STATE OF CALIFORNIA
**FRANCHISE TAX BOARD**

# FTB Publication 1158

# 2002 Guidelines for Businesses Claiming Economic Development Area Tax Incentives

## INTERNET ASSISTANCE

We've made significant changes to our Website in an effort to help answer questions when completing your income tax return. Come visit us at **www.ftb.ca.gov** to get helpful information such as:

- Getting a Customer Service Number and other tips for e-filing your tax return
- Find out if you can TeleFile
- Checking the status of your refund and account balance inquiry (NEW)
- Learn about new and more convenient methods for paying your tax
- Download tax forms and publications - sorted by year and by form number
- View internal procedure manuals to learn how we administer the law (NEW)
- Access legal notices, rulings, regulations; see FTB's analysis of pending legislation; and get current law/policy information by reading Tax News Online

# Contents



**Note:** Because there are differences in some Economic Development Area (EDA) tax incentives, refer to the applicable FTB EDA business booklet for detailed information on how to compute and claim each EDA tax incentive in each program area. See page 3, column 2, for a list the FTB EDA booklets.

# What's New

For taxable years beginning in 2002, the designation of a Local Agency Military Base Recovery Area (LAMBRA) is for an eight-year period after the Technology, Trade and Commerce Agency (TTCA) determines the designation date.

For taxable years beginning in 2002 and 2003, California has suspended the Net Operating Loss (NOL) carryover deduction. However, the deduction for disaster losses is not affected by the NOL suspension rules.

The carryover period for suspended losses is extended by two years for losses incurred before January 1, 2002 and by one year for losses incurred after January 1, 2002 and before January 1, 2003.

For more information, get forms FTB 3805V and 3805Q.

For taxable years beginning on or after January 1, 2002, the general NOL carryover computation for the California taxable income of a nonresident or part-year resident is no longer limited by the amount of net operating loss from all sources. Only your California sourced income and losses are considered in determining if you have a California NOL.

For the 2002 taxable year only, no addition to tax shall apply with respect to any underpayment of estimated tax to the extent the underpayment of an installment was created or increased by any provisions of law enacted or amended by an act chaptered during the 2002 calendar year. Get Forms 5805 (Underpayment of Estimated Tax by Individuals and Fiduciaries) and 5806 (Underpayment of Estimated Tax by Corporations) for more information.

# General Information

**Federal/State Conformity**

In general, California law conforms to the Internal Revenue Code (IRC) as of January 1, 2001. Therefore, California has conformed to the income tax changes made to the IRC by the federal Internal Revenue Service Restructuring and Reform Act of 1998 (Public Law 105-206), the Tax and Trade Relief Extension Act of 1998 (Public Law 105-277), the Surface Transportation Revenue Act of 1998 (Public Law 105-178), the Ricky Ray Hemophilia Relief Fund Act of 1998 (Public Law 105-369), the Ticket to Work and Work Incentives Improvement Act of 1999 (Public Law 106-170), the Miscellaneous Trade and Technical Corrections Act of 1999 (Public Law 106-36), the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 (Public Law 106-519), the Consolidated Appropriations Act of 2001 (Public Law 106-554), and to technical corrections made by the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16). However, there are continuing differences between California and Federal law. California has not conformed to some of the law changes made by the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16) or the federal Job Creation and Worker Assistance Act of 2002 (Public Law 107-147).

**Codes for Principal Business Activity and Standard Industrial Classification**

The FTB implemented a Principal Business Activity (PBA) code chart based on the North American Industry Classification System (NAICS) published by the United States Office of Management and Budget, 1997 Edition. However, the Revenue and Taxation Code (R & TC) still refers to the Standard Industrial Classification (SIC) for purposes of qualifying for some of the EDA credits. Refer to the applicable FTB EDA business booklet to determine which PBA or/and SIC Codes are used for purposes of business classification.

**Pass-Through Entities**

For purposes of this booklet, the term "pass-through entity" refers to an S corporation, estate, trust, partnership, and limited liability company (LLC). References to "partnerships" include LLCs classified as partnerships.

# Introduction

## Economic Development Area Tax Incentives

This publication provides a brief explanation of various Economic Development Area (EDA) tax incentives established in the State of California. These incentives have been established to stimulate growth and development in selected areas that are economically depressed. Detailed information about the methods used to compute allowable tax incentives can be found in related FTB EDA business booklets. EDA tax incentives apply only to certain business transactions that are undertaken after an EDA has received final designation.

Refer to the applicable FTB EDA business booklet for EDA designations and expiration dates.

A business may qualify for special credits and deductions if it operates or invests in a trade or business located within the geographic boundaries of an EDA.

## Types of EDAs

Tax incentives are available to individuals and businesses operating or investing within the following EDAs:

- Enterprise Zones (EZ)
- Local Agency Military Base Recovery Areas (LAMBRA)
- Targeted Tax Area (TTA)
- Manufacturing Enhancement Areas (MEA)

## Available EDA Tax Incentives

**Enterprise Zones**
Taxpayers investing or operating in an EZ may be eligible for the following credits and deductions:

- Hiring Credit
- Sales or Use Tax Credit
- Business Expense Deduction
- Net Interest Deduction for Lenders
- Net Operating Loss Carryover Deduction

Employees working in an EZ may qualify for a credit. If you are an employee working in an EZ, get form FTB 3553, Enterprise Zone Employee Credit.

