SECTION 18000 LOS ANGELES REVITALIZATION ZONE SALES OR USE TAX CREDIT

References (Repealed Sections) 17052.15(a); 17052.15(d); 23612.6(a); 23612.6(d)

For each income or taxable year beginning on or after January 1, 1992 and before January 1, 1998, a taxpayer engaged in a trade or business within the Los Angeles Revitalization Zone (LARZ) can take a credit for sales or use tax paid or incurred in connection with the purchase of qualified property.

The LARZ was established to aid economic development in areas that suffered damage during the civil unrest that occurred in the County of Los Angeles during April and May 1992. The LARZ became operative on May 1, 1992, and applied to businesses with taxable or income years beginning on or after January 1, 1992. The LARZ expired on December 1, 1998.

- No new LARZ credits may be generated in taxable or income years beginning on or after January 1, 1998. However, LARZ credit carryovers may still be claimed for 15 years from the year the credit was generated.

- Taxpayers that receive a LARZ *Sales or Use Tax Credit* in their taxable or income year beginning on or after January 1, 1998, from a 1997 fiscal year pass-through entity *may not* claim this credit in their taxable or income year beginning on or after January 1, 1998. This credit can only be claimed for taxable or income years beginning *before* January 1, 1998.

18100 Geographic Boundaries

For a listing of LARZ cities, see "LARZ *Locations and Designation Dates*" EDAM 1350. To verify an address, refer to EDAM 1300.

NOTE: Effective 1/1/96, the LARZ geographic area was re-determined (downsized) to eliminate previously qualified addresses. For taxpayers that operate in the portion of the LARZ that was excluded when the LARZ was downsized, LARZ benefits that were incurred when the LARZ designation was effective are allowed after downsizing (carryover amounts). In regards to the applicability of LARZ benefits incurred after the downsize of the LARZ, the sales or use tax credit is no longer available, as of the first day of the income or taxable year beginning on or after January 1, 1996, the determination date.

18200 Exclusive Credit

References (Repealed Sections) 17052.15(c); 23612.6(c)

If the LARZ sales or use tax credit is claimed for the purchase of qualified property during the income or taxable year, no other credit is allowed with respect to that property.

18300 Qualified Taxpayer

References (Repealed Sections) 17052.15(b)(1); 23612.6(b)(1)

EDAM 18310 Pass-Through Entities

A "taxpayer" is a person or entity engaged in a trade or business within the LARZ.

18310 Pass-Through Entities

The determination of whether a taxpayer is a qualified taxpayer is made at the entity level. The term "pass-through entity" means any partnership or S corporation. The sales or use tax credit is allowed to the pass-through entity and passed through to the partners or shareholders.

18400 Qualified Property

References (Repealed Sections) 17052.15(b)(2); 23612.6(b)(2)

Qualified property is property purchased on or after May 1, 1992, and before the zone expiration date. Qualified property is the purchase of either, or both, of the following:

- Building materials to replace or repair the taxpayer's building and fixtures;
- Machinery or equipment, excluding inventory, to be used by the taxpayer exclusively in the LARZ.

18410 Capitalized Requirement

References (Repealed Sections) 17052.15(b)(2); 23612.6(b)(2)

Qualified property must be purchased and placed in service before the LARZ expires, is no longer binding or becomes inoperative. Qualified property cost(s) are costs chargeable to a capital account (subject to depreciation) of the qualified taxpayer. If costs are expensed, rather than capitalized, no credit is allowed.

18420 Leased Property

Taxpayers who acquire property by lease arrangement may qualify for the sales or use tax credit. Lease arrangements structured using a financial (conditional sales) contract generally will qualify the taxpayer to take the sales or use tax credit. For reference sources to determine if a lease qualifies as a purchase rather than a lease arrangement, refer to IRS Revenue Ruling 55-540, 1955-2 C.B. 39, and FTB Legal Ruling 94-2, March 23, 1994.

