Labhart Miles Consulting Group, Inc.

States of Affair

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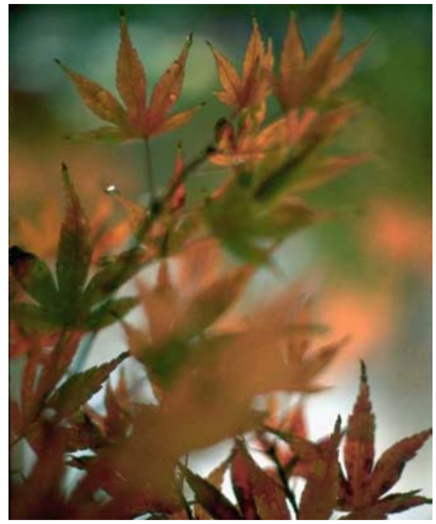


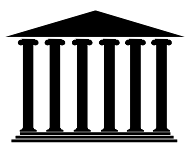
MIC "In Lieu" - Latest Events

Anticipated Decision is Pro Taxpayer

Two related cases before the California State Board of Equalization (SBE) regarding a seldom used sales tax statute (see CRTC § 6902.2), were decided on August 6 in favor of two Silicon Valley technology companies. The SBE's split decision allowed the two companies to receive partial sales/use tax refunds in lieu of claiming the California Manufacturers' Investment Credit ("MIC"), a credit which must be claimed against a company's franchise tax. The SBE's ruling was contrary to the recommendation of SBE staff, which argued that because the two companies applied another credit, the research and development credit, resulting in a zero tax liability, they could not also take advantage of the "in lieu" sales tax refund equal to the amount of MIC which could have been claimed for the years at issue.

Who Says They Can't Act Fast?

In reaction to the SBE decision and unwilling to risk the estimated $500 million in projected refunds to subsequent claimants, lawmakers approved a bill (SB 1064, authored by Senator John Burton) in the final hours of the 2003 legislative session on September 13 to prevent other corporate taxpayers from seeking the same treatment. As part of a compromise, Senator Burton's bill permits those businesses with claims filed prior to August 6, 2003, to proceed with their claims through the SBE appeals process. Outgoing Governor Gray Davis signed the bill into law in early October.



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Amnesty Programs - Quarterly Update

In continued efforts to bring companies into compliance, states are still offering limited amnesty periods. Following are the ongoing programs for this quarter:

Maine: Sept. 1 - Nov. 30, 2003

Virginia: Sept. 2 - Nov. 3, 2003

Illinois: Oct. 1 - Nov. 17, 2003

Kansas: Oct. 1 - Nov. 30, 2003

North Dakota: Oct. 1 - Jan. 31, 2004

NY City: Oct. 20, 2003 - Jan 23, 2004

States whose amnesty programs recently ended include: Florida, Missouri, & Arizona (ended 10/31/03)

Please contact Labhart Miles for questions or assistance in utilizing these amnesty programs or in reviewing your company's nexus determinations.

Pass it On:

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.

Thanks to all of you that have sent suggestions for articles. If you know of someone who could benefit from this publication, please let us know.

We welcome your comments. For more information, please contact us at

408-266-2259 or www.labhartmiles.com

Bill Labhart & Monika Miles

Streamlined Sales Tax Project

No Big Surprise...California Joins

With the continued focus on California's budget problems and on managing tax revenue, the SSTP is now being taken seriously by the California Legislature. S.B. 157 (sponsored by Sen. Debra Bowen - D) has been signed by Governor Davis and **makes California a voting member of the Project,** making it possible for the state to adopt the Streamlined Sales and Use Tax Agreement (SSUTA). Additionally, the legislation creates a board of governance to represent California at SSTP meetings, provide status updates to state leaders and ultimately make recommendations for additions or amendments to state laws for the implementation of the SSUTA. The board will include a Republican and a Democrat from both the Senate and Assembly, one member of the State Board of Equalization, one member from the Franchise Tax Board and one member from the governor's Department of Finance. The new law takes effect January 1, 2004.

