



States of Affair

Volume 3, Issue 1 Autumn 2004

California Amnesty - Blessing or Curse?

Governor Schwarzenegger, on August 18, 2004, signed legislation (SB1100) which authorizes the Franchise Tax Board (FTB) and State Board of Equalization (SBE) to administer a tax amnesty program. At present there is little guidance explaining the program.

States of Affair has reported on amnesty programs in the past. Most amnesty programs traditionally cover taxpayers that have created nexus in a state but, for whatever reason, haven't been filing. The California program covers this type of taxpayer but also covers in-state taxpayers that have been filing but have underreported certain taxes.

Note: Because of the lack of regulations, forms or guidance, it is imperative that taxpayers who might want to take advantage of the program plan ahead. Taking advantage of the amnesty program, which has only a two month window of opportunity, takes much preparation. Additionally, a thoughtful consideration of amnesty entails a careful analysis of the substantive tax issues giving rise to exposure and of the procedural and practical options existing without amnesty.

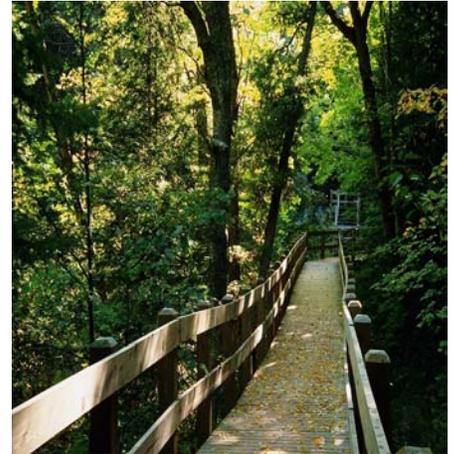
The Program: SB1100 covers unreported income/franchise and sales/use tax issues. The upcoming amnesty program is currently scheduled from February 1, 2005 through March 31, 2005, during which time a taxpayer must complete and submit an amnesty application. All delinquent

taxes applicable to tax years prior to January 1, 2003, must be paid. Both filing and payment of taxes and interest must occur on or before May 31, 2005, unless the taxpayer enters into an installment payment arrangement, which permits payment by June 30, 2006.

After the Amnesty Program: Double the penalty rates will be applied to: (a) any applicable tax that is assessed at any time after the expiration of the amnesty period that could have been reported under amnesty; and (b) any underreported tax in a period for which amnesty was applied for, but only to the extent of the underreported amount. For any taxable year which amnesty could have been requested, but wasn't, California will also assess an interest surcharge of 50% of the interest accrued from the original due date of a tax liability to the last day of amnesty, whether the amount was due and payable during the amnesty period or became due and payable after that date. Criminal prosecution may still be brought with respect to any such amounts.

Amnesty is not available to a taxpayer who is on notice of a criminal investigation, or if a court proceeding has already been initiated. Amnesty is also not available for amounts attributable to tax shelter items that could have been reported under prior favorable California and federal amnesty programs.

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New Team Member:

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.

This month we'd also like to introduce you to **John Bialy**. Please join us in welcoming John as our marketing manager.

We welcome your comments. If you know of someone who could benefit from this publication, please let us know. For more information, please contact us at

408-266-2259 or www.labhartmiles.com

Bill Labhart & Monika Miles



Federal Credits Renewed:

On October 4, President Bush signed H.B. 1308 into law, extending the federal R&D Credit, the Worker's Opportunity Tax Credit ("WOTC") and the Welfare to Work Tax Credit. All had expired, but have now been extended to 12/31/05.

Special Guest Article - Property Tax Refresher

Many companies don't realize that a property tax review is in order each and every year, as all company costs deserve an annual review to protect the bottom line.