**Local Agency Military Base Recovery Areas**
Taxpayers investing or operating in a Local Agency Military Base Recovery Area may be eligible for the following credits and deductions:

- Hiring Credit
- Sales or Use Tax Credit
- Business Expense Deduction
- Net Operating Loss Carryover Deduction

**Targeted Tax Area**
Taxpayers investing or operating in a Targeted Tax Area may be eligible for the following credits and deductions:

- Hiring Credit
- Sales or Use Tax Credit
- Business Expense Deduction
- Net Operating Loss Carryover Deduction

**Manufacturing Enhancement Areas**
Taxpayers investing or operating in a Manufacturing Enhancement Area may be eligible for only the hiring credit.

## Who Can Claim the EDA Tax Incentives?

The EDA tax incentives are available to individuals, sole proprietors, corporations, estates, trusts, partnerships and LLCs operating or investing within the designated EDA.

## Net Increase in Jobs

A taxpayer that conducts a trade or business within a LAMBRA, and for the first two taxable years has a net increase in jobs of one or more employees in the LAMBRA, may claim certain economic incentives. Increase in Jobs is defined as 2,000 paid hours per employee per year.

**Net Increase in Jobs within California**
The net increase in jobs is determined by subtracting the total number of full-time employees in California, prior to starting business in the LAMBRA, from the number of full-time employees in California in the second year after operation in the LAMBRA. For this purpose, the number of full-time employees for each year is determined as:

- The total number of hours worked in California by hourly employees (not to exceed 2,000 hours per employee) divided by 2,000; and
- The total number of months worked in California by salaried employees divided by 12.

If your only business in California began with your LAMBRA business, your number of California employees prior to starting business in the LAMBRA is zero.

If your business in California began during the taxable year, the first year employment information is prorated. Multiply the divisors 2,000 (hours for hourly employees) and 12 (months for salaried employees) by a fraction: the numerator is the number of months of doing business and the denominator is 12.

**Net Increase in Jobs within LAMBRA**
If your business has a net increase in jobs for the first two taxable years after commencing business operations in the LAMBRA: you must also employ one or more full-time employees within the LAMBRA in each of these years. For this purpose, the number of full-time employees for each year is determined as:

- The total number of hours worked in the LAMBRA by hourly employees (not to exceed 2,000 hours per employee) divided by 2,000; and
- The total number of months worked in the LAMBRA by salaried employees divided by 12.

If your business in the LAMBRA began during the taxable year, the first year employment information is prorated. Multiply the divisors 2,000 (hours for hourly employees) and 12 (months for salaried employees) by a fraction: the numerator is the number of months of doing business and the denominator is 12.

**Note:** If your business does not have a net increase in jobs for the two taxable years after commencing business operations in the LAMBRA and employ one or more full-time employees within the LAMBRA in each of the first two years, you must recapture (in the current year) any LAMBRA credits or deductions that were previously taken.

## How to Claim the EDA Tax Credits and Deductions

To claim any EDA credit or deduction, the business must complete and attach the applicable EDA form to its California tax return. Attach a separate form for each business you operate or invest in that is located within the designated EDA. See below for FTB EDA business booklets to determine the correct amount of deductions and credits that may be claimed for operating or investing in a trade or business within the EDA.

- FTB 3805Z Enterprise Zone Business Booklet
- FTB 3807 Local Agency Military Base Recovery Area Business Booklet
- FTB 3808 Manufacturing Enhancement Area Business Booklet
- FTB 3809 Targeted Tax Area Business Booklet

# Hiring Credit (EZ, TTA, LAMBRA and MEA)

Employers conducting a trade or business in an EZ, TTA, and LAMBRA can claim the hiring credit for qualified employees hired after the designation date and before the expiration date of the EDA for the first five years of employment. For an MEA, only taxpayers operating a trade or business in selected businesses may claim the credit.

A qualified employer conducting a trade or business within the EDA can reduce tax on EDA business income by a percentage of qualified wages paid to one or more qualified employee(s). Taxpayers can claim the hiring credits and carryovers to the extent of tax on business income apportioned to the EDA, until the credit is fully utilized.

**Note:** Because there are differences in some EDA tax incentives, refer to the applicable FTB EDA business booklet for a detailed definition of a qualified employee.

Employers hiring qualified employees **must get Form TCA EZ1** from the local agency responsible for verifying employee eligibility. Form TCA EZ1 is required to support a claim for the hiring credit. Information about your local agency responsible for verifying employee eligibility, can be found in the Technology, Trade and Commerce's Website at **www.commerce.ca.gov**.

The percentage of wages used to compute the credit depends on the number of years the employee works for the employer in the EDA. The applicable percentage begins at 50% and declines 10% for each year of employment. After the fifth year of employment, no credit can be generated.

Wages that qualify for the hiring credit are those wages paid to a qualified employee for the consecutive 60-month period beginning on the first date the employee commenced employment with the employer while the EDA designation is in effect. For EZ, if the 60-month period of employment extends beyond the expiration date, the wages paid or incurred after the expiration date will still qualify for the hiring credit until the 60-month period is completed. For a taxpayer that operates a business that has regularly occurring seasonal or intermittent employment decreases and increases, reemployment of an individual is not a new hire. It is a continuation of the prior employment and does not constitute commencement of employment for the qualified wages test.

