

**SECTION 19000 LOS ANGELES REVITALIZATION ZONE BUSINESS
EXPENSE DEDUCTION**

References (Repealed Sections) 17266(a); 24356.4(a)

The Los Angeles Revitalization Zone (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.

For income or taxable years beginning on or after January 1, 1992, and prior to January 1, 1998, the law allowed taxpayers, who conducted a trade or business within the LARZ, to elect to treat the cost of qualified property as a business expense rather than a capital item. The deduction was allowed for the income or taxable year in which the property was placed in service.

NOTE: The LARZ business expense deduction may not be generated in taxable or income years beginning on or after January 1, 1998. Taxpayers that receive a LARZ *business expense deduction* in their taxable or income year beginning on or after January 1, 1998, from a 1997 fiscal year pass-through entity *may* claim this deduction in their taxable or income year beginning on or after January 1, 1998.

EDAM 19100	GEOGRAPHIC BOUNDARIES
EDAM 19200	QUALIFIED TAXPAYER
EDAM 19300	QUALIFIED PROPERTY
EDAM 19400	DEDUCTION AMOUNT
EDAM 19500	MAKING THE ELECTION
EDAM 19600	CREATING A NET OPERATING LOSS
EDAM 19700	ALTERNATIVE MINIMUM TAX
EDAM 19800	CHECKLIST TO DETERMINE ELIGIBILITY FOR THE BUSINESS EXPENSE DEDUCTION
EDAM 19900	RECORD KEEPING REQUIREMENTS

19100 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 business expense deduction 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.

19200 Qualified Taxpayer

References (Repealed Sections) 17266(c)(1); 24356.4(c)(1)

EDAM 19210 Estates and Trusts
EDAM 19220 Pass-Through Entities

For purposes of the LARZ business expense deduction, *taxpayer* means a person or entity that conducts a trade or business within the LARZ.

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19210 Estates and Trusts

References (Repealed Section) 17266(e)

Estates and trusts are not allowed to take the business expense deduction.

The information provided in the Franchise Tax Board's internal procedure manuals does not reflect changes in law, regulations, notices, decisions, or administrative procedures that may have been adopted since the manual was last updated

19220 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 business expense deduction is allowed to the pass-through entity and passed through to the partners or shareholders.

19300 Qualified Property

References (Repealed Sections) 17266(c); 17266(g); 24356.4(c); 24356.4(e)

EDAM 19310 Leased Property
EDAM 19320 Property Not Qualified

Qualified property is IRC § 1245 property (as defined in section 1245(a)(3) of the Internal Revenue Code) purchased and placed in **service on or after September 1, 1992**, for *exclusive use* in a trade or business conducted within the LARZ. The property must also be purchased and placed in service *before* the date the LARZ designation expires, is repealed, or becomes inoperative.

Qualified property under IRC § 1245 includes, but is not limited to, tangible personal property (excluding buildings and inventory) that is subject to the allowance for depreciation. This includes most equipment and furnishings purchased for exclusive use within the LARZ. Office supplies and other small non-depreciable items are not included.

19310 Leased Property

Taxpayers who acquire property by lease arrangement may be able to take the business expense deduction. The structure of the leasing arrangement itself is critical. Lease arrangements structured using a financial (conditional sales) contract generally will qualify the taxpayer to take the business expense deduction. 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.

19320 Property Not Qualified

References (Repealed Sections) 17266(c); 17266(d); 17266(f); 24356.4(c); 24356.4(d)

The business expense deduction is not allowed if the property:

- Was transferred between members of an affiliated group;
- Was acquired as a gift or inherited;
- Was traded for other property;
- Was received from a personal or business relation as defined by IRC § 267, as modified by 17266(c)(3)(A) and 24356.4(c)(3)(A);
- Was received from a personal or business relation as defined by IRC § 707(b); or
- Is described in IRC § 168(f).

19400 Deduction Amount

References (Repealed Sections) 17266; 24356.4

- EDAM 19410 Basis reduction / Depreciation
- EDAM 19420 Interaction with the Manufacturer's Investment Credit
- EDAM 19430 Recapture

There are no limitations for the LARZ business expense deduction. The full cost of the qualified property can be expensed. However, the basis of the asset is to be reduced by the expense deduction claimed.

This deduction is available for income or taxable years beginning on or after January 1, 1992 and before January 1, 1998. No deduction is allowed for property purchased after the date the LARZ designation expires, is repealed, or becomes inoperative.