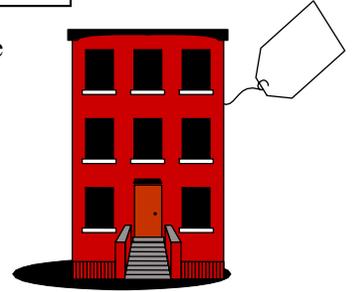
As you probably know, real property tax values in California are set when properties transfer or when new construction is completed, and then those values are factored each year by Proposition 13's statutory amount of up to 2% to determine the property tax assessment. However, property tax law allows for a reduction of that assessment when "market" values are lower.

Currently many commercial and industrial properties in the Bay Area have lower (Proposition 8) values than their tax assessments reflect. Rents are down and vacancies are up, generally, and properties with their value bases set in better times may be eligible for property tax relief until the market returns to prior levels. Many tenants have subleased all or part of their buildings at lower rents than they are actually paying, have renegotiated their rents downward with their landlords, or have abandoned their leases altogether. These properties often deserve lower property taxes to reflect the market downturn.

Even many properties with performing tenants who have existing leases at rent levels higher than today's market rents are entitled to property tax relief at this time. This is because property tax law requires tax assessments to be based on current prevailing market rent levels and sale amounts, not on those in effect when the lease was signed or when the last transfer or new construction took place and the tax base was set.

A word about base values. Do not think that a sales price is the appropriate assessed value for a property if it had above market leases in place on the transfer date, as the purchase price reflected the higher than market income to be received. That higher than typical income is a benefit that may have

been paid for in the price, but the Assessor is required to discount the sales price to reflect the rents in the marketplace on the transfer date. That is also true for the assessed value for major new construction. The assessor is required to use the prevailing market rents on the date the construction was completed to determine the property tax assessment, not the rent that was negotiated previously when rents were higher. *Sometimes this means that the assessed value of new construction can actually be less than the construction costs.*



The best time to see a property tax professional each year is in January to review the particulars of your property tax assessment, before the next year's assessment is determined. You should also contact a property tax specialist at any time during the year when you acquire a property or complete major new construction, *before* the tax base is set. Many firms that specialize in this work do not charge for this review, or charge a modest amount, pending a contingency fee upon achieving a reduction to the assessed value. Property tax specialists will also appeal your property tax assessment in any year that it is not satisfactory. The appeal deadline for secured property is September 15th in Santa Clara and Alameda counties, and November 30th in the other Bay Area counties.

This article was prepared by Andrea Harris of Declaration Services, Inc., a San Jose firm specializing in property tax compliance and property tax reduction work in the Bay Area.

See accompanying charts on next page....

Federal Taxes: Individual Deduction for Sales Tax Paid

A newly passed law allows individual taxpayers an opportunity to choose to take an itemized deduction for sales tax paid (rather than income tax) on their 2004 and 2005 returns. This will help bring parity to individuals in states that don't impose an individual income tax, like FL, NV, SD, TN, TX, WA and WY. It allows individuals in states which impose an income tax to choose between a deduction for either sales tax or income tax paid. (The more things change... half of the Labhart Miles team remembers a time we used to get an itemized deduction for sales tax.....the other half just read about it!)



This newsletter is distributed free of charge to clients and other contacts. It is written in general terms and is not intended to be a substitute for specific tax advice. While reasonable care has been taken in the preparation of this document, Labhart Miles Consulting Group, Inc. accepts no responsibility for errors it may contain or for any losses sustained by any person or entity that relies on it.