Leased employees may qualify an employer to take the hiring credit under certain limited circumstances.

Consider the following in making this determination:

- Generally, the qualified employer can be identified due to the obligation to pay the payroll taxes of the employee.
- The application of 20 standard tests of establishing an employment relationship may be necessary in certain situations to determine if an employer-employee relationship exist.

Internal Revenue Service Publication 15-A*, Employer's Supplemental Tax Guide, lists the 20 factors and provides examples to consider in determining the employer-employee relationship.

You may claim up to 50% of the qualified wages paid to a qualified employee as a credit against tax imposed on EDA business income.

The chart below shows the actual percentage of qualified wages paid that can be claimed as a hiring credit.

| Period of employment (from the date of hire) | Credit allowed on qualified wages paid or incurred |
|---|---|
| 0 - 12 months | 50% |
| 13 - 24 months | 40% |
| 25 - 36 months | 30% |
| 37 - 48 months | 20% |
| 49 - 60 months | 10% |
| After 60 months | 0% |

The credit is based on the smaller of the following:

- The actual hourly rate paid or incurred by the employer for work performed by the employee during the taxable year; or
- 150% of the minimum hourly wage established by the Industrial Welfare Commission.

Where the California minimum wage is higher than the federal minimum wage, the California minimum wage is used for purposes of computing the EDA hiring credit. The current minimum wage is $6.75 per hour.

For purposes of computing the EDA hiring credit, 150% of the minimum wage is $10.12 per hour.

**Example 1:** (The example below shows the hourly rate that qualifies for the hiring credit).

John Anderson was hired January 1, 2002. John's hourly rate for the first month was $7.00. At the beginning of the second month, his hourly rate increased to $8.00. In the third month, John's hourly rate increased to $12.00. The hourly rate that qualifies for the credit is limited to 150% of the minimum wage, or $10.12 per hour for 2002.

| Month(s) | Hours x per month | Hourly rate | Qualified wages per month |
|---|---|---|---|
| 1 | 175 | $ 7.00 | $1,225 |
| 2 | 170 | $ 8.00 | $1,360 |
| 3 | 170 | $10.12 | $1,720.40 |

**Example 2:** Your business has a June 30 fiscal year end. On January 1, 2002, you hired a qualified employee who worked 2,080 hours in your enterprise zone business through 12/31/02. For two consecutive fiscal years, you paid this qualified employee minimum wages to work at your business. Your hiring credit for the year ending June 30, 2002, is calculated as follows:

Step 1: 1/1/02 to 6/30/02 - 1040 hrs x $6.75 = $7,020
Step 2: $7,020 x 50% (.50) = $3,510
Your total hiring credit for fiscal year ending June 30, 2002 is $3,510

**Example 3:** Use the same facts as above except that the qualified employee is earning $9.00 an hour beginning January 1, 2003. Your hiring credit for the taxable year ending June 30, 2003, is calculated as follows:

Step 1: 7/1/02 to 12/31/02 - 1040 hrs x $6.75 = $7,020
Step 2: $70,20 x 50% (.50) = $3,510
Step 3: 1/1/03 to 6/30/03 - 1040 hrs x $9.00 = $9,360

Step 4: $9,360 x 40% (.40) = $3,744
Step 5: $3,510 + $3,744 = $7,254
Your total hiring credit for fiscal year end June 30, 2003, is $7,254.

**Long Beach Enterprise Zone Only**

The percentage of wages on which the hiring credit is based increased for taxpayers **engaged in aircraft manufacturing activities** (described in Codes 3721, 3724, 3728, and 3812 of the Standard Industrial Classification Manual, 1987 Edition, published by the United States Office of Management and Budget) and located in the Long Beach EZ. Qualified wages for purposes of the hiring credit for such aircraft manufacturers located in the Long Beach Enterprise Zone, **for up to a maximum of 1,350 qualified employees**, are based on the smaller of:

- The actual hourly rate paid or incurred by the employer for work performed by the employee during the taxable year; or
- The rate (based on the time qualified wages paid or incurred) which represents **202**% of the minimum wage.

For purposes of computing the hiring credit (for the Long Beach EZ only), 202% of the minimum wage is $13.63 per hour.

**Example 4:** John Anderson was hired January 1, 2002. John's hourly rate for the first month was $9.00. At the beginning of the second month, his hourly rate increased to $11.00. In the third month, John's hourly rate increased to $14.00. The hourly rate that qualifies for the credit is limited to 202% of the minimum wage, or $13.63 per hour.

| Month(s) | Hours x per month | Hourly rate | Qualified wages per month |
|---|---|---|---|
| 1 | 175 | $ 9.00 | $1,575 |
| 2 | 170 | $11.00 | $1,870 |
| 3 | 170 | $13.63 | $2,317.10 |

**Hiring Credit Limitations (applicable to all EDAs)**

- The amount of the hiring credit claimed for any taxable year cannot exceed the amount of tax on the EDA business income in any taxable year.
- In the case where the wage expense qualifies the business to take more than one EDA hiring credit, the business can claim only one credit. However, a different rule applies regarding the Joint Strike Fighter Credit, as described on page 5, column 2.
- S corporations are allowed only 1/3 of the EDA hiring credit. The remaining 2/3 of the credit is lost. However, 100% of the credit is passed through to the shareholders. See example 5.

