Credits and Incentives Briefing

A global and domestic credits and incentives network publication

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Dear Clients and Alumni,

Thank you for the wonderful reception of the inaugural issue of the Credits and Incentives Briefing newsletter. A number of you reached out and told us that the newsletter provides a much needed, concise summary of important credit and incentive developments in an easily accessible format. We hope to continue providing you the information you need to stay informed about credit and incentive developments. In this edition, among other stories, we summarize recent changes to the New York Excelsior Program and the New Jersey BRRAG Program. In addition, we highlight important federal tax credit and incentive developments, and provide information and insight with respect to the application of federal New Markets Tax Credits to further your economic development incentives needs. We also provide insight into an important California ruling that may create tax refund opportunities, despite attempts by the California Franchise Tax Board to limit the benefits of the ruling.

Please send us your comments on the newsletter - your feedback is invaluable. We hope you enjoy reading this edition of our newsletter, and look forward to hearing from you.

Regards,
Kenneth M. Hunter
National Leader - Global and Domestic Credits and Incentives Network

Inside this issue:

pwc

NEW YORK

UPDATE: New York Excelsior Jobs Program

Enacted Legislation Expands Program Benefits

The March 2011 issue of the *Credits and Incentives Tax Newsletter* featured an article about the New York State Excelsior Jobs Credit Program, and identified some of the proposed program enhancements under consideration by the New York State Legislature. Since then, statutory amendments enacted as part of the 2011/2012 New York State budget bill (S.B. 2811-C, A.B. 4011-C, enacted 3/31/11) make a number of important changes to the program. In summary, those changes include the following:

Extended credit period – The amendments extend to ten years from five years the period during which credits may be claimed.

Program enhancements extend benefit period and increase credit amounts.

Jobs tax credit – Prior to amendment, the jobs tax credit ranged from 5 percent to 1.33 percent, based on the level of wages and benefits, and the credit was capped at $5,000 per new job. As amended, the credit equals 6.85 percent of gross wages, regardless of the level of wages and benefits, and the $5,000 per job-credit cap is eliminated.

Research and Development Tax Credit – The amendments increase the credit to 50 percent from 10 percent and cap the credit at three percent of qualified research and development expenditures attributable to activities conducted in New York State.

Real Property Tax Credit – The amendments extend to ten years from five years the period during which a real property tax credit may be claimed. The credit percentage equals 50 percent in year one, and phases out in five percent increments each year of the 10 year period. Previously, the credit equalled 50 percent in year one and phased out in 10 percent increments each year. Most notably, the amendments allow taxpayers to compute the annual credit based on the eligible real property taxes claimed in computing taxable income for the year at issue, rather than tying the credit to the taxes paid in the year immediately before applying for the program. In doing so, the amendments allow a taxpayer to claim a credit for taxes associated with property improvements over the 10-year period.

Credit Overlap – The amendments allow taxpayers to claim both the excelsior investment tax credit and the research and development property investment tax credit for the same property investments. In addition, the amendments allow taxpayers to use qualifying research and development expenditures, including salary and wage expenses related to research and development activities conducted in New York, to claim both the excelsior research and development tax credit and the qualified emerging technology company facilities, operations and training credit.

Qualification Criteria Modifications – The amendments modify the credit qualification criteria. As amended, qualification will be based on the nature of the activities conducted at the facility for which the credit is claimed, and not solely on the nature of the business entity claiming the credits.

Aggregate Credits – The amendments increase the amount of aggregate credits allowed in tax years 2017, 2018 and 2019 to $200 million each year from $150 million, $100 million, and $50 million in each year, respectively.

Compliance – The amendments require taxpayers to attach to their annual return the certificate of tax credit as a prerequisite to claiming the credit in any tax year.

Clawback Changes – The amendments clarify that the credit will be recaptured against taxes due, rather than against taxable income, in any year that the taxpayer fails to meet the eligibility requirements set forth under the statute.

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FEDERAL

New Guidance Addresses Interplay of I.R.C. Sections 48 and 168(k)

Revenue procedure clarifies bonus depreciation computation.

