SECTION 23000 PROGRAM AREAS SALES OR USE TAX CREDIT

References (Repealed Sections) 17052.13(a), (b); 23612(a), (b)

Program Areas converted to Enterprise Zones as of January 1, 1997. Prior to this date, taxpayers had to be certified by the California Trade and Commerce Agency or TCA in order to be eligible to utilize the Program Area tax incentives. TCA could certify a taxpayer to take the hiring credit only or all five Program Area incentives. The type of certification is determined from the certification letter.

Certification was generally valid for three years. After three years, the taxpayer would have to be re-certified. De-certification could occur if a company failed to meet the requirements.

A taxpayer certified by TCA to claim all five Program Area tax incentives, and operating in a Program Area, can take a credit for the sales or use tax paid or incurred in connection with the purchase of qualified property.

- In any year, individuals may claim a credit equal to the sales or use tax paid or incurred on the purchase of the first $1 million of qualified property.
- In any year, corporations may claim a credit equal to the sales or use tax paid or incurred on the purchase of the first $20 million of qualified property. (See special rule for S corporations and shareholders in EDAM 23500)

No credit may be claimed for property purchased after the Program Area designation expires.

23100 Geographic Boundaries and Designation Dates

For a listing of Program Area cities, see "Program Area Locations and Designation Dates " EDAM 1360. To verify an address, refer to EDAM 1300.

23200 Qualified Business

References (Repealed Sections) 17052.13(b)(1)(A); 23612(b)(1)(A)

EDAM 23210 Pass-Through Entities

A "Qualified Business" is a person or entity certified by TCA and engaged in a trade or business within a Program Area. A taxpayer does not qualify for the Program Area tax incentives, if they fail to be certified.

23210 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.

23300 Qualified Property

References (Repealed Sections) 17052.13(b)(2); 23612(b)(2)

EDAM 23310 Capitalized Requirement
EDAM 23320 Leased Property

Qualified property must be used exclusively in the Program Area and is defined as:

- Machinery and machinery parts used for:
    - Fabricating, processing, assembling, and manufacturing a product.
    - The production of renewable energy resources.
    - Air or water pollution control mechanisms.

Generally, qualified machinery parts include those parts that are necessary for the operation of the machinery (e.g., a conveyor belt).

Excluded parts are those used to complete a certain job. They are typically expensed to cost of good sold or general expense accounts (e.g., specialized drill blades and oil utilized for routine maintenance work).

23310 Capitalized Requirement

References (Repealed Sections) 17052.13(b)(2); 23612(b)(2)

Qualified property must be purchased and placed in service before the PA 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.

23320 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.

23400 Credit Computation – Asset Value Limitation

References (Repealed Sections) 17052.13(a); 17052.13(b)(2); 23612(a); 23612(b)(2)

EDAM 23410	Use Tax Paid on Qualified Property
EDAM 23420	Depreciable Basis
EDAM 23430	Business Income Activity Limitation
EDAM 23440	General Provisions - Income Apportionment
EDAM 23441	Property Factor – Income Apportionment
EDAM 23442	Payroll Factor – Income Apportionment
EDAM 23443	Sales Factor – Income Apportionment
EDAM 23444	Apportionment – Combined Groups
EDAM 23445	Apportioning for Personal Income Tax Taxpayers

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.

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

Individuals, estates or trusts, partnerships, and limited liability companies (LLCs) taxed as partnerships may claim a credit on the sales or use tax paid or incurred to purchase up to $1 million of qualified property. Corporations may claim a credit on the sales or use tax paid or incurred to purchase up to $20 million of qualified property. This limitation applies to each income or taxable year. (For S corporations and shareholders see EDAM 23500)

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 for the exemption amount.

23410 Use Tax Paid on Qualified Property

References (Repealed Sections) 17052.13(c); 23612(c)

If a taxpayer, operating within a Program Area, purchases property out of state and pays or incurs a use tax, the credit is allowed only if qualified property of a comparable quality and price is not timely available for purchase in this state.

23420 Depreciable Basis

References (Repealed Sections) 17052.13(e); 23612(e)

Any taxpayer that elects to claim the sales or use tax credit, shall *not* increase the basis of the qualified property by the amount of the sales or use tax paid or incurred.