  **Example 5:** In 2002, an S corporation qualified for a $3,000 EDA hiring credit. S corporations can claim only 1/3 of the credit ($3,000 x 1/3 = $1,000). Therefore, the S corporation must reduce its wage deduction by $1,000. On Form 100S, Schedule K, line 1, column (c), the S corporation would add $3,000 to the S corporation's ordinary income or loss to reflect the credit passed through to the shareholder(s).
- The credit cannot reduce the minimum franchise tax, (corporations and S corporations), annual tax (partnerships, LLCs classified as partnerships, and QSubs), the alternative minimum tax (corporations, exempt organizations, individuals, fiduciaries), the built-in gains tax (S corporations), or the excess net passive income tax (S corporations).

**Additional Hiring Credit Limitations (applicable to specific EDAs)**

- The cumulative qualified wages used to compute the credit cannot exceed $2,000,000. The limit applies to each taxpayer for each taxable year, regardless of the number of qualified employees employed (LAMBRA and MEA only).
- Taxpayers must reduce any deduction for wages by the amount of the hiring credit allowed, including any carryover to future years, except for TTA.
- S corporations must reduce their wage deduction by 1/3 of the amount of hiring credit allowed (EZ, MEA, and LAMBRA).
- In the case where the wage expense qualifies the business to take the EZ hiring credit as well as the Joint Strike Fighter (JSF) wage credit, the EZ hiring credit and the JSF wage credit can be claimed on the same wages.
- For TTA and EZ, the credit can reduce regular tax below tentative minimum tax.
- For LAMBRA and MEA, the credit cannot reduce regular tax below tentative minimum tax.

**Hiring Credit Carryover**

If the amount of the hiring credit is greater than the tax on EDA business income in any year, the taxpayer can carry over the excess credit to future years to offset tax on the EDA business income.

For taxpayers engaged in a trade or business in a former (expired) EDA, the hiring credit carryovers may still be claimed to the extent of business income apportioned to the former EDA, or portion thereof, until the credit is fully utilized.

**Hiring Credit Recapture**

The employer must recapture (add to the current year tax liability) the amount of credit attributable to an employee's wages if the employer terminates an employee at any time during the longer of:

- The first 270 days of employment (whether or not consecutive); or
- 90 days of employment plus 270 calendar days.

The employer must add to the current year's tax the amount of credit claimed in the year of termination and all prior years in which the credit was claimed for the terminated employee.

Employers of seasonal employees must recapture the amount of hiring credit attributable to the employee's wages if:

- The employer terminates the employee before the completion of 270 days of employment; and
- The 270 days is during the 60-month period beginning the day the employee commences employment with the employee.

A "day of employment" means any day for which the employee receives wage compensation (including a paid sick day, holiday, or vacation day). The credit recapture does not apply if the termination of employment was:

- Voluntary on the part of the employee;
- In response to misconduct of the employee;

- Caused by the employee becoming disabled (unless the employee was able to return to work and the employer did not offer to reemploy the individual);
- Carried out so that other qualified individuals could be hired, creating a net increase in both the number of qualified employees and their hours worked; or
- Due to a substantial reduction in the employer's trade or business operations.

**Job Creation Required in Claiming Hiring Credit (only for LAMBRA)**
In addition to the general hiring credit recapture provisions, if at the close of the second taxable year of operating within the LAMBRA, the taxpayer does not have a net increase of one or more jobs in this state and one or more employees working within the LAMBRA during each of the taxable years, the amount of the LAMBRA hiring credit previously claimed must be added to the taxpayer's current year tax liability for the second taxable year and the taxpayer is no longer eligible for the LAMBRA tax incentives.

There are no exceptions to this recapture rule. Refer to FTB 3807 booklet for additional information on the net increase in jobs requirement.

**Record Keeping**
If you hire qualified employees and claim this credit on your tax return, keep the following records to support the hiring credit:

- Copies of Form TCA EZ1 for each qualified employee for which the hiring credit is claimed, indicating review and approval by the local agency responsible for verifying employee eligibility;
- Records of any other federal or state subsidies you may have received for hiring qualified employees; and
- A schedule for the first 60 months (five years) of employment showing (at least) the:
  - Employee's name;
  - Date the employee was hired;
  - Number of hours the employee worked for each month of employment;
  - Smaller of the hourly rate of pay for each month of employment or 150% (202%, if the employer is an aircraft manufacturer in the Long Beach Enterprise Zone) of the minimum wage;
  - Total qualified wages per month for each month of employment; and
  - Location of the employee's job site and the duties performed.

**Note:** Keep the above information for the life of the hiring credit.

# Sales or Use Tax Credit (EZ, TTA and LAMBRA)

Individuals, estates, trusts, and partnerships operating or investing in the EZ, TTA or LAMBRA can claim a credit equal to the sales or use tax paid or incurred to purchase up to $1 million of qualified property purchased for exclusive use in the EDAs.

Corporations can claim a credit equal to the sales or use tax paid or incurred to purchase up to $20 million of qualified property. S corporation shareholders (other than S corporations) may claim their pro-rata share of pass-through credit to the extent the S corporation paid or incurred the sales or use tax to purchase up to $1million of qualified property. See the example on page 7.