The Internal Revenue Service issued long-awaited guidance on the new 100 percent bonus depreciation provisions of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "2010 Act"). Revenue Procedure 2011-26 provides guidance on the eligibility requirements for the 100 percent additional first-year depreciation deduction created by the 2010 Act. Internal Revenue Bulletin 2011-16, April 18, 2011.

Of particular importance to renewable energy investors, developers, and consumers, Section 3.03(a)(5) of Revenue Procedure 2011-26 clarifies that in cases where a taxpayer has costs that are eligible for both 100 percent bonus depreciation and either section 48 investment tax credits or the Treasury grant in lieu of investment tax credits (the section 1603 grant), those energy incentives may be determined first, and 100 percent bonus depreciation applied to the remaining basis.

While anticipated by many practitioners and consistent with prior guidance on 50 percent bonus depreciation, these rules may result in a significant opportunity to obtain tax benefits for renewable energy investments during the period for which 100 percent bonus depreciation is available. For new renewable energy systems acquired and placed in service after September 8, 2010, and before January 1, 2012, first-year cash tax savings could reach nearly 60 percent of eligible project costs.

Example -- During 2011, XYZ Corp acquires and places into service a new solar panel installation. Its eligible cost basis for purposes of both the section 1603 program and 100 percent bonus deprecation is $100,000. Under Revenue Procedure 2011-26, XYZ Corp may first claim a Treasury grant of $30,000. It then reduces its basis in the solar property by $15,000. Finally, as long as all of the 100 percent bonus requirements have been met, XYZ Corp may claim 100 percent bonus depreciation on its remaining basis, yielding a cash tax benefit of

$29,750 ($85,000 times its marginal tax rate of 35 percent). In all, XYZ Corp's 2011 cash tax benefits from its $100,000 of project costs total $59,750.

New Markets Tax Credit: 2010 Credit Extension, 2011 Proposed Enhancements Support Economic Development

Partnership between community development entities and economic development agencies may increase incentive opportunities.

The New Markets Tax Credit (NMTC) program was signed into law on January 21, 2000, as part of the Community Renewal Tax Relief Act of 2000. The intent of the program is to help spur economic and community development and job creation in low-income and rural communities by attracting private sector capital investment.

In exchange for making what is known as a Qualified Equity Investment (QEI) into a Community Development Entity (CDE), investors receive a 39 percent federal tax credit, spread out over seven years. CDEs receiving QEIs are required to invest substantially all of the QEI, by making loans or investments into Qualified Active Low Income Community Businesses (QALICB), in low income and/or rural areas.

Initially funded with $15 billion over five years (with an additional $1 billion added for the Hurricane Katrina GO Zone Authority), the program was twice extended with the most recent extension approved December 2010 providing for an additional $7 billion in tax credit allocation authority over two years. The Obama administration has proposed in its 2012 budget another $3 billion over two years to be utilized for small and disadvantaged businesses.

Who administers the NMTC program? The NMTC program is administered by the Community Development Financial Institutions Fund (CDFI Fund), which is an arm of the U.S. Treasury Department. The CDFI Fund is responsible for: certifying the CDEs to ensure they are qualified CDEs; providing guidance on the CDE application for the NMTC allocation, allocating the NMTC authority to the approved CDEs; and, monitoring compliance with the NMTC program rules.

How the NMTC program works. Community Development Entities seek out investments from investors in exchange for a 39 percent tax credit. Once an investor has made a QEI in a CDE, the CDE issues the investor a certificate allowing the investor the ability to take its 39 percent tax credit over seven years; five percent each year for the first three years and six percent for each of the last four years of the investment period. The CDE is then responsible for reinvesting the QEI by making Qualified Low Income Community Investments (QLICI) in QALICBs that meet the NMTC program requirements and the CDE's application commitments. The QLICI must remain in effect for a minimum of seven years for the Investor not to have a recapture of the tax credits.