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

23430 Business Income Activity Limitation

References (Repealed Sections) 17052.13(d); 17052.13(f)(1); 23612(d); 23612(f)(1)

The amount of sales or use tax credit and hiring credit (see EDAM 22000) claimed, including any credit carryover from prior years, may not exceed the amount of tax on the taxpayer's Program Area business income in any year. The Program Area business income is that portion of *worldwide* business income that is apportioned to the Program Area. Non-business income or loss is not included in the calculation of business income from the Program Area. Each taxpayer claiming the credit must compute the Program Area business income and resulting tax.

Example: Corp. A operates exclusively within a Program Area. 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 current tax rate (the tax rate prior to 1997 was 9.3%).

Net Business Income	$13,000
x 9.3%	x 0.093
Tax associated with business income	$1,209

In this example, the taxpayer can offset the tax of $1,209 with the sales or use tax credit available (up to $1,209).

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

23440 General Provisions - Income Apportionment

References (Repealed Sections) 17052.13(f); 23612(f)

If a business is located within and outside of a Program Area, or in more than one Program Area, the taxpayer must determine the portion of the total business income that is attributable to each Program Area.

- 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, 1991, and ending on or before December 31, 1996 (1991 - 1995 years and 1996 calendar year taxpayers), business income is apportioned to the Program Area 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 1996 fiscal years, income or loss attributed to the Program Area is determined by multiplying *worldwide* business income or loss by a fraction, the numerator of which is the property factor, payroll factor, and sales factor (double weighted), the denominator of which is four (4).

For income or taxable years beginning before January 1, 1991, income or loss attributed to the Program Area is determined by multiplying *worldwide* business income or loss by a fraction, the numerator of which is the property factor, payroll factor, and sales factor, the denominator of which is three (3).

23441 Property Factor – Income Apportionment

References (Repealed Sections) 17052.13(f) 23612(f)

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 Program Area* during the income or taxable year. 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*.

Rented property is valued at eight (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.

23442 Payroll Factor – Income Apportionment

References (Repealed Sections) 17052.13(f) 23612(f)

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 Program Area* during the income or taxable year. The denominator is the total compensation paid to employees working *worldwide* during the income or taxable year.

23443 Sales Factor – Income Apportionment

The sales factor is a fraction. The numerator of the sales factor is composed of the gross receipts as defined under the provisions of CR&TC §25134 - 25136, derived during the taxable or income year from transactions and activities occurring within the taxpayers trade or business in the Program Area. The denominator is composed of the gross receipts as defined under the provisions of CR&TC §25134 - 25136, derived during the taxable or income year from transactions and activities related to worldwide operations

General rules regarding the double weighting of the sales factor are applicable.

Example: For the income year ending 12/31/95, Corporation A operates within and outside a Program Area. Total business income of $13,000 needs to be apportioned to the Program Area. The following amounts apply to Corp. A's property and payroll:

Program Area Property	$40,000
WW Property	$100,000
Program Area Payroll	$5,000
WW Payroll	$10,000

Program Area Property/WW Property	=.40	
Program Area Payroll/WW Payroll	=.50	
	.90/2 = .45	Program Area Apportionment Factor

Business income	$13,000
Apportionment Factor	x 0.45
Program Area Business Income	$5,850
Current Tax Rate (Prior to 1997 – 9.3%)	x 0.093
Tax attributable to Program Area business income	$544

23444 Apportionment – Combined Groups

For members of a combined group, the credit limitation will be based on the combined groups worldwide business income (before CA apportionment). The numerator of the apportionment formula will be based on each Program Area taxpayer's separate Program Area payroll and property amounts (and sales as discussed in EDAM 23443) and the denominator will be based on the combined groups worldwide payroll and property amounts (and sales as discussed in EDAM 23443).

Example: For the income year ending 12/31/95, Parent Corporation A has two subsidiaries, B and C. Corporations A and B operate within a Program Area. The combined group operates within and outside California and apportions its income to California using Schedule R. The combined group’s business income is $1,000,000.

Business income apportioned to the Program Area was determined as follows:

	A	**B**	**C**	**Combined**
<u>Property Factor</u>				
Program Area Property	$2,000,000	$1,000,000	$0	$3,000,000
Worldwide Property				$5,000,000
Apportionment %	40%	20%		60%
Payroll Factor				
Program Area Payroll	$2,000,000	$800,000	$0	$2,800,000
Worldwide Payroll				$4,000,000
Apportionment %	50%	20%		70%
Average Apport. % (Property + Payroll Factors)/2	45%	20%		65%
Business Income				$1,000,000
Program Area Income	$450,000	$200,000		$650,000

23445 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 a Program Area and one outside the Program Area. Eighty percent (80%) of the S corporation's business is attributable to the Program Area. (**NOTE**: This percentage was determined by the S corporation, using Worksheet V from the FTB 3805Z 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 Program Area.

