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7 **BOARD OF EQUALIZATION**

8 **STATE OF CALIFORNIA**

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10 In the Matter of the Appeal of:) **HEARING SUMMARY²**
11) **CORPORATION FRANCHISE TAX APPEAL**
12 **NASSCO HOLDINGS, INC.¹**) Case No. 317434

<u>Years</u>	<u>Proposed Assessments³</u>
1994	\$160,415
1995	\$ 53,159
1999	\$298,538
2000	\$927,274
2001	\$567,908

18 Representing the Parties:

19 For Appellant: Gail H. Morse, Jenner & Block, LLP
20 Jon A. Sperring, PricewaterhouseCoopers, LLP

21 For Franchise Tax Board: Renel A. Sapiandante, Tax Counsel III

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23 **QUESTION:** Whether appellant is entitled to apply its enterprise zone tax credits and other credits to
24 reduce alternative minimum tax liability, which would result in no tax owed.

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26 ¹ Appellant is headquartered in San Diego, San Diego County.

27 ² This appeal was originally scheduled to be heard at the August 16, 2006 Board hearing, but was deferred per the request of
28 the parties to the December 12, 2006 Board hearing. The appeal was then deferred for settlement discussions before being placed back on the hearing calendar for the first available Culver City Board hearing in 2009, at appellant's request.

³ FTB will provide interest calculations at the hearing.

1 HEARING SUMMARY

2 Background

3 The facts of this case are undisputed. Appellant, a shipbuilding company, has an
4 industrial manufacturing facility located in San Diego, California. The parties agree that appellant is
5 eligible to use enterprise zone (EZ) credits because it conducts almost 100 percent of its business within
6 the zone. Although neither party specifically discusses the Manufacturer's Investment Credit (MIC), it
7 appears that the parties agree that appellant is eligible to receive it as well. For each year at issue,
8 appellant incurred an alternative minimum tax (AMT) liability, which it attempted to offset with tax
9 credits, completely eliminating the AMT each year.

10 For 1994 and 1995, appellant applied EZ credits against its AMT liabilities, reducing
11 them to zero. For those years, appellant had AMT liabilities of \$163,216 and \$54,874, respectively.
12 (App. Appeal Letter, exhibit B.) For 1999, appellant offset its AMT liability in the amount of \$298,538
13 with EZ credits, and for 2000 and 2001, appellant offset its AMT liabilities in the amounts of \$927,285
14 and \$567,964, respectively, with its MIC in the same amounts. (*Id.*)

15 Subsequently, respondent (FTB) audited appellant's returns and denied its use of tax
16 credits to offset the AMT. (App. Appeal Letter, exhibit B.) Respondent issued proposed assessments
17 for each tax year and appellant timely protested. Respondent affirmed the disallowance of appellant's
18 attempted use of the MIC and EZ tax credits to offset the AMT. (App. Appeal Letter, exhibit A.)
19 Appellant filed this appeal.

20 Contentions

21 Appellant

22 Appellant contends that, in 1993, Revenue and Taxation Code (R&TC)⁴ section 23036
23 was amended to permit the use of credits to directly offset AMT in addition to the limited credits
24 specified by the former code section. (App. Supp. Br., p. 2.) Appellant argues that the term "tax" in
25 section 23036 is defined one way in subsection (a), another way in subsection (b), and not specifically
26 defined in subsection (d), which provides that specified credits (such as enterprise zone hiring credits)
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28 ⁴ Unless otherwise specified, all section references are to the Revenue and Taxation Code.

1 may reduce the “tax” below the tentative minimum tax (as defined by section 23455, subdivision (a)(1)).
2 (*Id.*, at pp. 3-4.) Appellant contends that when the language of section 23036 is read as a comprehensive
3 whole, it is clear that the Legislature intended the EZ tax credits (as well as the other credits listed in
4 section 23036, subdivision (d)) to be an exception to the general rule that credits cannot reduce the
5 AMT. (*Id.*, at p. 4.)