How to utilize the NMTC as an "incentive" As the economy recovers, businesses will need to critically evaluate their ability to expand operations and invest in new development and capital assets. At the same time, state and local governments that fall within low income census tracts must evaluate their ability to encourage business development in historically under-invested-in communities. By partnering with CDEs (or applying for their own CDE status and allocation authority) that have allocations that cover their community, an Economic Development Office (EDO) may potentially include equity from NMTC-leveraged loans in its incentives package. The EDO may then use the NMTC program as an incentive for the business to consider when drafting

business expansion plans. A business may also be able to partner with a CDE without the involvement of the local EDO in order to help finance its project. The typical NMTC project has the potential of providing up to 20 percent of the project costs, depending on how the deal is structured.

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FTB acts to limit refund opportunities.

CALIFORNIA

Caution: FTB Responds to BOE Determination Allowing Use of EZ Credits/MIC to Reduce AMT Liability

In *Appeal of NASSCO Holdings, Inc.*, 2010-SBE-001 (Nov. 17, 2010), the California Board of Equalization (Board) allowed a corporate taxpayer to use enterprise zone credits (EZ credits) and manufacturer's investment credits (MICs) to reduce its alternative minimum tax (AMT) liability. The case is a formal precedential opinion and is applicable to all California taxpayers impacted by the relevant California Revenue and Taxation provisions. In response to the decision, the California Franchise Tax Board (FTB) issued Notice 2011-02 (Mar. 18, 2011). The Notice apparently concedes to the findings in *NASSCO,* but substantially narrows the scope of the decision and interprets it in such a manner as to possibly create whipsaw issues against corporate taxpayers.

While the taxpayer only had two specified credits at issue, the court indicated that all tax credits under Cal. Rev. & Tax Code (CRTC) Section 23036(d)(1) (e.g., the research and development credit, EZ credit, MIC, solar energy credit, and the Los Angeles Revitalization Zone sales tax credit) could reduce the AMT liability. Separately, the FTB did not consider a potential defense (and related defense) available to taxpayers in interpreting the decision, creating potential whipsaws against corporate taxpayers.

Corporate taxpayers that have incurred California AMT and generated the specified tax credits should review the decision and the follow-on Notice to consider its implications, including the ASC 740-10 (former FIN 48) potential financial statement exposure.

***NASSCO* ruling.** On February 25, 2009, the Board issued a non-precedential letter decision in the *Appeal of NASSCO Holdings, Inc.* (Case ID No. 317434). In that decision, the Board concluded that NASSCO could apply its EZ credits and MICs to reduce its California AMT liabilities for the years at issue. Following an appeal by the FTB, the Board then issued a formal precedential opinion in *Appeal of NASSCO Holdings, Inc.*, 2010-SBE-001 (Nov. 17, 2010), affirming its prior decision. The Board's conclusion invalidates the FTB's narrower interpretation as reflected on Form 100 and accompanying instructions (1994–2009), and may provide both significant opportunities and potential exposures for many corporate taxpayers.

FTB Notice and other guidance. On March 18, 2011, the FTB issued guidance (Notice 2011-02) regarding the formal opinion in *Appeal of NASSCO*, in which the Board agreed that a corporate taxpayer properly applied EZ credits and MICs to reduce its AMT liability for the taxable years at issue.

The guidance, which implies that the FTB has conceded the issue in *NASSCO,* provides insight to the scope and collateral consequences of the opinion. In particular, the guidance notes that as a result of the opinion, corporate taxpayers liable for AMT in any taxable year beginning on or after January 1, 1994, that have or had valid EZ credits or MICs may need to revise their tax credit carryover amounts and/or file refund claims with the FTB. However, the guidance does not consider all of the associated issues.

1) Credits must be carried back to first year allowed/allowable

The guidance states that based on *NASSCO,* corporate taxpayers may need to redetermine the correct amount of available EZ credit and MIC carryovers prior to filing returns or assigning credits. Similarly, according to the guidance, corporate taxpayers that are barred from claiming refunds based on the applicable statute of limitations also may need to redetermine the correct amount of available EZ credit and MIC carryovers (but see potential recoupment defense below).

