Enterprise Zone Investment Tax Credit

WHAT IS THE ENTERPRISE ZONE INVESTMENT TAX CREDIT (ITC)?

The enterprise zone investment tax credit is three percent of any qualified investment in section 38 property acquired and placed in service or constructed during the tax year, and used exclusively in a Colorado enterprise zone for the first year of its ownership by the taxpayer. [§39-30-104 (1) C.R.S. The enterprise zone investment tax credit with respect to any qualified investment is in lieu of any "old" (§39-22-507.5 C.R.S.) investment tax credit otherwise allowed with respect to the same expenditure.

NOTE: "Section 38 property" is defined in section 48 of the Internal Revenue Code as that section existed prior to 1990.

For income tax years beginning on or after Jan. 1, 1997, except to the extent such relocation meets the criteria for an expansion as described in Section 39-22-508.2(2)(b) and (2)(c), no investment tax credit shall be allowed if the investment resulted from the relocation of a business operation from within the state to an enterprise zone. This is regardless of whether the original location of the operation was within an enterprise zone. [§39-30-104 (6) C.R.S.] Expansion facilities are described in FYI Income 10 "Enterprise Zone New Business Facility Employee Credits."

WHAT ARE QUALIFIED INVESTMENTS?

The value of investments must be reduced before the three percent ITC rate is applied if the depreciable life of the asset falls into certain categories.

In the case of section 38 recovery property, the amount of qualified investment is the sum of these property classes:

1) 100 percent of the basis of 15-year public utility, 10-year, and 5-year recovery property; plus

2) 60 percent of 3-year recovery property; plus

3) Either 100 percent of the cost of class 1 used recovery property up to $150,000;or 60% of the cost of class 2 used recovery property up to $150,000.

In the case of section 38 property that is not recovery property, the cost or other basis (including up to $150,000 of used property) that qualifies is limited if the property has a useful life of less than seven years. Only two-thirds of the basis or cost is taken into account if the useful life is at least five and less than seven years. Only one-third is taken into account where the useful life is at least three and less than five years. No credit is allowed if the useful life is less than three years.

All other Internal Revenue Code section 46 (as such section existed prior to 1990) restrictions on qualified investment also apply for purposes of the Colorado enterprise zone investment tax credit. For example, any amounts expensed under section 179 of the Internal Revenue Code do not qualify.

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WHAT IS SECTION 38 PROPERTY?

Section 38 property is either federal recovery property or other depreciable or amortizable property having a useful life of three years or more that qualifies under one of the following eight categories:

1) Tangible personal property.

a. In general, tangible personal property used in a taxpayer's trade or business is section 38 property. This includes items such as machinery, furniture, appliances, law books or vehicles. (Remember, vehicles and other mobile property must be used solely and exclusively within an enterprise zone for at least the first 12 months of service to qualify for this credit.) Three specific items of tangible per sonal property excluded from the definition of section 38 property are:

    i. air conditioning units,

    ii. heating units, and

    iii. certain boilers fueled by petroleum or petroleum product that fail to meet special qualifications (old federal code section 48(a)(10)).

b. Livestock. Depreciable livestock (not including horses) is section 38 property if it has a three-year useful life. However, if within a one-year period starting six months before the date of acquisition, substantially identical livestock is disposed of without any federal investment tax credit recapture, the credit will be allowed only on the excess of the cost of the acquired livestock over the amount realized on the disposition. The age and sex of the livestock, and the use to which it is put, determine whether the livestock disposed of is substantially identical.

c. Lodging. Tangible personal property used predominately to furnish lodging (or in connection with furnishing lodging) is not section 38 property except when such property is used in connection with a hotel or motel furnishing accommodations predominately to transients. However, coin operated vending machines, washing machines and dryers are section 38 property even when they are used in connection with the furnishing of lodging. Tangible personal property used as part of the rehabilitation of certified historic structures is section 38 property even though the structure is used to furnish lodging. Also, non-lodging commercial facilities, such as tangible personal property in a drug store or restaurant situated in an apartment building or hotel, can qualify as section 38 property if they are available to persons not using the lodging facilities.

2) Other tangible property. Other tangible property (including real property but not including a building or its components) is section 38 property if it is used as an integral part of:

a. manufacturing,

b. extraction,

c. production, or

d. furnishing of transportation, communications, electrical energy, gas water, or sewage disposal services.

This category would include such things as blast furnaces, oil and gas pipelines, railroad tracks and signals, telephone poles, broadcasting towers, oil derricks, and fences used to confine livestock.

3) Elevators and escalators. Elevators and escalators are specifically included in the definition of section 38 property.