18500 Credit Computation

References (Repealed Sections) 17052.15(a); 23612.6(a)

EDAM 18510	Depreciation
EDAM 18520	Business Income Activity Limitation
EDAM 18530	General Provisions – Income Apportionment
EDAM 18531	Property Factor – Income Apportionment
EDAM 18532	Payroll Factor – Income Apportionment
EDAM 18533	Apportionment – Combined Groups
EDAM 18534	Apportioning for Personal Income Tax Taxpayers
EDAM 18540	S Corporation & Shareholder Credit Amounts

The sales or use tax credit is equal to the amount of sales or use tax “paid or incurred” by the taxpayer in connection with the purchase and use of qualified property. Qualified property costs are not limited for LARZ entities.

Example: Taxpayer spent $53,750 to purchase machinery used in the taxpayer's business within the LARZ. The sales tax paid on the purchase is $3,750. The sales tax credit is $3,750.

NOTE: Upon acquisition, if the taxpayer/purchaser was exempt from paying sales tax on the property under the California Revenue & Taxation Code (CR&TC), then the taxpayer/purchaser did not pay or incur sales tax in connection with the purchase of the property to the extent of the exemption. Thus, the taxpayer/purchaser is not allowed to take the sales or use tax credit on the amount of the exemption.

18510 Depreciation

References 18036; 24916;(Repealed Sections) 17052.15(e); 23612.6(e)

Taxpayers electing to utilize the sales or use tax credit are not entitled to increase the basis of the property for which sales or use tax was paid or incurred in connection with the purchase of the property.

Example: Taxpayer spent $53,750 to purchase machinery used in the taxpayer's business within the LARZ. The sales tax included in the purchase price was $3,750. The depreciable basis of the property is $50,000 ($53,750 less $3,750 sales tax).

Depreciation of the capitalized cost of the asset may be claimed using any method of depreciation allowable beginning in the year the asset is placed in service.

NOTE: If the business expense deduction is taken for the same property, relevant depreciation will start with the income or taxable year following the year in which the property is placed in service. The depreciation is calculated on the remaining basis *after* reduction for the sales or use tax credit and business expense deduction amounts.

18520 Business Income Activity Limitation

References (Repealed Sections) 17052.15(f)(1)-(2); 23612.6(f)(1)-(2)

The amount of sales or use tax credit or hiring credit (see EDAM 17000) claimed, including any credit carryover from prior years, may not exceed the amount of tax on the LARZ business income in any year. Depending on the tax year involved, the LARZ business income is that portion of the taxpayer's *California source* business income or the worldwide income that is apportioned to the LARZ. Non-business income or loss is not included in the calculation of business income from the LARZ.

Example: Corp. A operates exclusively within the LARZ. In order to determine the amount of sales or use tax credit allowable, the business income and the tax on that business income must be determined. Corp. A has the following items of income and expense:

Income from business operations	$30,000
Interest from investment which is unrelated to Corp. A's business operations	$2,000
Business expenses	(17,000)
Net Taxable Income	$15,000

Corp. A's income attributed to business operations is:

Income from business operations	$30,000
Business expenses	(17,000)
Net Business Income	$13,000

To determine the sales or use tax credit allowable, the net business income is multiplied by the applicable tax rate.

Net Business Income	$13,000
x 8.84%	x 0.0884
Tax associated with business income	$1,149

In this example, the taxpayer can offset the tax of $1,149 with the sales or use tax credit available (up to $1,149).

NOTE: "net tax"/"tax" and alternative minimum tax impose limitations on the allowable offset but were not considered a factor in this example.

18530 General Provisions – Income Apportionment

References (Repealed Sections) 17052.15(f)(1)-(2); 23612.6(f)(1)-(2)

If a business is located within and outside of the LARZ, the taxpayer must determine the portion of the total business income that is attributable to the LARZ.

- Business income is defined under the provisions of the Uniform Division of Income for Tax Purposes Act (UDITPA).
- Components of the factors are defined under the provisions of UDITPA.