Specifically, the guidance provides that corporate taxpayers that paid AMT in a prior taxable year may be entitled to a refund if they could have applied EZ credits or MICs against such liability and subject to the statute of limitations being open. However, the guidance makes clear that in filing a refund claim for previously paid AMT, a corporate taxpayer will be required to demonstrate that the credits giving rise to the refund claim were not allowed or allowable against AMT in a taxable year prior to the taxable year for which the refund claim is made -- even if the year that the credits first were allowed or allowable is closed under the statute of limitations. Similarly, the guidance provides that corporate taxpayers who claim or claimed EZ credits or MICs against their tax liability on an originally filed return will be required to demonstrate the claimed credits were not allowed or allowable against AMT in a prior taxable year. If a corporate taxpayer was entitled to apply those same credits in a prior taxable year, the taxpayer is not entitled to claim them in the later taxable year since those credits were "allowable" in such earlier year.

2) Limited impact to credit assignments given relatively new law

Similar requirements apply where a corporate taxpayer wants to assign EZ credits or MICs under CRTC Section 23363. That section, added in 2008, allows a taxpayer to assign certain credits to any affiliated corporation that is properly treated as a member of the same combined reporting group, subject to certain limitations relating to when the credit was earned and when the taxpayer became a member of the combined group. The assigned credit can be applied only by the eligible assignee against the tax liability of the assignee in a taxable year beginning on or after January 1, 2010. The election to assign any credit is irrevocable and must be made on the taxpayer's original return for the taxable year in which the assignment is made. Eligible credits include credits earned by the taxpayer in a taxable year beginning on or after July 1, 2008, or a credit earned in any taxable year beginning before July 1, 2008, that is eligible to be carried forward to the taxpayer's first taxable year beginning on or after July 1, 2008.

The guidance specifically provides that the assigning corporation must demonstrate that the EZ credits or MICs to be assigned or that previously were assigned were neither allowed nor allowable against the assigning corporation's AMT in a taxable year prior to the taxable year in which the assignment election is made.

3) Summary of FTB Notice

The guidance suggests that a corporate taxpayer that claimed EZ credits or MICs against tax in an open taxable year that -- based on *NASSCO* -- otherwise could have been claimed against AMT in a closed taxable year, has understated its tax liability in the year the credits originally were claimed. Accordingly, the guidance suggests that the taxpayer would need to self assess and remit taxes originally offset by those credits in a later taxable year. Separately, the guidance does not clarify whether such understatement would be subject to interest and penalties.

4) California forms and instructions

Taxpayers should be reminded of FTB informal guidance regarding the ability to offset AMT with credits, including instructions to California Form 100, Schedule P, for taxable years 1994 through 2009. That guidance generally provided that if the corporation has AMT and remaining solar energy credit carryover and commercial solar energy credit carryover after reducing the regular tax to the minimum franchise tax (if applicable), the corporation may reduce AMT using these credits. In addition, the instructions provided that corporations may carry over any credits remaining after reducing the AMT to zero to future taxable years.

The instructions were modified for the 2010 taxable year to provide that if the corporation has AMT, the corporation may reduce AMT using current EZ credits and/or remaining credit carryover from either the solar energy, commercial solar energy, EZ, Los Angeles Revitalization sales tax credits, or MICs after reducing the regular tax to the minimum franchise tax (if applicable). The modified instructions also provide that corporations may carry over any credits remaining after reducing the AMT to zero to future taxable years.

Distinctions between FTB guidance and *NASSCO*. Notice 2011-02 appears to narrow significantly the conclusion of the Board in *NASSCO,* which simply states that NASSCO was entitled to apply available EZ credits and MICs to reduce its AMT liabilities for the appeal years. The narrow guidance appears to address assertions raised by the FTB in filing a petition for rehearing – that were not responded to by the Board - that the decision would "negatively affect a large number of taxpayers" because "taxpayers may lose potential tax credits for years in which the statute of limitations for a claim for refund has already passed, and that taxpayers assigning EZ credits as eligible credits to affiliated corporations may be exposing themselves to additional liability."

The FTB's assertion, that a large number of taxpayers would be harmed by the ruling, stems from the FTB's reliance on *Hill v. Commissioner*, 95 T.C. 437 (1990), which it cited in support of its claim that taxpayers may need to recompute tax liabilities for closed taxable year(s) based on the failure to claim the appropriate credits in those year(s). The FTB's reliance on *Hill,* however, apparently fails to account for the distinction between *Hill* and its predecessors and progeny and the facts in *NASSCO*.