By itself the SSUTA does not create a new tax. It is designed to force those selling into California that do not have nexus, to collect and remit the tax from California residents and businesses. In-state residents and businesses in virtually all states are already required by law to self-assess use tax for purchases made from out of state vendors. But it is much easier to require a few vendors to collect and remit the tax than to track and require potentially thousands of buyers to remit the tax. U.S. Rep. Ernest Istook (OK – R) introduced H.R. 3184 in September to give states that adopt the SSUTA the authority to require out-of-state retailers to collect the states' use taxes. The measure would overturn the 1992 U.S. Supreme Court decision in *Quill v. North Dakota*.

SSTP Facts

The SSTP has been gaining momentum nationally in the past year. The project, organized in March 2000, is aimed at simplifying sales/use collection and administration by providing:

- uniform definitions within tax laws (i.e.; use of common definitions when referring to taxability or exemption);
- rate simplification;
- state level tax administration of all state and local sales and use taxes (no more tax returns filed with local governments, thus reducing the sheer numbers of returns);
- uniform sourcing rules, exemption certificates, and audit procedures.

The SSTP has now gone into effect since at least 10 states, comprising at least 20 percent of the population of states imposing a sales tax, have adopted the measure.

For more information, please visit the Project's website at www.streamlinedsalestax.org.

Credits & Incentives - State Tidbits

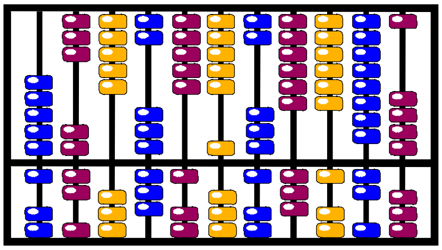
Florida - Scripps Research Institute will be receiving $310 million in cash for building a new laboratory complex. The funds will be used for equipment purchases and start-up payroll. The facility is expected to create 6,500 jobs over the next 15 years.

New Mexico - Philips Semiconductor recently agreed to pay back $13.1 million to the city of Albuquerque because it is closing a local plant, and did not meet all of its obligations relative to an incentives package received in 2000.

Ohio - The state will be reinstating its $20 million allocation to the training credit for 2004. The credit, which was suspended for 2002 and 2003, is available on a first-come basis. Interested parties training their employees should apply as soon as possible, as the funds are likely to be exhausted by January.

Pennsylvania - The House unanimously approved an extension of the state's R&D credit. The program authorizes $15 million annually for qualified taxpayers; $3 million of that amount is required to be awarded to small companies. This program is also based upon first-come, first served.

Wisconsin - Legislation recently enacted under S.B 197, Laws of 2003, provides a single sales factor method of apportioning corporate taxable income. The current formula uses a three factor, double weighted sales factor. The new formula (sales factor) will be phased in until finally, for tax years beginning after 2007 the sales factor will be the only factor. Financial institutions, public utilities, transportation and insurance companies will also see changes in their respective apportionment methods.



Accounting Hot Topics

Tax Shelters

Tax shelters are in the news again as an October Senate Finance Committee hearing focused on the issue and emphasized again in Washington the need for additional provisions to address tax shelters. The IRS continues to work on several initiatives aimed at curbing tax shelter abuses. The AICPA also has provided its recommendations to help deal with misuse of the tax code through "inappropriate tax avoidance transactions", according to a letter to its members in March of 2003. The AICPA's plans focus mainly on disclosure of abusive tax shelter positions.

Congress is attempting to enact legislation to impose harsh penalties on tax shelter promoters. The "Auditor Independence and Tax Shelters Bill" co-sponsored by Rep. John McCain, R - Arizona and Max Baucus, D - Montana would bar an accounting firm from auditing the books of any publicly traded company to which it has sold a tax shelter and codify other auditor independence principles.

California has also passed legislation aimed at tax shelters with the passage of four separate bills signed by the governor in October. Despite a lower budget for audits, the FTB has promised to focus more attention on tax shelters set up by taxpayers to shift tax out of California.

Sarbanes-Oxley Section 404

This section of the Act requires public companies to provide a statement of management's responsibility for establishing and maintaining an adequate internal control structure and procedures for financial reporting in their financial statements. Further, yearly evaluations of internal controls must be performed and incorporated into a company's annual report. Sec. 404 also requires a company's auditor to attest to and report on management's assessment of these internal controls.

Impact on the state tax function?