6 Thus, appellant contends that section 23036, subdivision (a), defines “tax” as “including”
7 (but not limited to) the tax imposed by, e.g., Chapter 2 (the corporation franchise tax measured by net
8 income or the minimum franchise tax); whereas subdivision (b) defines “tax” to include the alternative
9 minimum tax for the various administrative purposes of withholding, deficiency assessments, filing
10 returns, and payments. (App. Supp. Br., p. 15.) In contrast, appellant contends that section 23036,
11 subdivision (d), does not define the term “tax” in providing that “[n]o credit may reduce the “tax” below
12 the tentative minimum tax” Thus, upon viewing the statute as a whole, appellant argues that the
13 plain language of the statute does not support that the meaning of the term “tax” necessarily means
14 “regular tax,” as respondent contends. (*Id.*, at p. 16.) In addition, appellant argues that if the Legislature
15 had intended to limit the meaning of “tax” to “regular tax” it could have simply cross referenced the
16 definition of “regular tax” in section 23455, as it cross referenced the meaning of “tentative minimum
17 tax” (TMT) in the same subdivision. (*Id.*)

18 Appellant argues that the meaning of the term “tax” in section 23036, subdivision (d), is
19 therefore ambiguous, and it is appropriate to look at the legislative intent in enacting the 1993
20 amendment. (App. Supp. Br., p. 3.) Appellant provides correspondence from legislators, tax
21 consultants, and agencies summarizing and commenting on AB 57 as permitting businesses to reduce
22 their tax liability below the AMT. (App. Appeal Letter, exhibit C; App. Supp. Br., exhibits 1-8.)
23 Appellant also provides various legislative documents addressing AB 57, among them the Senate Rules
24 Committee Bill Analysis of AB 57 (amended September 8, 1993), which provides:

25 “This bill would permit the jobs credit and sales tax credit available to businesses located
26 in enterprise zones, program areas and the Los Angeles Revitalization Zone to be used in
27 computing AMT. (Technically, these credits would be permitted to reduce the regular
28 tax below the tentative minimum tax.) The bill is intended to make the full benefits

1 promised under the enterprise zone, program area and Los Angeles Revitalization Zone
2 concepts available whether the taxpayer is subject to regular tax or alternative minimum
3 tax. The argument is that if a benefit is offered to a business as an inducement to locate
4 in a zone, the operation of our “tax break limit,” the AMT, should not thwart that
5 objective.” (Emphasis added.)

6 (App. Supp. Br., exhibit 10.)

7 The Trade and Commerce Agency (TCA) enrolled bill report likewise summarizes AB 57
8 as follows:

9 “This bill permits businesses operating in enterprise zones and the Los Angeles
10 Revitalization Zone to reduce their tax liability below their alternative minimum tax by
applying tax credits authorized to businesses operating in the zones.”

11 TCA recommended that the Governor sign AB 57. (App. Supp. Br., exhibit 13.)

12 Appellant also provides a letter from Speaker of the Assembly Willie Lewis Brown, Jr.,
13 to the Governor asking that the Governor approve his bill (AB 57). (App. Supp. Br., exhibit 13.) Mr.
14 Brown notes that AB 57 “corrects an inequity in the application of tax credits to businesses operating in
15 enterprise zones.” Mr. Brown further states therein that:

16 “Currently California conforms its bank and corporation tax to the federal policy that
17 businesses should not be able to use tax credits and exemptions to reduce their tax
18 liability below the alternative minimum tax (AMT) level. However, for businesses that
19 choose to locate in enterprise zones and program areas, to the extent that they are subject
20 to the AMT they are prohibited from taking advantage of the very tax incentives that
21 brought them to the enterprise zone in the first place. AB 57 corrects this inequity and
permits business to take full advantage of their jobs credits and sales tax credits within
the enterprise zones, program areas, and the LA Revitalization Zone. It is an important
part of California’s effort to improve our business climate, particularly in some of our
most disadvantaged communities.”

22 Appellant also provides the Legislative Counsel’s Digest for AB 57, which also
23 concludes that AB 57 would allow the specified MIC and EZ tax credits to reduce the AMT. (App.
24 Supp. Br., exhibit 13.)