Just as importantly, it appears that the guidance misrepresents the breadth of credits that may be used to offset an AMT liability. As the Board observed, Cal. Rev. and Tax Code Sec. 23036(d)(1) provides a listing of credits that may be used to offset the AMT. However, the guidance, apparently relying on a reference to statutory amendments, effective in 1994, that expanded the application of EZ credits and MICs, states that *NASSCO* only supports the offset of EZ credits and MICs, and not other credits listed in Section 23036(d)(1).

Potential equitable recoupment defense. The requirement that corporate taxpayers determine whether EZ credits and MICs should have been claimed in closed taxable years and reduce claimed credits in open taxable years and pay the applicable tax in the open taxable years (ignoring potential interest and penalties), without the ability to obtain a refund of previously paid AMT, may give rise to an equitable recoupment defense.

In general, the equitable recoupment doctrine is a judicial standard used as a defense by either a taxpayer or the government that allows redress against a timely assertion that result in a double inclusion or double exclusion of items when the correction of such items would be barred by the statute of limitations. The equitable recoupment doctrine has a sister doctrine, the duty of consistency doctrine, which is based on the theory that the taxpayer owes the IRS, and vice versa, the duty to be consistent in the tax treatment of items and will not be permitted to benefit from its own prior error or omission. Stated another way, the duty of consistency doctrine prevents a taxpayer or a taxing agency from taking one position on one tax return and a contrary position on a subsequent return after the limitations period has run for the earlier year. Based on these doctrines, in this instance, a corporate taxpayer may, for California tax purposes, assert that no reduction in claimed credits is required in the open taxable years.

Effect of *NASSCO* on the AMT credit carryover – AMT credit carryover generally not reduced by available credits.

1) In general

In general, for federal income tax purposes, corporate taxpayers are subject to the greater of the tentative minimum tax (TMT) or the regular tax, and the amount by which the TMT exceeds the regular tax is the AMT. (Sections 53, 55–59) The AMT paid in any year generally is available as a carryover and can be claimed as a tax credit (AMT credit carryover) in a later year in the amount by which the regular tax exceeds the AMT.

Based on the legislative history of the federal corporate AMT, when the amount of AMT paid in a year is reduced by available credits, generally the AMT credit carryover is determined without reduction for an amount equal to the credits claimed (i.e., unreduced AMT credit carryover).

In general, California law conforms to federal AMT provisions, except as otherwise provided. (CRTC Section 23400 et seq.) Accordingly, to the extent a taxpayer's California TMT exceeds its "regular tax," a taxpayer must pay the difference as AMT. In addition, the California AMT rules generally follow the federal AMT rules with respect to the carryover of AMT credits (i.e., AMT credits generally are carried over gross not net, even when offset by available tax credits in any taxable year).

2) Example

Assume XYZ Corporation has $3.5 million and $46.5 million in regular tax liability in Year 1 and Year 2, respectively. In addition, XYZ Corporation has $500,000 and $0 in AMT in Year 1 and Year 2, respectively. Also assume that XYZ Corporation has $7 million in available EZ credits.

In Year 1, XYZ Corporation would owe, before available credits, $4 million in income taxes ($3.5 million in regular tax and $500,000 in AMT), and generate a $500,000 AMT credit available to carry forward to future taxable years. As a result of *NASSCO*, XYZ Corporation would reduce the $4 million in income taxes by $4 million in EZ credits. The net result is that XYZ Corporation would owe $0 in income taxes in Year 1. In Year 2, XYZ Corporation would owe, before available credits, $46.5 million in income taxes ($46.5 million in regular tax and $0 in AMT). XYZ Corporation would reduce the $46.5 million by the remaining $3 million in EZ credits and $500,000 AMT credit. The net result is that XYZ Corporation owes $43 million in taxes in Year 2.