4) Research facilities and facilities for the bulk storage of fungible commodities. Research facilities and facilities for the bulk storage of fungible commodities (including liquids or gases) are section 38 property but only to the extent they are used in connection with the activities described in category 2) above. Fungibles are commodities, such as oil or grain, that can be mixed together. Later, they can be returned to parties in the mixed state. For example, if two people put grain in a grain silo, they could each pull out the original amount put in, but the grains would be mixed.

5) Single purpose agricultural or horticultural structures. Single purpose agricultural or horticultural structures may be section 38 property. A single purpose agricultural structure is section 38 property if it is designed, constructed, and used for housing, raising and feeding a particular type of livestock, such as cattle, pigs, or poultry, and their produce, and housing the equipment necessary for the particular activity.

A horticultural structure is section 38 property if it is specifically designed, constructed, and used for the commercial production of plants and/or mushrooms. Work space in the structure is permitted if such space is used solely for stocking or caring for livestock or plants, for collecting their produce or for maintaining the structure and equipment or stock housed in it.

6) Qualified rehabilitation expenditures. Qualified rehabilitation expenditures are section 38 property.

7) Qualified timber property. Qualified timber property for which amortization is claimed under Internal Revenue Code section 194 is section 38 property.

8) Petroleum storage facilities. Storage facilities used in connection with the distribution of petroleum or its primary products are section 38 property.

LEASED PROPERTY

The owner of the property may elect to pass on the investment credit to the lessee of the property if the leased property is new section 38 property and is qualifying property both to the owner and to the lessee. A lessor cannot pass on the credit for used property to the lessee.

Non-corporate lessors and S corporation lessors are eligible for the enterprise zone investment credit only if:

- the leased property has been manufactured or produced by lessor, or
- the term of the lease is less than 50 percent of the January 1, 1986 Asset Depreciation Range (ADR) class life for recovery property (useful life for other property) of the leased property,
- and the lessor's business expense deductions (other than rental payments and reimbursed expenses) related to the property are more than 15 percent of the rental income from the property for the first year of the lease.

Where new section 38 property with an ADR class life of more than 14 years is leased (not a net lease) for a period which is shorter than 80 percent of its class life, the lessor may pass through to the lessee only that portion of the credit which the lease period covers.

The investment tax credit will not be allowed when a tax-exempt organization sells depreciable property to pass the tax benefits to the new owners and then leases back the property.

COMMON QUESTIONS

Are there limits on how much Enterprise Zone Investment Tax Credit I can claim in one year?

For tax years beginning prior to Jan. 1, 1996, the Enterprise Zone Investment Tax Credit could be claimed to the extent of the first $5,000 of tax liability plus 25 percent of the liability in excess of $5,000. For years beginning on or after Jan. 1, 1996, the credit is allowed to the extent of the first $5,000 of tax liability, plus 50 percent of the liability in excess of $5,000.

If you have more ITC than you can claim based on the limits of your tax liability in a particular year, you can carry the unused amount of your ITC back three years and forward up to twelve years. (Seven years for credits earned in taxable years beginning prior to Jan. 1, 1996.)

Can the Enterprise Zone Investment Tax Credit and the "new" corporate one percent Investment Tax Credit be claimed for the same property?

Yes. The new investment credit may be claimed only by C corporations.

Does claiming the Enterprise Zone Investment Tax Credit reduce my tax basis in the property?

No.

Can tangible property expensed under Section 179 be used to claim this credit?

No.

FURTHER INFORMATION

For more information on related topics, consult the following DOR publications:

FYI General 1 "Department of Revenue Publications";

FYI General 6 "General Information About Colorado Enterprise Zones";

FYI Income 10 "Enterprise Zone New Business Facility Employee Credits";

FYI Income 22 "Research and Development Income Tax Credit For Enterprise Zones";

FYI Income 23 "Tax Credit for Private Contributions to Enterprise Zone Programs";

FYI Income 24 "Tax Credit for the Rehabilitation of Vacant Buildings in an Enterprise Zone";

FYI Sales 10 "Sales/Use Tax Exemption for Manufacturing Equipment";

FYI General 8 "The FYI Program - Index and General Information."

Single FYIs are free from the Taxpayer Service Division. They may be obtained at any statewide Taxpayer Service Center; or by writing to the Colorado Department of Revenue, 1375 Sherman St., Denver, CO 80261; or by calling the DOR Forms Hotline at (303) 232-2414. Please use the FYI number (General 1, Sales 9) when ordering FYI publications. FYIs and commonly used forms are available on the Web at *www.revenue.state.co.us*

For a complete set of FYIs (approximately 130, on sales, income, excise and withholding taxes), you may purchase The Complete Book of FYIs at low cost from the State Forms Center, Division of Correctional Industries, 4200 Garfield St., Denver, CO 80216. An order form is contained in FYI General 1, or call the State Forms Center, (303) 321-4164, for ordering information.