Special Guest Article - Property Tax Refresher (cont'd)

Possible Property Tax Reduction Example

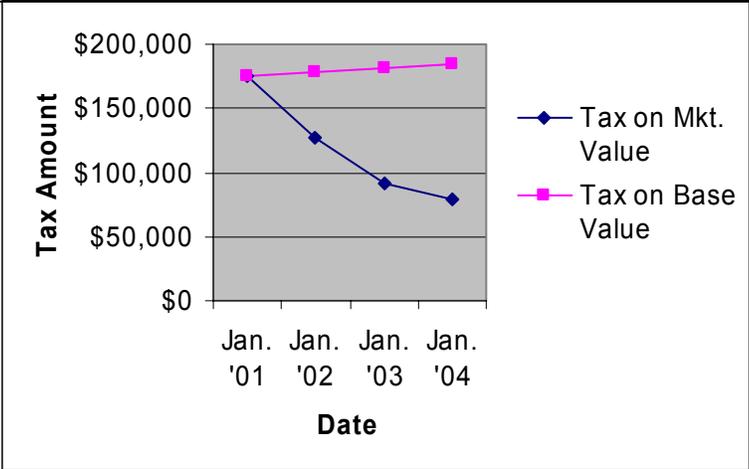
DATE	Base Value for Prop Tax	Prop Tax on Base Value	Market Value	Prop Tax on Market Value	Poss. % Tax Decr. From '01	Value/sf	Market NNN Rent*
Jan '01	\$15.9M	\$175K	\$15.9M	\$175K	n/a	\$250	\$2.20
Jan '02	\$16.2M	\$178K	\$11.5M	\$127K	28%	\$190	\$1.60
Jan '03	\$16.5M	\$182K	\$ 8.3M	\$ 91K	48%	\$138	\$1.15
Jan '04	\$16.8M	\$185K	\$ 7.2M	\$ 79K	55%	\$120	\$1.00



These charts, prepared by Declaration Services, Inc. - show the impact of using different base values in the computation of property taxes.

** Note that "NNN" in the chart above refers to a "Triple Net Lease" which means that the lessee of a building pays the rent to the landlord **net of property taxes, net of insurance and net of maintenance**. The lessee is responsible for those expenses, whereas, in a gross lease, the landlord covers these costs, but charges higher rent.*

Example of property tax on base value vs. tax on market value



Amnesty Programs - Quarterly Update

In continued efforts to bring companies into compliance, more states are offering limited amnesty periods. Following are the current programs (in addition to California's program, discussed in detail on Page 1):

Mississippi: Sept 1 - December 31, 2004 - Covers all taxes from 1999 forward. Civil and criminal penalties are waived during the amnesty period, and the state promises harsh penalties for eligible taxpayers that do not come forward during the amnesty period.

Illinois: October 15, 2004 - Jan 31, 2005 ("Tax Shelter Voluntary Compliance Program") Just last year, Illinois offered taxpayers a major amnesty. Now they are at it again with a more targeted amnesty program for taxpayers that have engaged in abusive tax shelters as designated by the Internal Revenue Service. The program allows taxpayers to avoid substantial penalties by disclosing participation in specified transactions and paying the taxes due.



Focus On: Michigan "The Wolverine State"



Business Climate:

Michigan, the 26th state, admitted to

the Union on January 26th, 1837, is known as "The Wolverine State." According to the 2000 census, the population is almost 10 million. It also gave the world the Ford Model T in 1908.

Principle industries include: manufacturing, tourism and agriculture. Manufacturing includes automobile, non-electric machinery, furniture, appliances, cereal, baby food, chemicals, pharmaceuticals and lumber.

Taxes

Michigan levies a Single Business Tax (SBT), which is the only general business tax levied by the state. In 1999 the Governor signed legislation which provides for a phasing out of the SBT, ratably over 23 years. As a value added tax, it is levied on services consumed or benefits received. The SBT base consists of three components: compensation paid, capital employed, and profit. The rate is 2.3% through 1999 and then is reduced .1% each year until it is phased out.

Firms doing business in Michigan and other states apportion their tax using a formula based upon a percentage of property, payroll and sales in Michigan. The unitary method of taxation is not used for SBT purposes. The tax applies to individuals, firms,

banks, partnerships, limited partnerships, joint ventures, corporations, and limited liability corporations which have gross receipts of \$250,000 or greater.

The state imposes a state sales/use tax, levied at 6%. The state levies no city, local or county sales tax.