The qualified property must be purchased and placed in service on or after the designation date, before the expiration date of the EDAs. The sales or use tax must be paid or incurred on or after the designation date. The business must use the property **exclusively** within the boundaries of the EDAs.

The use tax paid or incurred on purchases of property manufactured outside of California qualifies for the credit only if property of a comparable quality and price was not available for timely purchase and delivery from a California manufacturer. The taxpayer must keep records documenting the unavailability of comparable property.

**Note:** Differences exist in some EDAs as to what is included in qualified property. Refer to the applicable FTB EDA business booklet for more information on qualified property in each EDA.

**Sales and Use Tax Credit Limitations**

- The amount of sales or use tax credit and carryover claimed cannot exceed the amount of tax on the EDA business income in any year.
- In the case where the business is qualified to take the TTA or LAMBRA sales or use tax credit as well as another credit (e.g., manufacturers' investment credit) for the same piece of property, the business may only claim one credit.
- A taxpayer can claim the manufacturers' investment credit and the EZ sales or use tax credit for the same item of property.
- The credit cannot reduce the minimum franchise tax, (corporations and S corporations), annual tax (partnerships and Qsubs), the alternative minimum tax (corporations, exempt organizations, individuals and fiduciaries), built-in gains tax (S corporations), or the excess net passive income tax (S corporations).
- For EZ and TTA, the credit can reduce regular tax below tentative minimum tax.
- For LAMBRA, the credit cannot reduce regular tax below tentative minimum tax.

**Claiming Both Hiring Credit and Sales or Use Tax Credit**
Taxpayers who claim both the sales or use tax credit and the hiring credit cannot claim a total credit amount that exceeds the tax imposed on the EDAs' business income in any one taxable year. However, credits that exceed this amount can be carried over to offset tax imposed on the EDA business income in subsequent years.

**Leased Property**
The sales tax paid or incurred on qualified property being leased under a financial (conditional sales) contract qualifies for the sales or use tax credit. To determine whether the lease qualifies as a purchase rather than a true lease, see Revenue Ruling 55-540, 1955-2 C.B. 39 and FTB Legal Ruling 94-2, March 23, 1994.

**Depreciation**
Any taxpayer that elects to claim this credit cannot increase the basis of the qualified property by the sales or use tax paid or incurred in connection with the purchase of qualified property.

**Example:**
XYZ Inc., an S corporation, purchases qualified property for $20 million ($20 m.). The sales tax rate is 8% (.08).

The credit allowed XYZ Inc. and the depreciable basis of the qualified property for XYZ Inc. are computed as follows:

| | | Depreciable basis |
|---|---|---|
| Qualified property (purchased by XYZ Inc.) | $20 m. | $20 m. |
| Sales tax (paid by XYZ Inc.) ($20 m. x .08) | 1.6 m. | +1.6 m. |
| Sales or use tax credit on qualified property | 1.6 m. | (1.6 m.) |
| Depreciable basis of qualified property for XYZ Inc. | | $20 m. |
| Credit allowed to offset the entity-level tax ($1.6 m. x 1/3) | | $0.53 m. |

XYZ Inc. has two 50% shareholders. The credit allowed the shareholders and the depreciable basis of the qualified property for the shareholders are computed as follows:

| | | Depreciable basis |
|---|---|---|
| Qualified property (purchased by XYZ Inc.) | $20 m. | $20 m. |
| Sales tax (paid by XYZ Inc.) | 1.6 m. | +1.6 m. |
| Maximum qualified costs for sales or use tax credit | 1 m. | |
| Sales or use tax credit allowed the shareholders ($1 m. x .08) | .08 m. | (.08 m.) |
| Depreciable basis of qualified property for the shareholders | | $21.52 m. |
| Total amount of credit allowed the shareholders | | $ .08 m. |

**Note:** Each shareholder is allowed a $40,000 (.08 m. ÷ 2 = .04 m.) sales or use tax credit.

**Credit Carryover**
If the amount of the sales or use tax credit is greater than the tax on EDA business income in any year, the excess credit can be carried over to future years to offset tax on the EDA business income, until the credit is fully utilized.

S corporations may claim only 1/3 of the sales or use tax credit. However, 100% of the credit is passed through to the shareholders.

For taxpayers engaged in a trade or business in a former (expired) EDA, the sales or use tax credit carryovers may still be claimed to the extent of business income apportioned to the former EDA, or portion thereof, until the credit is fully utilized.

**Sales or Use Tax Credit Recapture (LAMBRA only)**
The sales or use tax credit is subject to recapture (added back to tax liability) if, before the close of the second taxable year after the property was placed in service, it is disposed of or is no longer used exclusively in the LAMBRA trade or business. In that case, the credit amount for that property is added to the tax in the current taxable year.

In addition to the above recapture requirement, the LAMBRA credit is also subject to recapture if the net increase in jobs requirement is not met. Refer to form FTB 3807 booklet for more information on net increase in jobs.

**Record Keeping**
To support the sales or use tax credit claimed, keep all records that document the purchase of the qualified property, such as the sales receipt and proof of payment. Additionally, 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 on its purchase;
- The location where it is used; and
- If purchased from a manufacturer located outside California, records to substantiate that property of comparable quality and price was not timely available for purchase in California.