25 Finally, appellant contends that respondent permits solar energy credits to reduce AMT
26 without any distinguishing language in the statute indicating that solar energy credits should be treated
27 differently than the MIC or EZ credits. (See App. Appeal Letter, pp. 6-7 & exhibit C, “Corporate Tax
28 Examination,” dated January 8, 2004, p. 2, para. 5.) If the language in section 23036, subdivision (d)(1),

1 is sufficient to provide that solar energy credits may reduce AMT, then appellant contends that the
2 language should also be sufficient to permit all the credits listed in that section (including the specified
3 MIC and EZ credits) to reduce AMT. (App. Appeal Letter, pp. 6-7; App. Supp. Br., p. 6.) Appellant
4 argues that its broader definition of “tax” is the only way to harmonize the provisions of section 23036.

5 Respondent

6 Respondent argues that appellant has incorrectly calculated its AMT liability by using
7 MIC and EZ credits to directly offset AMT, rather than using them to reduce regular tax below tentative
8 minimum tax (TMT), as allowed by section 23036. (Resp. Reply Br., p. 2.) Respondent contends that
9 the definition of “tax” in section 23036, subdivision (a), is the appropriate definition of “tax” as used in
10 subdivision (d)(1), and that the AMT is included in the definition of “tax” only for the purposes stated in
11 section 23036, subdivision (b). Respondent argues that no ambiguity exists in section 23036. (Resp.
12 Reply Br., p. 3.) Alternatively, respondent argues that the analysis contained in the Legislative Council
13 Digest is flawed in its interpretation of the 1993 amendment. Respondent contends that neither the
14 statutory language enacted, nor the official bill analysis is consistent with the digest. Further,
15 respondent argues that allowing taxpayers to avoid all tax liability is unfair. In support of this statement,
16 respondent points to the policy behind the AMT. (Resp. Reply Br., pp. 3-4.) Finally, respondent
17 contends that tax credits are a matter of legislative grace and the burden falls on the taxpayer to show the
18 statutory conditions are met; respondent argues that the credits listed in section 23036, subdivision
19 (d)(1), are not allowed to offset AMT because the credits may only be used to offset “tax” pursuant to
20 the definition provided in subdivision (a). (Resp. Reply Br., p. 2.)

21 Applicable Law

22 The corporate AMT was created by Congress in the Tax Reform Act of 1986, and is
23 codified in sections 55 through 59 of the Internal Revenue Code (IRC). The corporate AMT is intended
24 to ensure that corporate taxpayers who are eligible for many income tax exclusions, adjustments, credits,
25 and deductions pay at least a minimum amount of tax each year. The AMT has its own set of rules for
26 calculating income and deductions and its own tax rates, which are different in certain respects from the
27 rules and rates that make up the regular tax system. In order to determine whether a taxpayer owes
28 AMT, the taxpayer must compute both its tentative minimum tax and its regular tax for the taxable year,

1 and must pay the greater of the two. (*Sequa Corp v. United States* (2004) 350 F.Supp.2d 447, 448.)
2 IRC section 55(a) defines the AMT as “a tax equal to the excess (if any) of . . . the tentative minimum
3 tax for the taxable year, over . . . the regular tax for the taxable year.” Thus, if the tentative minimum
4 tax exceeds the regular tax, the difference is the AMT.

5 California law generally conforms to the federal AMT statutory provisions. R&TC
6 section 23455 provides for an AMT that parallels (with some modifications) the federal AMT provided
7 by IRC section 55. R&TC section 23455, subdivision (a)(1), establishes the AMT. If a taxpayer’s
8 regular corporate franchise tax computed in accordance with R&TC section 23101 is less than the
9 tentative minimum tax, the taxpayer is required to pay the difference as the AMT. “The net minimum
10 tax, or amount of minimum tax due, is the amount by which the tax computed under this system (the
11 tentative minimum tax) exceeds the taxpayer’s regular tax. Although the minimum tax is, in effect, a
12 true alternative tax, . . . technically the taxpayer’s regular tax continues to be imposed, and net minimum
13 tax [AMT] is added on.” (752 – 1st Tax Management Working Papers – 1, p. 437.)

14 Section 23036, subdivision (a), defines “tax.” It provides that,

- 15 (1) The term "tax" includes any of the following:
16 (A) The tax imposed under Chapter 2 (commencing with Section 23101).
17 (B) The tax imposed under Chapter 3 (commencing with Section 23501).
18 (C) The tax on unrelated business taxable income, imposed under Section 23731.
19 (D) The tax on S corporations imposed under Section 23802.
20 (2) The term "tax" does not include any amount imposed under paragraph (1) of
21 subdivision (e) of Section 24667 or paragraph (2) of subdivision (f) of Section 24667.