Credits & Incentives:

A number of credits are available to offset the SBT, including incentives which provide an almost tax free environment. The Michigan Economic Growth Authority (MEGA) was created to promote high quality economic growth and job creation. Since their inception in 1995, MEGA tax credits have spurred an estimated \$5.1 billion in private investment, creating 29,000 jobs and spinning off another 35,000. Companies in electronics, communications, medical science and other high technology fields which devote at least 25% of operating expenses to research and development, and are expanding in Michigan, may be eligible for a high-tech job creation tax credit against the SBT. Each credit may be awarded for up to 20 years and for up to 100% of the tax related to the project.

Designed to spur new jobs and investment, Michigan has 34 Renaissance



Michigan's current flag and seal were adopted by the legislature in 1911 and reflect the design of Lewis Cass, second Governor of the Michigan Territory from 1813-1831. Written below the shield is the Latin inscription translated as "If you seek a pleasant peninsula, look about you." This reference was to the Lower Peninsula, because the Upper Peninsula was not added until after the seal was adopted in 1837. It was in compensation for the loss of a strip of land on its southern border, which was obtained by Ohio when Congress recognized Michigan as a state.

Zones around the state designed as virtually tax free for any business or resident presently in, or moving into, a zone. The zones include urban, rural and agricultural areas as well as former military bases. To date, the zones have spurred more than \$2.1 billion of private investment in more than 340 projects and creation of more than 7,500 jobs. The duration of the zone designation ranges from 10 to 15 years, starting from January 1, 1997. The tax relief is phased out in 25% increments over the last three years of the zone.

Job training:

Michigan has been rated as one of the nation's best in workforce training. All Michigan-based companies are eligible to compete for specialized training funds under the Economic Development Job Training program. Grants are awarded through an application procedure beginning in October with awards announced by the end of March. Monies can be used to create jobs or upgrade skills for existing workers.

Michigan Quotables

"People can have the Model T in any colour - so long as it's black." - Henry Ford, industrialist

"You're only given a little spark of madness. You mustn't lose it!" - Robin Williams, actor and comedian

"While we have the gift of life, it seems to me that the only tragedy is to allow part of us to die - whether it is our spirit, our creativity, or our glorious uniqueness." - Gilda Radner, comedienne.

Other famous Michiganites: Gerald Ford, Charles Lindbergh, Stevie Wonder

CA Amnesty.....Continued from page 1

No refunds will be granted of any penalties paid prior to the time amnesty is requested, and no claims for refund may be filed with respect to any tax and interest amounts paid under this amnesty program.

The Process: A taxpayer who is eligible to request amnesty must: (a) file a completed amnesty application, signed under penalty of perjury; and (b) within 60 days after the conclusion of the amnesty program, file completed tax returns for all previously unreported periods, and file amended returns for all tax periods previously underreported; and (c) pay in full the taxes and interest due for all periods reported under amnesty, or, apply for an installment payment agreement (paid in full by June 30, 2006).

Compliance Warning: The amnesty program may require filing many different overdue past returns. This could occur in a relatively short period of time when your tax professionals are addressing normal compliance demands. It is suggested that taxpayers wishing to avail themselves of this program plan now in order to avoid undue compliance crunches or misjudgments.

Looking at an Example: The bill increases the accuracy penalties from 20% to 40% and also increases interest on unpaid taxes by 50%. To put this in perspective, hypothetically, assume you have a \$50,000 tax liability for a pre-December 31, 2002 tax year. The accuracy related penalty would be \$20,000 (40% of the \$50,000 tax liability). If the accumulated interest rate was 30%, the adjusted rate would now be increased 50% to 45% (150% of 30%). So now, instead of \$65,000 (\$50,000 plus interest of \$15,000), the liability is a whopping \$92,500; \$20,000 of which is not deductible.

