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Paid California AMT? Generated EZ Credits? File a Refund Claim.

Author: Marty Dakessian, Partner, Los Angeles
Author: Brian W. Toman, Partner, San Francisco
Author: Kyle O. Sollie, Partner, Philadelphia
Author: Mike Shaikh, Associate, Los Angeles

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Enterprise Zone credits can be one of the most effective tools in reducing California franchise tax. Recognizing this, the California Franchise Tax Board ("FTB") has been on a campaign to limit the effectiveness of the credits. The FTB's efforts continue to fail. Last week, the FTB lost yet another battle. The California State Board of Equalization ("SBE") held that taxpayers may use EZ credits against their California Alternative Minimum Tax ("AMT") liabilities, despite the FTB's efforts to the contrary. We will discuss the most recent taxpayer win in Appeal of Nassco in this Client Alert. Taxpayers should now look at their California franchise tax returns (and California audits) for the following refund opportunities:

- Not applying EZ credits against your California AMT? File a refund claim.
- Generating more EZ credits than are being used? FTB's policies to silo credits are contrary to the purpose and text of the EZ legislation. If you've got a lot of EZ carryovers, consider a claim.
- Claiming only "location"-based hiring credits, not worker classification credits? File a refund claim.
- Computing EZ sales-and-use credits only for "capital" purchases, not expense purchases? File a refund claim.
- Did FTB audit and reject credits vouchered by a locality? Protest or file refund claim.

Last week's Nassco holding

Last week, the SBE published a formal opinion in the *Appeal of Nassco Holdings, Inc.*,[1] holding that Enterprise Zone credits could be applied against the taxpayer's AMT liability.

In *Nassco*, the taxpayer incurred AMT liabilities. The taxpayer attempted to use EZ credits to offset these AMT liabilities. The FTB, however, argued that under California Revenue and Taxation Code Section 23036(d), EZ credits could only be used to offset the regular tax.

Section 23036(d) generally does not permit credits to reduce the "tax" below the tentative minimum tax, but specifically permits EZ credits to do so. However, Section 23036(d) does not provide a definition for "tax." The issue in *Nassco* was whether the term "tax" includes the AMT. If "tax" includes the AMT, Section 23036(d) would permit taxpayers to use EZ credits to reduce both the regular tax and the AMT, potentially reducing a taxpayer's total tax liability to zero. If "tax" includes only the regular tax, then taxpayers with AMT liabilities would receive no immediate benefits of EZ credits because, although such credits would reduce the amount of regular tax, doing so would increase AMT by corresponding amounts such that the total amount of tax owed would remain equal to the tentative minimum tax.

The FTB argued that the proper definition of tax was set forth in Section 23036(a), which excludes the AMT. The taxpayer argued that the proper definition of tax was set forth in Section 23036(b), which specifically includes AMT. The taxpayer claimed that Section 23036(d) was silent with regard to the definition of the term tax and, therefore, the statute was ambiguous. As a result, legislative intent must be considered. The taxpayer then cited multiple legislative documents indicating intent to allow the EZ hiring credits to be claimed against AMT. The FTB countered, stating that the statute was clear because Section 23036(b) limited the inclusion of the AMT in the definition of tax to certain limited purposes, none of which included the application of EZ credits.

On February 25, 2009, the SBE determined that taxpayers could use their EZ credits against the AMT. The FTB filed a petition for rehearing, which the SBE rejected August 31, 2009. Last week, on November 17, 2010, the SBE issued a formal opinion, adopting the taxpayer's position. The SBE found that Section 23036 does not clearly express the meaning of the term "tax" for purposes of subdivision (d)(1), and that an ambiguity existed in this regard. The SBE refused to "sacrifice legislative intent or purpose by overlooking a latent ambiguity and adopting a literal construction," as the FTB insisted. According to the SBE, sustaining the FTB's action would create the "absurd result" of disparate treatment for AMT and non-AMT taxpayers. In order to avoid "frustrat[ing] the purpose of the statute," the SBE reviewed the relevant legislative history and, having done so, concluded that the legislative documents presented by the taxpayer "clearly show that the intent of the bill was to allow EZ credits to be used against the AMT."

Reed Smith lawyers are at the forefront of EZ credit matters. We are handling the lead case in the California Supreme Court concerning the FTB's authority to audit vouchered EZ hiring credits (*Dicon v. FTB*), and we are handling litigation at the Court of Appeal regarding the FTB's policy of allowing only capitalized purchases to qualify for the EZ sales-and-use tax credit (*Taiheiyo Cement v. FTB*). We have handled numerous other successful EZ credit matters at the SBE (*Appeal of Jessica McClintock*, *Appeal of Devry, Inc.*), and at protest and settlement before the FTB.

For more information on the *Nassco* decision and other California enterprise zone matters, contact Marty Dakessian or any of the other authors of this Alert, or another member of the Reed Smith State Tax Group. For more information on Reed Smith's California tax practice, visit www.reedsmith.com/CAtax

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[1] State Board of Equalization Case Identification Number 317434.