# Business Expense Deduction (EZ, TTA and LAMBRA)

A trade or business operating or investing within an EZ, TTA and LAMBRA can elect to deduct the cost of qualified property purchased for exclusive use in an EZ, TTA and LAMBRA as a business expense in the first year the property is placed in service rather than depreciate it over several years, subject to limitations. The qualified property must be purchased and placed in service on or after the designation date, but before the expiration date of the TTA, EZ, and LAMBRA.

**Note:** The TTA, EZ, and LAMBRA business expense deduction is not allowed for estates or trusts.

**Qualified property** is any recovery property that is IRC Section 1245 property. This includes, but is not limited to, tangible personal property (excluding buildings), most equipment, and most furnishings acquired by purchase after the applicable EDA received its final designation and before the designation expires for exclusive use within an EDA. Office supplies and other small nondepreciable items are not included.

The maximum business expense deduction for all qualified property is the smaller of 40% of the cost of the qualified property or the amounts shown in the chart below, based on when the property was placed in service. The maximum aggregate cost of the qualified property against which the 40% deduction may be claimed in any taxable year is determined by a reference to the number of taxable years that have elapsed since the applicable EDA received its final designation.

| Taxable year of EDA designation | Maximum deduction |
|---|---|
| Taxable year of designation | $40,000 |
| 1st taxable year after designation | $40,000 |
| 2nd taxable year after designation | $30,000 |
| 3rd taxable year after designation | $30,000 |
| Each remaining taxable year after designation | $20,000 |

**Note:** Refer to the applicable EDA booklet for designation and expiration dates.

**Election**
An election to treat the cost of qualified property as a business expense must be made in the year the property is first placed in service. An election is made by using Forms FTB 3805Z, FTB 3807 and FTB 3809 (filed with your return) and claiming the deduction on your original return for the year the property is placed in service. The election is revocable only upon the written consent of the FTB. This deduction is not allowed if the property was:

- Transferred between members of an affiliated group;
- Acquired as a gift or inherited;
- Traded for other property;
- Received from a personal or business relation as defined in IRC Section 267 or 707(b); or
- Described in IRC Section 168(f).

**Note:** The EDA business expense deduction cannot be claimed on an amended return.

**Depreciation (EZ, LAMBRA , and TTA)**
Normal depreciation is allowed on the cost of the property in excess of the expensed amount, starting with the taxable year following the taxable year the property was placed in service. The depreciable basis of the property must be reduced by the business expense deduction elected by the taxpayer. Subtract the amount claimed as a business expense from the basis or cost of the property and depreciate the remaining basis or cost.

**Depreciation of Assets for Which Business Expense Deduction is Taken**

- The basis (cost for depreciation purposes) of the property must be reduced by the amount allowed as a deduction.
- The remaining basis may be depreciated in the year following the year the qualified property was placed in service (EZ and TTA). Taxpayers may begin depreciating the remaining basis in the same year the qualified property was placed in service in the LAMBRA.
- Taxpayers may not claim additional first year depreciation under IRC Section 179 or R&TC Section 24356 (as applicable) for these assets.
- Depreciation on the cost of the property in excess of the amount deducted may be claimed using any method of depreciation normally used.

**Business Expense Deduction Recapture**

- The full amount of the deduction must be recaptured and included in income if the property ceases to be used exclusively in the TTA, EZ, and LAMBRA for the remainder of the taxable year the property was placed in service and the two subsequent taxable years immediately thereafter.
- In addition, if at the close of the second taxable year of operating within the LAMBRA, the taxpayer does not have a net increase of one or more jobs in this state and one or more employees working within the LAMBRA during each of the taxable years, the amount of the LAMBRA business expense deduction previously claimed must be added back to the taxpayer's income for the taxpayer's second taxable year and the taxpayer is no longer eligible for the LAMBRA incentives.

**Business Expense Basis Adjustment**
As of the first day of the taxable year in which the recapture event occurs, the recapture amount is added back to the basis in the year of recapture and then depreciated over the remaining life of the qualified property.

**Record Keeping**
You should maintain information that will allow you to substantiate your claim for the first-year business expense deduction. The records for each item should show (at least):

- A description and purchase price of the property;
- The date the property was first placed in service in an EDA;
- The location where the property is used;
- The date qualified property was sold or otherwise ceased to be used exclusively in an EZ, TTA, or LAMBRA; and
- Documentation supporting the taxpayer's claim that property is qualified property.

# Net Interest Deduction for Lenders (EZ Only)

A lender can take a deduction for the amount of “net interest” received on loans made to a trade or business located **solely** in an EZ. “Net interest” means the full amount of the interest, less any direct expenses incurred in making the loan. Some examples of direct expenses are: commissions paid to the loan representative and the cost of money incurred in funding the loan. Types of loans that qualify for this deduction include business loans, mortgages, and loans from non-commercial sources. The deduction is no longer allowed when the EZ expires or the borrower moves out of the EZ. (See FTB 3805Z for the EZ expiration dates.)

**Requirements**

- The loan is made to a trade or business located solely within an EZ.
- The money loaned is used strictly for business activities within the EZ.
- The lender has no equity or other ownership interest in the trade or business.
- The loan was made after the EZ was designated.

**Refinance of loan**
Refinance of the loan qualifies for the net interest deduction to the extent new monies were obtained and invested in the enterprise zone, or to the extent the original loan qualified the prior creditor for the net interest deduction.

