible employees. In addition, in the current case, the vouchering agent allowed the taxpayer's representative to submit vouchers with the vouchering agent's signature already affixed even though the vouchering agent had not yet received or reviewed appellant's submissions. Furthermore, the vouchers in dispute were approved by the vouchering agent even though the jobs for

which the credit was claimed were located in the Antelope Valley EZ, and the vouchering agent in that zone had previously refused to issue vouchers on behalf of the employees for which the credit was claimed.

Not all of the vouchers were disallowed. There are 13 qualifying categories under which an employee can qualify for the credit. The vouchers in dispute in this case were in the qualifying categories of employees eligible for the federal Job Training Partnership Act (JTPA) and dislocated/disadvantaged workers. Both are somewhat subjective and often difficult to substantiate. The taxpayer was given 30 days to provide additional documentation to support the validity of the disputed vouchers.

It is because of cases such as this, and the perceived abuses in “cross vouchering,” as with Oakland vouchering the Antelope Valley employees, that the regulations discussed on page 1 have been proposed. Taxpayers, their consultants, the zones and the FTB alike will likely benefit as some of the ambiguities in the programs are defined in regulations. It is our hope that once these regulations are in place, the FTB will have more faith in the integrity of the vouchering process and have less need to “audit behind the voucher” as they have in this case.



Concluding Note: This is an example of a good issue with a terrible set of taxpayer facts. It's not surprising that the SBE concluded as they did. But the unfortunate result is that subsequently situated taxpayers with good facts must now live with a decision resulting from bad taxpayer facts.

The Manufacturer's Investment Credit (MIC) - The Epilogue

Once the envy of the national economic development community, California's proponents of tax spending and opponents of business have all but squashed the MIC and won this battle. When Californians in November voted down the caps on state spending sought by the Governor, the proponents of big government spending programs beat down the conservative, pro-business interests and all but killed the chance of the MIC coming back any time soon. As one pundit put it, “Given the political realities and the disconnect between the legislature and the real world, don't count on it

(coming back). Right now, the public sector unions feel pretty empowered and want to get back at the business-oriented initiatives that were on the ballot this past November.” All of this translates into not much, if any, chance of seeing anything resembling the previous MIC. As they see their jobs disappearing overseas, the people who want more jobs and higher salaries are the very people lobbying heavily to make business - small and large - pay, at any cost, even at the cost of those jobs.

California - Three New Enterprise Zones Established

As reported in *States of Affair* in Summer 2005, three new zones have been designated by HCD. The Stanislaus EZ, which encompasses areas of Modesto, Ceres, and Turlock is officially designated as of November 16, 2005, and street maps and street ranges are available on their website at www.stanalliance.org.

The City of Brawley EZ is currently under conditional designation and expects to be official on March 1, 2006. They are in the process of getting final approval on the zone maps and street ranges. City Manager, Oscar Rodriguez is listing a job opening for EZ Manager. Barstow is also officially designated as of February 1, 2006. Street maps and ranges are expected to be posted on the HCD website by March 1.

CA - Enterprise Zone Net Interest Deduction for Lenders (EZNIID)

Benefits for Banks!

As reported in previous issues of *States of Affair*, the EZNIID is a statutory deduction allowed to lenders making loans to businesses located in California enterprise zones. The EZNIID continues to be a benefit for banks doing business in California, provided they can properly determine and document qualifying loans. Labhart Miles uses its tested process and methodology to serve banking clients with assets ranging from \$150M to several \$ billion. **Tax savings have ranged up to \$2,000,000 per year.**

For banks operating in or near cities with enterprises zones (now 42 across the state, including all the major metropolitan areas like Los Angeles, San Francisco, Oakland, the Central Valley (Fresno, Stockton, Bakersfield) this benefit should not be overlooked.

The California Enterprise Zone & Economic Development Landscape

The following map indicates the approximate location of the various California economic development areas.



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Inside this Issue:

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