For income or taxable years beginning on or after January 1, 1992, and before January 1, 1994, business income is apportioned to the LARZ by multiplying the *worldwide* business income by a fraction, the numerator of which is the property factor plus the payroll factor, and the denominator of which is two (2).

For income or taxable years beginning on or after January 1, 1994, business income shall be apportioned to the LARZ by multiplying the taxpayer's *California* source business income by a fraction, the numerator of which is the property factor plus the payroll factor, and the denominator of which is two (2).

18531 Property Factor – Income Apportionment

The property factor is a fraction. The numerator of the property factor is the average value of the real and tangible personal property owned or rented and used or available for use by the taxpayer *within the LARZ* during the income or taxable year.

- For income or taxable years beginning on or after January 1, 1992, and before January 1, 1994, the denominator is the average value of all real and tangible personal property owned or rented and used or available for use during the income or taxable year *worldwide.*
- For income or taxable years beginning on or after January 1, 1994, the denominator is the average value of all real and tangible personal property owned or rented and used or available for use by the taxpayer during the income or taxable year *within California*.

Rented property is valued at 8 times the net annual rental rate. The net annual rental rate is the total rent paid for the property, less any subrental rates paid by subtenants.

18532 Payroll Factor – Income Apportionment

The payroll factor is a fraction. The numerator of the payroll factor is the total compensation paid to employees working for the taxpayer *within the LARZ* during the income or taxable year.

- For income or taxable years beginning on or after January 1, 1992, and before January 1, 1994, the denominator is the total compensation paid to employees working *worldwide* during the income or taxable year.
- For income or taxable years beginning on or after January 1, 1994, the denominator is the total compensation paid to employees working for the taxpayer *in California* during the income or taxable year.

Example: For the income year ending 12/31/96, Corp A operates within and outside the LARZ. California business income of $13,000 needs to be apportioned to the LARZ. The following amounts apply to Corp. A's property and payroll:

LARZ Property	$40,000
CA Property	$100,000
LARZ Payroll	$5,000
CA Payroll	$10,000

LARZ Property/CA Property	=.40	
LARZ Payroll/CA Payroll	=.50	
	.90/2 = .45	LARZ Apportionment Factor

Business income	$13,000
Apportionment Factor	x 0.45
LARZ Business Income	$5,850
Applicable Tax Rate	x .0884
Tax attributable to LARZ business income	$517

NOTE: Had the above example been for an income or taxable year beginning on or after January 1, 1992, and before January 1, 1994, the denominator of the property and payroll factors would have been from worldwide sources rather than CA sources. See EDAM 23440.

18533 Apportionment – Combined Groups

For income or taxable years beginning on or after January 1, 1992, and before January 1, 1994: For members of a combined group, the credit limitation will be based on combined groups worldwide business income (before CA apportionment). The numerator of the apportionment formula will be based on each LARZ taxpayer's separate LARZ payroll and property amounts, and the denominator will be based on the combined groups worldwide payroll and property amounts.

For an example of apportionment under this method refer to EDAM 23440.

For income or taxable years beginning on or after 1/1/1994: For members of a combined group, the limitation will be based on the intrastate apportioned business income for each taxpayer doing business within the LARZ. The numerator of the apportionment formula will be based on each LARZ taxpayer's separate LARZ property and payroll amounts and the denominator will be based on each LARZ taxpayer's separate California property and payroll amounts.

Example: For the income year ending 12/31/96, parent corporation A has two subsidiaries, B and C. Corporations A and B operate within the LARZ. The combined group operates within and outside California and apportions its income to California using Schedule R. The combined group's business income apportioned to California was $1,000,000. Corporation A and B's share of California business income is $228,000 and $250,000 respectively. Corporation A and B's separate LARZ and separate California property and payroll factor amounts are shown below.