**Record Keeping**
To support the "net interest" deduction on your tax return, you should maintain records for each enterprise zone loan showing (at least):

- The identity and location of the trade or business to which you have loaned the money;
- The amount of your loan, the amount of interest earned and the amount of any direct and indirect expenses associated with the loan;
- Use of the loan proceeds; and
- The borrower's trade or business was located solely within EZ.

# Net Operating Loss Deduction Carryover (EZ, TTA and LAMBRA only)

For taxable years beginning in 2002 and 2003, California has suspended the Net Operating Loss carryover deduction. However, the deduction for disaster losses is not affected by the NOL suspension rules.

The carryover period for suspended losses is extended by two years for losses incurred before January 1, 2002 and by one year for losses incurred after January 1, 2002 and before January 1, 2003.

For taxable years beginning on or after January 1, 2002, the NOL carryover computation for the California taxable income of a nonresident or part-year resident is no longer limited by the amount of net operating loss from all sources. Only your California sourced income and losses are considered in determining if you have a California NOL.

A Net Operating Loss (NOL) Deduction is defined as the excess of business deductions (computed with certain modifications) over gross income in a particular tax year. A deduction is allowed for that loss, through an NOL carryover, in some other tax year(s) in which gross income exceeds business deductions. California does not conform to the federal NOL deduction carryback.

NOL Deduction Carryover is allowed to individuals, corporations, estates, and trusts. NOL Deduction Carryover is not allowed to partnerships, (but the deduction is allowed to the partners), and regulated investment companies, (losses are passed through to shareholders). EDA NOL Deduction Carryover of individuals, corporations, estates, and trusts can be carried over to future years to reduce the amount of taxable EDA income for those years. You may carry over 100% of the business loss from your EDA activity until the deduction is exhausted or for a period not to exceed 15 years, which ever comes first. The NOL carryover is determined by computing the business loss that results strictly from business activity in an EDA. The taxpayer's property and payroll located or incurred in the EDA as compared to property and payroll everywhere are used determine the EDA NOL.

For any water's-edge taxpayer, R&TC Section 24416(c) imposes a limitation on the NOL deduction if the NOL is generated during a non-water's edge tax year. The NOL carryover is limited to the lesser of the NOL or the re-computed NOL. The re-computed NOL carryover is determined by computing the income and factors of the original worldwide combined reporting group, as if the water's-edge election had been in force for the year of the loss. R&TC Section 24416(c) serves as a limitation. If this section applies, the NOL carryover for each corporation may only be decreased not increased.

**Election**
If you have an EDA NOL, you must make an irrevocable election to treat it either as an EDA NOL or include it as part of your general NOL. This election must be made on the **original** return for the year of the loss and be filed by the original or extended due date of the return.

**Note:** The EDA NOL deduction cannot be claimed on an amended return.

**Limitations**

- EDA NOL carryovers are allowed only for losses occurring in a tax year beginning after the date the area is designated as an EDA. Refer to the applicable EDA booklets for EDA designation and expiration date.
- Financial institutions using bad debt reserve methods may carry over the EDA NOL for a maximum of five taxable years (LAMBRA).
- An EDA NOL may not be applied to years before the year in which the EDA NOL occurred (no carry backs).

**Expired EDA**
For taxpayers operating in an expired EDA, any EDA credit or net operating loss carryover can be utilized to the extent of the tax on business income apportioned to the former EDA.

**Record Keeping**
To support your claim of an NOL carryover on your California tax return, you should maintain (at least):

- Records showing the date your business activities began in an EDA;
- Accounting records showing that the loss was the result of business activity in an EDA; and
- Financial data indicating that the income offset by the carryover is the product of business activity in an EDA.

For more information on computing the NOL, get forms FTB 3805V and 3805Q.

Refer to the applicable EDA FTB Business Booklets for additional information on treatment of EDA NOL.

For more information regarding the other types of NOLs, see the following forms or worksheets:

- FTB 3805V, Net Operating Loss (NOL) Computation and NOL and Disaster Loss Limitations - Individuals, Estates, and Trusts;
- FTB 3805Q, Net Operating Loss (NOL) Computation and NOL and Disaster Loss Limitations -Corporations;
- FTB 3805D, Net Operating Loss (NOL) Computation and Limitation - Pierce's Disease;
- FTB 3805Z, Enterprise Zone Business Booklet, Worksheet VI;
- FTB 3807, Local Agency Military Base Recovery Area Business Booklet, Worksheet V; and
- FTB 3809, Targeted Tax Area Business Booklet, Worksheet V.

**Amended Returns**
No NOL and business expense deduction will be allowed on the amended return. Election to claim these deductions must be made on the original return.

# Determination of EDA Income or Tax

For businesses operating within and outside an EDA, the amount of credit you may claim on your California tax return is limited by the amount of tax on business income attributable to the EDA. The amount of NOL deduction you may claim on your California tax return is limited by the amount of business income attributable to the EDA. For taxable years beginning on or after January 1, 1998, the formula used to determine the amount of tax or income attributable to an EDA is a formula based on the total property and payroll of the business located in the EDA compared to the total property and payroll of the business located in California.