22 Subdivision (b) also defines “tax” for purposes of Part 10.2. Part 10.2 of the R&TC, sets forth
23 administrative law relating to assessments, appeals, penalties, and collections. For the purposes of Part
24 10.2, subdivision (b) provides that “tax” also includes, in pertinent part, “[t]he alternative minimum tax
25 imposed under Chapter 2.5 (commencing with Section 23400).” (Rev & Tax Code § 23036, subd.
26 (b)(2).)

27 Consistent with the purpose of ensuring that every corporation pays at least some
28 minimum level of tax, R&TC section 23036, subdivision (d), generally limits the extent to which tax
credits may be applied so that the corporate franchise tax is not reduced below the tentative minimum
tax. However, subdivision (d)(1) expressly provides for certain exceptions to that limitation. In this
appeal, the relevant provisions listed in subdivision (d)(1) include section 23612.2 (relating to EZ sales

1 or use tax credit), section 23622 (relating to EZ hiring credit), section 23622.7 (relating to EZ hiring
2 credit), and section 23649 (relating to qualified property). (Rev. & Tax Code § 23036, subs. (d)(1)(H),
3 (J), (K), & (Q).) Section 23036, subdivision (d)(1), also includes credits allowed by former sections
4 23601, 23601.4, and 23601.5 (relating to solar energy). (Rev. & Tax Code § 23036, subs. (d)(1)(A)-
5 (C).) Former section 23036 allowed the application of solar credits, but did not include MIC or EZ
6 credits. (Stats. 1992, ch. 698 § 16.) In 1993, additional credits were added to subdivision (d)(1)
7 including the MIC and EZ credits. (Rev. & Tax Code § 23036, subs. (d)(1), as amended by Stats.
8 1993, ch. 879 § 3.)

9 The plain meaning of statutory language ordinarily is conclusive. (*Appeal of Michael*
10 *and Sonia Kishner*, 99-SBE-007, Sept. 29, 1999 (citing *United States v. Ron Pair Enters, Inc.* (1989)
11 489 U.S. 235, 241-242.)) The objective of statutory interpretation is to ascertain and effectuate
12 legislative intent by giving meaning to every word and phrase in the statute to accomplish a result
13 consistent with the legislative purpose. (*Plaza Hollister Ltd. Partnership v. County of San Benito* (1999)
14 72 Cal.App.4th 1, 35.) The words of the statute must be construed in context, keeping in mind the
15 statutory purpose, and statutes or statutory sections relating to the same subject must be harmonized,
16 both internally and with each other, to the extent possible. (*Dyna-Med, Inc. v. Fair Employment &*
17 *Housing Com.* (1987) 43 Cal.3d 1379, 1387.) Where the plain meaning of the words of the statute is not
18 dispositive, the statute's legislative history and the wider historical circumstances of enactment may be
19 considered in ascertaining legislative intent. (*Ibid.*) Where uncertainty exists, consideration should be
20 given to the consequences that will flow from a particular interpretation. (*Ibid.*)

21 STAFF COMMENTS

22 The parties should be prepared to discuss the language of section 23036, subdivision
23 (a)(1) and whether any ambiguity exists in the definition of "tax" in light of that sections' language that
24 the term "tax" "includes any of the following" and then sets forth four types of tax. The parties should
25 also be prepared to discuss whether there is any ambiguity in the definition of "tax" throughout section
26 23036 (and particularly with respect to subdivision (d), providing for certain credits to reduce the "tax"
27 below the tentative minimum tax) because subdivision (b) defines "tax" differently for purposes of
28 assessments, appeals, penalties, and collections, and subdivision (d) does not contain a definition of tax.

1 To the extent that the Board determines that the meaning of the term “tax” in subdivision
2 (d) is therefore ambiguous, it is appropriate to look to the legislative history of the statute to determine
3 the legislative intent behind the language. The Senate Rules Committee Bill Analysis for AB 57 and
4 other legislative materials and correspondence provided by appellant appear to support that the author of
5 the bill, and the legislature in enacting the bill, intended businesses in enterprise zones to be able to use
6 their EZ and MIC tax credits to reduce AMT liabilities.

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