With ever increasing scrutiny of public companies, it is important for all departments of large companies to become involved in maintenance of internal controls. State tax is an area that may be overshadowed by accounting for federal tax matters. For instance, sales/use tax is not dependent upon net income so a business may have created a significant tax responsibility even though it currently pays no income tax. Now may be a good time to consider the following:

- Is it time for a nexus review to determine whether the company is in compliance with its sales/use and income/franchise or capital tax filing requirements?
- Is documentation in place for any state tax planning performed in recent years? Does the planning have a well defined business purpose and necessary substance?
- Have supporting documents been compiled for tax credits claimed on returns (for example R&D, training, manufacturing)?

For assistance in building processes and procedures around your company's state tax function, please contact Labhart Miles.

Unreported state tax liabilities (including sales/use tax) could be an internal control issue

"The budget is a mythical beanbag. Congress votes mythical beans into it, and then tries to reach in and pull real beans out." - Will Rogers, The Autobiography of Will Rogers, 1949

Focus On: Colorado –The Centennial State

Business Climate:

Colorado derives its name from Spanish for “Colored Red” and is the 8th largest geographic state. Famous for being a prime winter sport destination, the state has 54 mountain peaks greater than 14,000 feet. From the Prehistoric Cliff Dwelling Civilization to the information-technology age, Colorado is rich in history. But, in addition to its history and natural attractions, it is also known as a business-friendly destination. Its workforce consists primarily of technology, services, manufacturing, retail, tourism, and government.

Taxes

- Colorado has a corporate income tax rate of 4.63% and taxes corporations’ combined business operations.
- If any three of six facts exist for the tax year and the two preceding years, a taxpayer may be required to file a combined return.
- It apportions income by permitting the taxpayer to elect one of two methods: the average of the property and payroll factors or the standard average of the property, payroll and sales factors.
- Colorado does not tax partnerships or Sub S corporations.

Colorado also imposes a sales/use tax (state, county and city), severance tax and property tax but does not impose a net worth tax. However, the state also provides a sales/use tax manufacturing equipment exemption for machinery that would have qualified under the federal investment tax credit.

Credits & Incentives:

Colorado’s most notable tax credits are associated with the state’s **enterprise zone** program. Approximately 70% of the state is designated as an enterprise zone.

- **Investment Tax Credit**: Businesses making investments in equipment used in any of the state’s 16 enterprise zones may claim a credit against the income tax equal to 3% of the investment amount up to a maximum of $5,000 plus 50% of the tax liability above $5,000 in any tax year. Qualified property is that which would have qualified under the pre-1986 federal investment credit. Excess credits may be carried forward 12 years or back 3 years.

- **Employee Hiring Credit**: A new enterprise zone business facility may claim an income tax credit of $500 per new employee. An additional $500 is available if the business adds value to agricultural commodities through manufacturing or processing and an additional $200 per employee is allowed during the first two years that the business pays at least 50% of a company sponsored health insurance plan.
- **Training**: A job training credit is available for 10% of eligible training investment costs conducted in an enterprise zone.
- **R&D:** A state-wide 3% research and development credit for expenditures as defined by federal tax law is also available.

Additionally, Colorado provides Community Development Block Grants and a Private Activity Bond Program.

Colorado is dominated by small businesses. The State ranks 4th in the nation in business starts per capita, as well as in the net formation of high tech firms.

California - Additional corner….

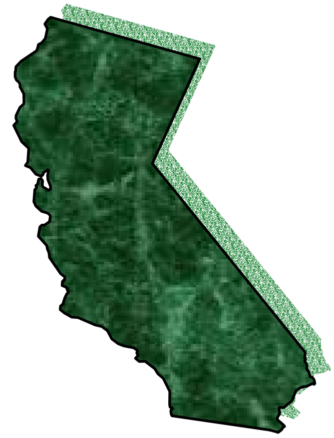
CA Enterprise Zones

The California Association of Enterprise Zones (“CAEZ”) held its annual meeting Oct 27 - 29, 2003 in Pasadena. Important items of note include:

- The EZ programs, which used to be overseen by the Technology Trade & Commerce Agency (TTCA) before the demise of that agency (due to budget cuts) are now overseen by the Department of Housing and Community Development.
- Several bills are circulating through the CA legislature that expand zones, etc. Interested parties should contact their legislative representatives to encourage their passage. Despite lobbying efforts by the CAEZ and others, it is unlikely that support for the EZ programs will continue without more taxpayer intervention.

For more information about CAEZ, please visit their website at *www.caez.org*. Labhart Miles is a member of CAEZ.