Business income apportioned to the LARZ was determined as follows:

	A	**B**
Property Factor		
LARZ Property	$1,000,000	$ 800,000
California Property	$1,000,000	$1,200,000
Apportionment %	100%	66.66%
Payroll Factor		
LARZ Payroll	$800,000	$ 800,000
California Payroll	$800,000	$1,000,000
Apportionment %	100%	80%
Average Apport. % (Property + Payroll Factors)/2	100%	73.33%

Apportioned		
Business Income	$228,000	$250,000
LARZ Income	$228,000	$183,333

18534 Apportioning for Personal Income Tax Taxpayers

The following examples show the application of the apportioning rules to personal income tax taxpayers.

Example: Ray Smith is vice president of an S corporation that has two locations, one within the LARZ and one outside the LARZ. Eighty percent (80%) of the S corporation's business is attributable to the LARZ. (**NOTE**: This percentage was determined by the S corporation, using Worksheet V from the FTB 3806 Business Booklet, at the time the S corporation return was prepared). Ray divides his time equally (50% & 50%) between the two offices of the S corporation.

Mary Smith (Ray's spouse) works for the S corporation at its office located within the LARZ.

Ray and Mary Smith have the following items of California income and expense:

Ray's salary from the S corp.	$100,000
Mary's salary from the S corp.	75,000
Interest on savings account	1,000
Dividends	3,000
Schedule K-1(100S) from the S corp.	
Ordinary income	40,000
LARZ business expense deduction	(5,000)*
Ray's unreimbursed employee expenses from Schedule A	(2,000)

*The LARZ business expense deduction is a separately stated item on Schedule K-1 (100S).

The Smith's LARZ income is computed as follows:

Ray's LARZ salary ($100,000 x 50%)	$50,000
Mary's LARZ salary ($75,000 x 100%)	75,000
Pass-through ordinary income from the S-Corp. ($40,000 x 80%)	32,000
LARZ business expense deduction from the S-Corp.	(5,000)
Ray's unreimbursed employee business expenses (2,000 x 50%)	(1,000)
Total LARZ income	**$151,000**

Ray and Mary must compute the tax on the total LARZ income of $151,000 (as if it represents all of their income). Using the tax rate schedule for the filing status *married filing joint*; the tax on $151,000 is $10,659. The $10,659 is the first limitation on LARZ credits for the tax year. The second limitation on the credits is the *net tax* on all income.

NOTE: The standard deduction and personal or dependency exemptions are not included in the computation of LARZ income since they are not related to trade or business activities.

18540 S Corporation & Shareholder Credit Amounts

References 23803(a)

S corporations operating within the LARZ may claim a credit on the sales or use tax paid or incurred to purchase qualified property during each income or taxable year. An S corporation's sales or use tax credit may reduce the LARZ tax at both the corporate and shareholder levels. However, the S corporation may only use one-third (1/3) of the credit to reduce the tax on the S corporation's LARZ income.

One hundred percent (100%) of the LARZ credits are passed through to the S corporation shareholders. The shareholders claim their pro-rata share of the credit calculated under the California personal income tax law. The Schedules K (100S) and Schedule K-1 (100S) must state the credit amounts allocable to the shareholders.

Example: Corp. Z, an S corporation, purchases $2 million of qualified property, and elects to take the LARZ sales or use tax credit. Corp. Z is allowed to claim a sales or use tax credit of $50,000 ($2,000,000 x 7.5% x 1/3 = $50,000). [Cost x sales tax rate x 1/3 S corporation credit limitation]

The corporation's two shareholders are each allocated a sales or use tax credit of $75,000 based on their pro rata share. (($2,000,000 x 7.5%) / 2 = $75,000). [(Cost x sales tax rate)* pro rata share (percentage)]

18600 Sales or Use Tax Credit and the Hiring Credit

References (Repealed Sections) 17052.15(f)(1); 23612.6(f)(1)

The amount of credit(s) allowed, in any income or taxable year, when a taxpayer is eligible to take both the sales or use tax credit and the hiring credit, is limited to the amount of tax imposed on the LARZ business income. Thus, the taxpayer must aggregate the credits and limit the total amount of credits to tax imposed on the LARZ business income.