A Potential Pitfall: So, you think it doesn't apply to you? These new penalties and interest rates apply to federal as well as California adjustments for which a taxpayer presently may or may not know the existence or probable outcome. And if the adjustments go back several years, because of an extended statute of limitations agreement, it matters not. In order for the increased penalties and interest to be abated, you have to apply for amnesty and have the tax paid by May 31, 2005. So an alternative is to make an additional payment outside of amnesty and file for a refund. This also presents some challenging issues. Remember, if you file under amnesty you give up your appeal rights. This may also cause additional issues. If the additional payment/liability is large enough, it might be a tax accrual adjustment and/or something highlighted during federal or California audits.

If you require any assistance regarding the amnesty program, performing exposure analysis, or with compiling supporting documentation, please contact Labhart Miles. Our website, www.labhartmiles.com, will provide updates as we become aware of them.



CA Amnesty: Who Should Perform an Exposure Review?

The current amnesty program covers existing CA companies that have underreported taxes. Companies should consider taking part in the program, if they:

- Are expecting significant federal or CA adjustments on positions taken;
- Have performed CA or multi-state planning which might be challenged;
- Have claimed credits for which there is little or no support (i.e.; - R&D, MIC).

Potential exposure might be reduced by shoring up support for some of the areas mentioned above.

California Enterprise Zones:

Labhart Miles participated in the CA Association of Enterprise Zones (CAEZ) annual conference held November 3-5, 2004, sponsored by Chula Vista, National City and San Diego. Topics of interest included:

- Strategy session for post-1990 zones whose designations are scheduled to expire in 2006.
- Upcoming legislation to be sponsored by Senator Ducheny.
- New EZ guidelines and oversight by Department of Housing and Community Development (HCD).
- Another EZ effectiveness study to be conducted by HCD.
- Process of selecting three new zones from field of nine applicant cities.
- Discussion regarding vouchering, FTB audits, correct documentation, etc.
- Presentation of University of Southern California white paper discussing the effectiveness of EZs on a national level from 1980 through 2000.

Sarbanes Oxley & State Tax: Unclaimed Property



Tax departments can't get a breather lately! What with regular federal and state filings, international compliance, sales tax returns, property tax returns, Sarbanes Oxley compliance, tax provision calculations...does it ever end? Well, no. In many companies, the tax department is also responsible for dealing with the company's unclaimed property, or "escheat" issues. And while it may be far down the "to do" list, perhaps now is a time to take a closer look.



What is unclaimed property? It is tangible and intangible personal property that has remained unclaimed by its rightful owner. Almost every large company has unclaimed property. Common examples are uncashed checks (payroll, vendor payments, employee benefits), credit balances in A/R, dividend payments, deposits at financial institutions, and unredeemed gift certificates or gift cards.

Particularly aggressive states include Arizona, California, Delaware, Minnesota, & New York

Most states have laws stating that if property remains unclaimed for a specified time, it is presumed abandoned by its owner and the holder of the property is required to turn it over to the state (essentially for safe-keeping, until the rightful owner can be found). The purpose for unclaimed property laws is essentially to protect the interests and property rights of the owner and make attempts to reunite the owner with their property. Yet the burden in identifying the owner (performing due diligence), identifying the varying dormancy periods until action must be taken, and determining the proper state to which to report the property is on the company.

Why bother with it now? There are several reasons, but two are most critical. First, with the increasing revenue shortfall being felt by all the states, jurisdictions are getting more aggressive in chasing down money – from whatever source. Many states charge penalties and interest on

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Speaking Out



Public Speaking:

Labhart Miles presented at the ASWA/AWSCPA Joint National Conference in Chicago, IL on Nov.10, 2004.

Topic: "State Tax Basics in Light of Sarbanes-Oxley"

Labhart Miles presented at the SBA-Cisco Systems San Jose Entrepreneur Center on October 19, 2004

Topic: "Sales Tax Basics"

We will be featured at the Silicon Valley San Jose Discussion Group meeting of the CA Society of CPAs on December 16, 2004.