Ray and Mary Smith have the following 1996 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
Program Area business expense deduction	(5,000)*
Ray's unreimbursed employee expenses from Schedule A	(2,000)

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

The Smith's Program Area income is computed as follows:

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

Ray and Mary must compute the tax on the total Program Area 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 1996 tax on $151,000 is $10,938. The $10,938 is the first limitation on Program Area credits for the 1996 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 Program Area income since they are not related to trade or business activities.

23500 S Corporation & Shareholder Credit Amounts

References 23803(a); (Repealed Section) 17052.13(b)(2) 23612(b)(2)

S corporations operating within a Program Area may claim a credit on the sales or use tax paid or incurred to purchase up to $20 million of qualified property. This limitation applies to each income year. The S corporation may only use one-third (1/3) of the credit to reduce the tax on the S corporation's Program Area income.

An S corporation's sales or use tax credit may reduce the Program Area tax at both the corporate and shareholder levels. One hundred percent (100%) of the Program Area credits are passed through to the S corporation shareholders. However, S corporation shareholders are only allowed to claim a credit on the sales or use tax paid or incurred on the purchase of up to $1 million of qualified property of the S corporation for each taxable year. The shareholders claim their pro-rata share of this credit as recomputed under the California personal income tax law (Part 10).

The sales or use tax credit is first computed for the S corporation using the actual qualified acquisition costs not to exceed $20 million. The amount of credit passing through to the shareholders is then computed using the actual qualified acquisition costs not to exceed $1 million. This credit based on the $1 million limitation is passed through to the shareholders based on their pro rata share. The Schedules K (100S) and 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 Program Area 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 (not to exceed $20,000,000) x sales tax rate x 1/3 S corporation credit limitation]

The corporation's two shareholders allocate between them a sales or use tax credit of $75,000 ($1,000,000 x 7.5% = $75,000). [Cost (not to exceed $1,000,000) x sales tax rate]

NOTE: The State Board of Equalization in an unpublished (non-citable) decision, concluded that the $20 million limitation applied to the S-Corp and the $1 million limitation applied collectively to the S-Corp shareholders. *Appeal of Barry and Wendy Breslow, Cal. St. Bd. Of Equal., November 6, 2001.*

23600 Sales or Use Tax Credit and the Hiring Credit

References (Repealed Sections) 17052.13(f) 23612(f)

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 Program Area business income. Thus, the taxpayer must aggregate the credits and limit the total amount of credits to tax imposed on the Program Area business income.

23700 Credit Usage and Carryover

References (Repealed Sections) 17052.13(d) 17052.13(f) 23612(d) 23612(f)

EDAM 23710 Credit Will Not Reduce Certain Taxes
EDAM 23720 Depreciation
EDAM 23730 Credit Recapture

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 succeeding years, until it is exhausted.

The aggregate amount of the Program Area 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 Program Area, determined as if that income represented all of the income of the taxpayer.

Example: A taxpayer has $4,900 in Program Area credits (sales or use tax credit *and* hiring credit). Tax imposed on Program Area 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 Program Area business income, or the tax on the taxpayer's overall "net tax"/"tax".

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

If the taxpayer has any unused credits as of the date of the repeal of the Program Area tax incentives (income or taxable years beginning on or after January 1, 1997), the unused credits may continue to be carried forward until they are exhausted as Enterprise Zone incentives.

23710 Credit Will Not Reduce Certain Taxes

The Program Area 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
- "Net tax" or "tax" below tentative minimum tax (TMT) before January 1, 1993

NOTE: For income or taxable years beginning on or after January 1, 1993, the Program Area hiring credit may reduce "net tax" / "tax" below TMT.

23720 Depreciation

References 18036 24916 (Repealed Section) 17052.13(e) 23612(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.

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, 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.

23730 Credit Recapture

There are no recapture provisions for the Program Area sales or use tax credit.

23800 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;
- The location where the property is used; and
- If purchased from a manufacturer located outside California, records to substantiate that property of comparable quality and price was not available for purchase in California.