DESCRIPTION	YEAR 1	YEAR 2	TOTAL
REGULAR TAX LIABILITY (BEFORE CREDITS) (DATA)	3,500,000	46,500,000	
TENTATIVE MIMIMUM TAX (BEFORE CREDITS) (DATA)	4,000,000	0	
AMT LIABILITY	500,000		
EZ CREDIT (YEAR 1 ONLY) (DATA)	7,000,000		
TOTAL INCOME TAX LIABILITY (BEFORE CREDITS)	4,000,000	46,500,000	50,500,000
EZ CREDIT (YEAR 1 ONLY) ALLOWED	(4,000,000)		(4,000,000)
EZ CREDIT CARRYOVER UTILIZED		(3,000,000)	(3,000,000)
AMT CREDIT CARRYOVER UTILIZED	0	(500,000)	(500,000)
NET INCOME TAX LIABILITY	**0**	**43,000,000**	**43,000,000**

Note: A corporate taxpayer must be careful when determining the AMT credit carryover as the unreduced AMT credit carryover does not apply in all instances. Consult a federal AMT treatise for further discussion of this matter.

The purpose of the unreduced AMT credit carryover as applied to a reduced amount rests with the difference in the EZ credit and MIC and the AMT credit. The EZ credit and MIC are permanent in nature while an AMT credit is timing in nature. It is generally necessary and appropriate to allow an unreduced AMT credit carryover so that when corporate taxpayers are in a regular tax position the EZ credits and MICs and the AMT credit carryover can permanently reduce the regular tax liability.

ASC 740 (FAS 109)/ASC 740-10 (FIN 48) considerations. Corporate taxpayers with EZ credit and MIC carryovers in their deferred tax asset account will need to evaluate carefully the impact of the Board ruling in *NASSCO* and the recent FTB guidance interpreting *NASSCO*.

PwC observes

"While the *NASSCO* guidance is silent on the application of equitable recoupment and duty of consistency doctrines, and appears not to distinguish the principle in

Hill, taxpayers should carefully evaluate their prior year tax liabilities to determine whether they qualify for tax refunds attributable to credits offsets to AMT payments," says Reed Schreiter, SALT Director with PwC in Sacramento. "In addition, taxpayers should carefully evaluate closed tax years to determine if they have potential exposures based on the FTB's assertion that taxpayers will need to carry back EZ credits and MICs to tax years beginning in 1994, taking into account the aforementioned potential defenses," says Jon Sperring, SALT Partner in Sacramento.

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NEW JERSEY

Program enhancements allow "stay in place" benefits.

BRRAG Program Revisions Increase Benefits, Modify Qualification Criteria

Enacted New Jersey legislation (S-2370, A-3389, enacted 1/7/11) strengthens incentives available under the New Jersey Business Retention and Relocation Assistance Grant ("BRRAG") Program, effective for tax years beginning after December 31, 2010. Program improvements include increases in the maximum credit for jobs relocated or retained in the state and an extension of the period over which credits may be claimed. The legislation also expands the categories of businesses that qualify for BRRAG program benefits.

Employment tax credit changes. Historically, a taxpayer that relocated or retained in New Jersey at least 50 full-time jobs earned a $1,500 per- job credit in the first year the taxpayer qualified for credits. In addition, prior to 2011, the credit for retained jobs only applied to projects that involved a relocation of jobs from one business location to another business location within New Jersey. Under the amended statute, taxpayers may now claim a $1,500 per- job credit for multiple years (see schedule below), depending on the number of jobs relocated or retained in the state, and the credit for jobs retained in the state is available absent an in-state relocation, provided the capital expenditure incurred to improve an existing facility equals at least the total value of the credits granted under the program.

Number of jobs relocated or retained	Years over which $1,500 credit may be claimed
At least 50 to 250	One year
At least 251 to 400	Two years
At least 401 to 600	Three years
At least 601 to 800	Four years
At least 801 to 1,000	Five years
More than 1,000	Six years

In addition, the legislation allows credits to be claimed for qualifying full time employees of professional employer organizations, certain employees who are residents of another state whose wages are not subject to New Jersey gross income tax, and certain partners in a business who perform qualifying activities for a qualifying partnership. The legislation also grants a "bonus" equal to 50 percent of the tax credit grant to any business that makes a capital investment equal to at least twice the total value of credits granted under the program.