19410 Basis reduction / Depreciation

References (Repealed Sections) 17266(a); 24356.4(a)

Taxpayers electing to take the business expense deduction cannot claim the additional first year depreciation allowed under IRC § 179 / CR&TC § 24356 for the same property.

The basis of the asset is to be reduced by the expense deduction claimed.

19420 Interaction with the Manufacturer's Investment Credit

References 17053.49(b)(1)(C); 23649(b)(1)(C)

Taxpayers claiming the business expense deduction and the Manufacturers' Investment Credit (MIC) for the same property must reduce MIC qualified costs by the amount of the business expense deduction before computing the MIC. Taxpayers that elect to take the business expense deduction are not allowed to capitalize the expensed amount.

19430 Recapture

References (Repealed Sections) 17266(h); 24356.4(f): See also Cal. Code Regs. (CCR) § 17267.2-1(a); 24356.7-1

The business expense deduction is subject to recapture (added back to income) if, before the *close of the second income or taxable year after* the property is placed in service, the property is sold, disposed of, or is no longer used exclusively within the LARZ trade or business.

To recapture the amount deducted, add to the current year income, the amount previously deducted for that property.

Example: Corp A purchases property on June 1, 1995, that qualifies it to take the LARZ business expense deduction. Corp A's taxable year ends December 31 of each year. Corp A disposes of the property August 5, 1997. The previous deduction is added to income in the 1997 taxable year because the property was disposed of before the close of the second taxable year after the property was placed in service (12/31/1997). The basis in the asset is increased by the recaptured amount effective January 1, 1997.

NOTE: The State Board of Equalization in an unpublished and uncitable decision held 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.*

19500 Making the Election

References (Repealed Sections) 17266(a); 17266(b); 24356.4(a); 24356.4(b)

The taxpayer must make an election to treat the cost of qualified property as a business expense, on the original return filed for the income or taxable year the property is first placed in service. The election must specify the items to which the election applies and the cost taken into account for purposes of determining the deduction amount.

The election may not be revoked, unless the taxpayer has obtained the consent of the Franchise Tax Board.

NOTE: For the 1992 income or taxable year, a taxpayer could file an amended return to claim the LARZ business expense deduction. The amended return had to be filed no later than June 30, 1994 (see [FTB Notice 93-9](#)).

The taxpayer makes the election by using:

- [Form FTB 3806](#) - Los Angeles Revitalization Zone Deduction and Credit Summary.

19600 Creating a Net Operating Loss

Unlike IRC § 179, there is *no* statutory prohibition on the amount of business expense deduction that may create a net operating loss.

19700 Alternative Minimum Tax

References 17062; 23457

The business expense deduction is *not* listed as a tax preference item.

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19800 Checklist To Determine Eligibility for the Business Expense Deduction

Checklist Items	Yes	No
<p>Is the business qualified?</p> <ul style="list-style-type: none"> Is a trade or business conducted within the LARZ? See EDAM 17200, "Taxpayer Defined". 		
<p>Is the property qualified?</p> <ul style="list-style-type: none"> Qualified property is Section 1245 property. See EDAM 18400, "Qualified Property". Is the property used exclusively within the boundaries of the LARZ? 		
<p>Is the correct deduction amount claimed?</p> <ul style="list-style-type: none"> Verify purchase on invoices or receipts. Verify the date the property is placed in service. The deduction is only available for income or taxable years beginning on or after January 1, 1992 and before January 1, 1998. 		
<p>Was a timely election made?</p> <ul style="list-style-type: none"> Election made on original return? Form FTB 3806 – Los Angeles Revitalization Zone Deduction and Credit Summary, or a separate statement attached to the return? 		
<p>Was the property acquired through a valid transaction?</p> <ul style="list-style-type: none"> See EDAM 19320, "Property Not Qualified". 		
<p>Were other deductions claimed for the same property? IRC § 179 expense may not be claimed for qualified property for which the business expense deduction is claimed.</p>		
<p>Is the deduction subject to recapture?</p> <ul style="list-style-type: none"> Was the property sold, disposed of or no longer used by the taxpayer in the LARZ, before the close of the second income or taxable year after the property was placed in service? Check current location of the qualified property. Check sale or disposal date of qualified property. 		

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19900 Record Keeping Requirements

To support the business expense deduction 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.); and
- The location where the property is used