18700 Credit Usage and Carryover

References (Repealed Sections) 17052.15(d); 17052.15(f); 23612.6(d); 23612.6(f)

EDAM 18710 Credit Will Not Reduce Certain Taxes

The portion of the credit that exceeds the "net tax"/"tax" for the income or taxable year, may be carried over and added to the credit, if any, in the following year. The credit may be carried over to the succeeding 15 income or taxable years, or until it is exhausted, whichever occurs first.

The aggregate amount of LARZ credits, including any credit carryover from prior years, that may reduce the "net tax"/"tax" for the income or taxable year, shall not exceed the amount of tax imposed on the taxpayer's business income attributable to the LARZ, determined as if that income represented all of the income of the taxpayer.

Example: A taxpayer has $4,900 in LARZ credits (sales or use tax credit *and* hiring credit). Tax imposed on LARZ business income is $4,700 and the taxpayer's overall "net tax"/"tax" is $4,000. The maximum amount of credit is limited to the lesser of the tax on the LARZ business income, or the tax on the taxpayer's overall "net tax"/"tax".

Total LARZ credit	$4,900
Tax on LARZ income	$4,700
First limitation:	
Lesser of total credit or tax on LARZ income	$4,700
Second limitation:	
Lesser of tax on LARZ income or "*net tax*"/"*tax*"	$4,000
Maximum credit allowed:	
Lesser of *LARZ tax limitation* or "*net tax*"/"*tax*" *limitation*	$4,000
Total LARZ credit	$4,900
Maximum credit allowed	$4,000
Carryover	$ 900

The LARZ expired on December 1, 1998. If the taxpayer has any unused credits as of this date, the unused credits may continue to be carried forward until they are exhausted, or for 15 years from the year the credit was generated, whichever occurs first. The LARZ will be deemed to remain in existence for purpose of computing the business income limitation.

18710 Credit Will Not Reduce Certain Taxes

The LARZ sales or use tax credit cannot reduce the:

- Minimum franchise tax (corporations, limited partnerships, limited liability partnerships, LLCs, and S corporations);
- Built-in gains tax (S corporations);
- Excess net passive income tax (S corporation);
- Alternative minimum tax (corporations, exempt organizations, individuals and fiduciaries); or
- Regular tax below tentative minimum tax for income or taxable years beginning prior to January 1, 1993.

The LARZ sales or use tax credit may however reduce regular tax below tentative minimum tax for income and taxable years beginning on or after January 1, 1993.

18800 *Credit Recapture*

References (Repealed Sections) 17052.15(g); 23612.6(g): See also Cal. Code Regs. (CCR) § 17267.2-1(a); 24356.7-1

Recapture of the LARZ sales or use tax credit is required if the qualified property is disposed of or no longer used by the taxpayer in the LARZ at any time before the close of the second income or taxable year after the property is placed in service. The amount of the credit previously claimed for that property is added to the taxpayer's tax liability in the income or taxable year of that disposition or nonuse.

Example: Corp. A purchases property on June 1, 1995, that qualifies Corp A to take the LARZ sales or use tax credit. Corp A's taxable year ends December 31 of each year. Corp A disposes of the property August 5, 1997. The credit is recaptured in the 1997 taxable year as the property was disposed of before the close of the second taxable or income year [12/31/1997] after the property was placed in service. Corp A will increase its basis in the asset by the recaptured amount effective January 1, 1997.

NOTE: The State Board of Equalization in an unpublished and uncitable decision agreed that the statute requires the closure of two taxable years after the end of the taxable year in which the property is placed in service and the election to claim the deduction on the original return is made. *Appeal of Accurate Metal Fabricators, Inc., 32552, Cal. St. Bd. Of Equal., July 3, 2000.*

18900 Record Keeping Requirements

To support the sales or use tax credit claimed, the taxpayer must keep all records that document the purchase of the qualified property. This includes items such as purchase receipts and proof of payment. In addition, taxpayers should keep all records that identify or describe:

- The property purchased (such as serial numbers, etc.);
- The amount of sales or use tax paid or incurred upon purchase; and
- The location where the machinery is used.