**EDA Locations and Designation Dates**

**Note:** Refer to the applicable FTB EDA business booklet for EDA locations and designation.

# Related FTB Forms and Publications

| | |
|---|---|
| FTB 3553 | Enterprise Zone Employee Credit |
| FTB 3805Z | Enterprise Zone Business Booklet |
| FTB 3806 | Los Angeles Revitalization Zone Business Booklet |
| FTB 3807 | Local Agency Military Base Recovery Area Business Booklet |
| FTB 3808 | Manufacturing Enhancement Area Business Booklet |
| FTB 3809 | Targeted Tax Area Business Booklet |
| FTB 3535 | Manufacturers' Investment Credit |
| FTB 1113 | Frequently Asked Questions About the Manufacturers' Investment Credit (MIC) |
| FTB 1118 | Frequently Asked Questions About the Local Agency Military Base Recovery Area (LAMBRA) Tax Incentives |
| FTB 1126 | Frequently Asked Questions About the Enterprise Zone Tax Incentives |

# How to Get California Tax Information

## Your Rights as a Taxpayer

Our goal at the Franchise Tax Board (FTB) is to make certain that your rights are protected so that you will have the highest confidence in the integrity, efficiency, and fairness of our state tax system. FTB Pub. 4058, California Taxpayers' Bill of Rights, includes information on your rights as a California taxpayer, the Taxpayers' Rights Advocate Program, and how you can request written advice from the FTB on whether a particular transaction is taxable. See "Where to Get Tax Forms and Publications" below.

## Where to Get Tax Forms and Publications

**By Internet –** You can download, view, and print California tax forms and publications from our Website at: **www.ftb.ca.gov**

Information about other state agencies can be accessed through the State Agency Index located on the California State Website at: **www.ca.gov**

**By phone –** To order California tax forms and publications, call our automated phone service at (800) 338-0505 and follow the instructions.

Please allow two weeks to receive your order. If you live outside California, please allow three weeks to receive your order.

**In person –** Many libraries, post offices, and banks provide free California personal income tax booklets during the filing season. Most libraries and some quick print businesses have forms and schedules for you to photocopy (a nominal fee may apply).

**Note:** Employees at libraries, post offices, banks, and quick print businesses cannot provide tax information or assistance.

**By mail –** Write to:

TAX FORMS REQUEST UNIT
FRANCHISE TAX BOARD
PO BOX 307
RANCHO CORDOVA CA  95741-0307

## Letters

If you write to us, be sure your letter includes your FEIN, Secretary of State file number, California corporation number, or social security number, your daytime and evening telephone numbers, and a copy of the notice (if applicable). Send your letter to:

PROFESSIONAL RESOURCES AND
EDUCATION SECTION  MS F-228
FRANCHISE TAX BOARD
PO BOX 1468
SACRAMENTO CA  95812-1468

We will respond to your letter within six weeks. In some cases, we may need to call you for additional information.
**Note:** Do not attach correspondence to your tax return unless the correspondence relates to an item on your return.

## General Toll-Free Phone Service

Our general toll-free phone service is available:

- Monday – Friday, 7 a.m. until 8 p.m.; and
- Saturdays, 8 a.m. until 5 p.m. (January through June only)

**Note:** We may modify these hours without notice to meet operational needs.

From within the United States . . . . . . . . . (800) 852-5711
From outside the United States . . . . . . . (916) 845-6500 (not toll-free)

**Assistance for persons with disabilities:**
The FTB complies with the Americans with Disabilities Act. Persons with a hearing or speech impairments, call:

From TTY/TDD . . . . . . . . . . . . . . . . . . . . . (800) 822-6268
(Direct line to FTB customer service)

**Asistencia bilingüe en español:**
Nuestro servicio telefónico gratuito está disponible:

- Lunes-viernes de 7 a.m. a 8 p.m.
- Sábados de 8 a.m. a 5 p.m. (de enero a junio)

**Aviso:** Nosotros podemos modificar este horario sin aviso previo de acuerdo a la demanda operativa.

Dentro de los Estados Unidos llame al: . . (800) 852-5711 (libre de cargos)
Fuera de los Estados Unidos llame al: . . (916) 845-6500 (cargos aplican)

Página Electrónica: **www.ftb.ca.gov**

**Asistencia para personas discapacitadas:**
El FTB está en conformidad con el Acta de Americanos Discapacitados. Personas con problemas auditivos o de habla pueden llamar:

De TTY/TTD – Línea directa al servicio de clientes del FTB (800) 822-6268

## Geographic Boundaries

To find a street address within the EDA geographic boundaries, go to the California Technology, Trade and Commerce Agency's Website at: **www.commerce.ca.gov**

If you still need additional information about the EDA, you may contact the California Technology, Trade and Commerce Agency at:

ENTERPRISE ZONE PROGRAMS
CALIFORNIA TECHNOLOGY, TRADE AND
COMMERCE AGENCY
1102 Q STREET, SUITE 6000
SACRAMENTO CA 95814

Tel:  (916) 324-8211
Fax:  (916) 322-3524

## Economic Development Area Information

Further information about the former LARZ is available from:

FRANCHISE TAX BOARD
Telephone: (916) 845-3464
FAX: (916) 845-6791
Website: **www.ftb.ca.gov**

# THIS PAGE INTENTIONALLY LEFT BLANK

Go to our Website:

www.ftb.ca.gov