CA Employment Training Panel ("ETP") Program:

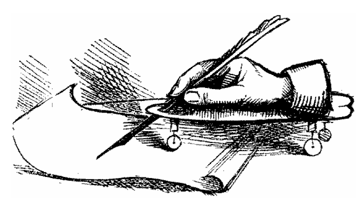


As discussed in previous editions of "*States of Affair*", California's ETP program awards funding to California companies engaging in qualified training. The program has been well funded in prior years (to the tune of $60 to $80 million annually), but has met with an unexpected dip for fiscal year 2003-2004. The ETP program was one of the casualties of the State Legislature's famous "all-nighter" during the final budget process as a significant portion of the expected funding for the year was **diverted to other programs**. The current year budget is now estimated to be approximately $35 million, and is expected to be fully awarded to qualifying companies before 12/31/03. The Panel, which usually holds monthly meetings, will **discontinue meetings until April or May** when they will begin discussions of the next fiscal year budgets and upcoming project funding.

It should be noted that funding for the program comes from the Employment Training Tax (ETT), which all California employers pay on each employee. So, should California employers be outraged to find that money paid by them to fund training is diverted to another agency? Organizations such as the Alliance for ETP believe that they should, and it is making noise in Sacramento to that effect. (For more information on the Alliance and how you can become involved in making your voice heard, please contact us or visit their website at www.allianceforetp.org.)

We continue to encourage companies that meet the qualifications for the program to put their plans and applications together and be ready to present them to the Panel in April or May, 2004. Next year's funding is expected to be $35 million or less, so **getting to the front of the line will be key**.

MIC "In Lieu": (continued from page 1)



This much-anticipated SBE decision and the subsequent passage of SB 1064 happened with the backdrop of the MIC's pending sunset on December 31, 2003. As previously reported in "*States of Affair*," the MIC statute has a termination provision which was triggered because manufacturing jobs in California were not maintained above a statutory minimum due to the downturn in the economy. This begs the question, why would the legislature allow a business benefit, whose sole purpose is to promote business spending and job creation, to sunset without some form of resurrection? The answer is probably somewhere between lack of forethought and budget problems.

What You Can Do

The good news is that when the next regularly scheduled legislative session begins, it is rumored that legislators from both parties will entertain reinstatement of the MIC in some form. The next regular session of the legislature is scheduled to begin in January 2004. **We recommend that those companies desiring to continue receiving future MIC benefit contact the appropriate legislative representatives and the Assembly and Senate Leadership to voice your corporate wishes**. In the meantime, companies are encouraged to accelerate capital manufacturing purchases into 2003 to the extent possible, keeping in mind that property must be placed into active service by 12/31/03 to qualify.

For more historical information on the MIC, please see previous issues of "*States of Affair*", available on our website.

Other MIC News:

In early September, the CA Legislative Counsel issued an opinion stating that the State Board of Equalization does not have the authority to hold that a regulation adopted by the Franchise Tax Board is invalid (as it did in the *Appeal of Save Mart Supermarkets* decision in Feb 2002).

As a result, the door has been opened for the FTB to potentially take another case on the same issue to the SBE and try to obtain a different ruling. However, there is no immediate impact to taxpayers, as the current *Save Mart* decision still stands. Also, given the political situation in Sacramento, there is no guarantee that the FTB will bring another such case up to the SBE.

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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

Public Speaking:

On **October 29, 2003**, Labhart Miles gave a presentation to the California Society of CPAs.

Topic: ***"California Tax Credits & Incentives"***

On **December 5, 2003**, Labhart Miles will be presenting at the Silicon Valley Small Business Development Center

Topic: "***CA Sales/Use Tax Issues for Small Companies"***

Ask About our Customized State Tax Training for your Business

Published:

Monika Miles penned an article for ***The Journal of Multistate Taxation and Incentives*** –November/December 2003 Edition about the recent events surrounding the MIC "In Lieu." Bill Labhart is also an editor for the ***Journal.***

Good Cause:

Labhart Miles sponsored a team for ***Making Strides Against Breast Cancer***, held October 26, 2003 in San Francisco's Golden Gate Park. Monika Miles was a leader in local fund raising efforts. Thanks to all who contributed and supported us!

Please visit our website for helpful links, current updates on other state tax information, and previous copies of our newsletter!