More industries qualify for program benefits. The legislation makes significant changes to the list of qualifying industries. Historically, BRRAG benefits were limited to businesses in a variety of "high tech" industries, such as biotechnology, environmental technology and medical technology, as well as those in manufacturing, financial services and transportation industries. As amended, the statute now authorizes program benefits to be granted to any industry identified by the New Jersey Economic Development Authority as "desirable for the state to maintain." The change allows the NJEDA to grade each project individually based on the economic factors of the project and adjust to changing market conditions. Another change allows businesses to include affiliates if the affiliate participates in job retention and capital expenditure. A provision prohibiting the sale or assignment of tax credits between "affiliated" businesses is eliminated.

Proof of "net positive result." One additional change the legislation adopts is a requirement that a taxpayer demonstrate, at the time of application, that the state will receive a net benefit in tax revenues by allowing the taxpayer to claim credits for preserving jobs in the state.

PwC observes

"The BRRAG program improvements provide expanded credits and incentives for taxpayers looking to expand operations or remain in New Jersey," says Gary Marx, State and Local Tax Director in Philadelphia. "The program changes, along with other tax legislation, such as the adoption of a single factor apportionment formula, are further evidence that the state remains focused on job retention, as well as job creation."

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MULTISTATE DEVELOPMENTS

While not fully inclusive of all developments in state tax credits and incentives, the following provides highlights of some notable items.

Arkansas

Central business improvement district rehabilitation and development investment tax credit. Enacted Arkansas legislation (H.B. 1118, Act 1166, enacted 4/4/11) allows authorized taxpayers that incur

rehabilitation and development expenditures in targeted business districts to claim a credit equal to 25 percent of the first $500,000 of qualifying expenditures related to income-producing property; or 25 percent of the first $200,000 of qualifying expenditures related to non-income-producing property. The legislation known as the Arkansas Central Business Improvement District Rehabilitation and Development Investment Tax Credit Act, which is intended to encourage economic development in targeted business districts, authorizes aggregate annual credits of up to $1 million. The credits, which are allocated on a first come, first serve basis, may be used to offset up to 100 percent of the income taxes due for the tax year, and excess credits may be carried over five years. Credits earned by a pass through entity pass through to the entity owners on a pro rata basis, or pursuant to an executed agreement among the entity owners. A taxpayer may opt to transfer, sell or assign the credits, provided certain criteria are met. To qualify for credits, a taxpayer must obtain an eligibility certificate from the governing body of the central business improvement district certifying that the project qualifies for benefits, and the total amount of qualifying expenditures eligible to be used in computing the credit. The legislation sets forth the eligibility criteria and other program parameters.

California

Packaging Company Engaged in R&D Granted $1.3 Million in Credits. Pacific Southwest Container ("PSC") claimed credits for the research and development ("R&D") activities it undertook in daily business operations for the years 1999 through 2001. PSC retained PwC to review and assist in documenting its R&D activities. PwC compiled 17 volumes of contemporaneous documentation to support the claimed credit, including computer-assisted design drawings of products, testing data, communications between company employees discussing testing, documents to show systematic trial and error, and interviews with employees discussing their daily activities, both R&D and non-R&D. The Franchise Tax Board ("FTB") denied 80 percent of PSC's claimed R&D credit at audit. PSC appealed to the California State Board of Equalization ("SBE"). After a lengthy appeal hearing, the SBE voted 5-0 in favor of PSC. The SBE members discussed the extensive documentation provided by PSC and stated that the FTB failed to impeach PSC's documentation or to provide a basis upon which to reject PSC's documentation. The SBE further stated that a contemporaneous summary detailing PSC's testing activities was not required. Finally, the SBE rejected the FTB's apparent "project accounting" approach to the audit.