Topic: "CA Enterprise Zone Hiring Credits"

In Print:

Bill Labhart is an editor for the *Journal of Multistate Taxation and Incentives*. He also recently penned two articles for the Nov/Dec 2004 "All Incentives Issue" of that publication. If you have an article that you would like to submit for future publication, please contact us.

In Our Community:

Labhart Miles sponsored a team for *Making Strides Against Breast Cancer*, October 23, 2004 in San Francisco's Golden Gate Park. Our team raised over \$8,700, and received donations from people in 28 states! Thanks to all who helped us reach this goal!



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

Credits & Incentives Updates

Sixth Circuit Declares Ohio Incentive Violates the Commerce Clause

In Cuno v. Daimler Chrysler, Inc. CA-6, Dkt. No, 01-3960, Sept. 2, 2004, a three judge panel of the Sixth Circuit ruled against the practice of states' offering tax credits as an incentive to encourage corporate investment and employment in targeted areas. The Sixth Circuit covers four states: Kentucky, Michigan, Ohio and Tennessee. However, although this case currently only affects these states, the case was promoted by a group who has, for many years, campaigned against economic development incentives as corporate welfare. Because of this decision, it is possible that similar cases will be pursued in other jurisdictions. Various parties are gearing up to challenge any adverse findings.

The package of benefits included two incentives that were challenged: a 13.5% investment tax credit, taken against the corporate franchise tax and a ten year, 100% exemption from the Toledo personal property tax. The court upheld the local property tax but struck down the credit against the franchise tax. The court ruled against the franchise tax credit because the state used its "tax power" to unlawfully influence an investment in-state which discriminated against other states, thus violating the Commerce Clause. The distinction drawn between the two incentives was that the tax credit reduced pre-existing taxes being paid by a current taxpayer, whereas the local ad valorem tax exemption eliminated potential future taxes. The court, in attempting to simplify the interpretation of its decision, quoted language from another Supreme Court decision in *Oregon Waste Systems, Inc. v. Oregon Department of Environmental Quality*, 511 U.S. 93 (1994). "Discrimination simply means differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter."

Conventional wisdom says that this decision will be challenged and will ultimately end up in the U.S. Supreme Court.

Market Watch...There is Still Good Incentive News!

Blaine, Minnesota

Northtown Mall Makeover - 10 year property tax abatement from the city of Blaine; the company hopes the county will match the abatement.

The city abatement is worth \$2.7 million over ten years and potentially, another \$2.9 million abatement.

Louisville, Kentucky

Hi-Tech Mold & Tool Inc. - Employment increases from 107 to 257, investing \$5.5 million.

A maximum \$2.2 million in Kentucky Industrial Development Act (KIDA) credits over 10 years.

Michigan

In October, the Michigan Economic Development Corporation (MEDC) announced 6 new economic development projects which will, in total, create more than 1200 new jobs and more than \$79 million in private investment in the state. The projects include 3 company expansions and 3 Brownfields redevelopment projects.



Unclaimed Property (cont'd from page 6)

unclaimed property which has not been properly reported and remitted to the state. Several states are aggressively pursuing companies, using third party bounty hunters, who get paid based upon a percentage collected. Second, is Sarbanes Oxley. Depending on how diligent a company has been (or hasn't been), there may be a significant understatement of liabilities, or at the least, a misclassification on the balance sheet for unclaimed property items. A review of this area should be on every internal control checklist for the tax department. (If it turns out that the company's shared services, A/P or other group ultimately has responsibility, then that's one more thing to check off the list!)

While the concept of unclaimed property is not a tax issue, per se, it may just fall into the lap of the tax department. If we can assist your company with identification, quantification, required due diligence, or amnesty/voluntary disclosure in this area, please contact us.



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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.

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