Kansas

Rural Opportunity Zone Credits Enacted. In an effort to grow shrinking rural communities, enacted Kansas legislation (S.B. 198, enacted 3/31/11) provides, for tax years 2012 through 2016, a personal income tax credit to out-of-state individuals that move into one of 50 designated rural opportunity zone counties. In addition, the legislation allows designated counties to participate in a state-matching program that repays, over a five-year period, up to $15,000 in outstanding student loans incurred in earning an associate, bachelor, or post-graduate degree by an individual that establishes domicile in a designated county on or after the date on which county signs onto the matching program. The legislation, also known as the Rural Opportunity Zone Program, targets many of the counties that experienced the sharpest population declines in recent years as well as counties with small populations that are relatively poor. The following counties are designated ROZs: Barber, Chautauqua, Cheyenne, Clark, Cloud,

Comanche, Decatur, Edwards, Elk, Gove, Graham, Greeley, Greenwood, Hamilton, Harper, Hodgeman, Jewell, Kearney, Kingman, Kiowa, Lane, Lincoln, Logan, Marion, Mitchell, Morton, Ness, Norton, Osborne, Pawnee, Phillips, Pratt, Rawlins, Republic, Rooks, Rush, Russell, Scott, Sheridan, Sherman, Smith, Stafford, Stanton, Trego, Thomas, Wallace, Washington, Wichita, Wilson or Woodson counties.

Maryland

2011 General Assembly Enacts Job/Investment Stimulus Incentives. The General Assembly passed the Invest Maryland Program (H.B. 173), which allows the state to borrow against future tax receipts to fund emerging Maryland technology companies. In addition, it approved proposed legislation (H.B. 587) that allows more companies to qualify for the biotechnology tax credit for the next two years. Keeping in line with business development, the General Assembly voted down proposed legislation (H.B. 620) that would have terminated job creation tax credits, subject to a sunset review process to be performed on a five-year cycle.

New York

Continuing Eligibility for Empire Zone Tax Benefits. The New York State Department of Taxation and Finance issued a series of technical memorandums that provide guidance about actions that may affect the continuing eligibility to receive Empire Zone (EZ) tax benefits for a business enterprise or taxpayer that was certified under Article 18-B of the General Municipal Law before the expiration of the Empire Zones Program. TSB-M-11(2)C, (3)I, (4)S (4/5/11).

Legislation enacted in 2010 contained certain transitional rules regarding the expiration of the Empire Zones Program, which expired at midnight on June 30, 2010. Under the transitional rules, certain businesses retained their eligibility for the EZ benefits after the expiration of the program.

For example, TSB-M-10(6)C, (12)I, (19)S, Legislative Changes to the Empire Zones Program, explains that a taxpayer that is certified as an EZ business under Article 18-B of the general municipal law on the day immediately preceding the day the Empire Zones Program expired will continue to be deemed certified under Article 18-B until April 1, 2014, for purposes of the investment tax credit. In addition, the areas designated as Empire Zones, in which the taxpayer is certified as an EZ business on the day immediately preceding the day the Empire Zones Program expired, will continue to be deemed Empire Zones until April 1, 2014. The TSB also discusses the impact of the legislation on other EZ Program benefits, including the EZ employment incentive credit, EZ capital tax credit, QEZE credit for real property taxes, the EZ wage credit, and QEZE sales and use tax certifications.

Additional guidance is set out in TSB-M-09(5)C,(4)I, Legislative Changes to the Empire Zones Program and TSB-M-09(12)S, Changes to Qualified Empire Zone Enterprise (QEZE) Program (Articles 28 and 29).

Virginia

General Research and Development Credit Enacted. Enacted Virginia legislation (H.B. 1447, enacted 3/28/11) allows refundable income tax credits for individuals and businesses for qualified research and development expenses for taxable years beginning on or after January 1, 2011, and before January 1, 2016. The tax credit equals (i) 15 percent of the first $167,000 in Virginia qualified research and development expenses, or (ii) 20 percent of the first $175,000 of Virginia qualified research and development expenses, if the research was conducted in conjunction with a Virginia public or private college or university, to the extent expenses exceed a base amount. The credit is capped at $5 million in any fiscal year. In general, the credit is computed by reference to I.R.C. Sec. 41, but is limited to expenses attributable to and research conducted in Virginia. In addition, credits granted to a pass through entity will be allocated to the individual owners of the entity in proportion to their ownership interests in such entities or in accordance with a written agreement between the entity owners.

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