# ANALYSIS OF AMENDED BILL

**Franchise Tax Board**

Author: Assembly Budget Committee | Analyst: Jahna Alvarado | Bill Number: AB 103

Related Bills: See Legislative History | Telephone: 845-5683 | Amended Dates: March 14, 17, & 24, 2011

Attorney: Patrick Kusiak | Sponsor:

**SUBJECT**: Geographically Targeted Economic Development Area (GTEDA) Tax Incentives/ Eliminate GTEDA Credit Carryover & Recalculate NOL Carryover/Business Income Apportionment/Repeal Elective Single sales Factor & Add Mandatory Single Sales Factor

## SUMMARY

Provisions of this bill would make the following changes:

**Provision 1:** Repeal the geographically targeted economic development area (GTEDA) tax incentives.

**Provision 2:** Modify the apportioning rules for multistate taxpayers.

This analysis will not address the bill's changes to the Insurance Taxation Law, Vehicle Code, and Welfare and Institutions Code as they do not impact the department or state income tax revenue.

This is the department's first analysis of the bill. The provisions of the bill will be discussed separately.

## SUMMARY OF AMENDMENTS

The March 14, 2011, amendments replaced the bill language as introduced on January 10, 2011, with the provisions discussed in this analysis. The provisions that would repeal the GTEDA tax incentives will be discussed separately from the provisions that would modify the apportioning rules.

The March 17, 2011, amendments would make changes to the Insurance Taxation Law, Vehicle Code, and Welfare and Institutions Code. The amendments would also add off-code language, including a requirement that the Director of Finance notify the Franchise Tax Board's (FTB) Chief Executive Officer, among others, upon approval by the voters during a statewide election during 2011 of an extension of the increased vehicle license fee rates. These amendments would not impact the department's programs or operations or state income tax revenue and therefore are not discussed in this analysis.

The March 24, 2011, amendments added references to former code sections 17276 and 24416 to a provision of the Personal Income Tax Law (PITL) and Corporation Tax Law (CTL) respectively.

| Board Position: | | | Executive Officer | Date |
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| _____ N | _____ OUA | | | |

The additional references are unnecessary. Technical amendments 1 and 2 are provided to eliminate these references.

**RECOMMENDATION AND SUPPORTING ARGUMENTS**

No position.

**Summary of Suggested Amendments**

Technical amendments 1 and 2 are suggested to remove unnecessary references.

**PURPOSE OF THE BILL**

According to the bill's language, the purpose of AB 103 is to address the fiscal emergency declared and reaffirmed by the Governor by proclamation on January 20, 2011.

**EFFECTIVE/OPERATIVE DATE**

As an urgency measure, this bill would be effective and operative immediately upon enactment and would specifically apply to taxable years beginning on or after January 1, 2011.

**ECONOMIC IMPACT – SUMMARY REVENUE TABLE**

| | Estimated Revenue Impact of Provisions 1 and 2 of AB 103<br>As Amended March 24, 2011<br>Effective for Taxable Years Beginning On or After January 1, 2011<br>Enactment Assumed On or Before April 15, 2011<br>($ in Millions) | | | | |
|---|---|---|---|---|---|
| | 2010-11 | 2011-12 | 2012-13 | 2013-14 | 2014-15 |
| Provision 1: Repeal GTEDA Tax Incentives | $43 | $650 | $650 | $600 | $600 |
| Provision 2: Modify The Apportioning Rules For Multistate Taxpayers | $300 | $1,000 | $1,100 | $1,100 | $1,000 |

## PROVISION NO. 1: REPEAL GTEDA TAX INCENTIVES

**ANALYSIS**

FEDERAL/STATE LAW

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Existing federal law provides special tax incentives for empowerment zones and enterprise communities to provide economic revitalization of distressed urban and rural areas.

Under the Government Code, state law provides for several types of GTEDAs: Enterprise Zones (EZs), Manufacturing Enhancement Areas (MEAs), Targeted Tax Areas (TTAs), and Local Agency Military Base Recovery Areas (LAMBRAs).

Under the Revenue and Taxation Code (R&TC), existing state law provides special tax incentives for taxpayers conducting business activities within a GTEDA. These incentives include a hiring credit, sales or use tax credit, business expense deduction, and special net operating loss treatment. Two additional incentives include net interest deduction for businesses that make loans to businesses within GTEDAs and a credit for employees working in an EZ. The following table shows the incentives available to each of the economic development areas. Additional detail on each of the incentives appears in Attachment A.

| Types of Incentives | EZ | LAMBRA | TTA | MEA |
|---|---|---|---|---|
| Sales or Use Tax Credit | X | X | X | |
| Hiring Credit | X | X | X | X |
| Employee Wage Credit | X | | | |
| Business Expense Deduction | X | X | X | |
| Net Interest Deduction | X | | | |
| Net Operating Loss | X | X | X | |

In addition to the current GTEDAs, unused incentives generated within the former Los Angeles Revitalization Zone (LARZ) could be carried forward for up to 15 years. The carryover period could be extended for up to two years if a LARZ credit carryover had been suspended during either or both taxable years 2008 and 2009.

Under general provisions regarding credits, unless otherwise provided, any remaining carryover of a credit allowed by a section that has been repealed or made inoperative shall continue to be allowed to be carried over under the provisions of the section as it read immediately prior to being repealed or becoming inoperative.

THIS PROVISION

This provision would, for taxable years beginning on or after January 1, 2011, repeal the GTEDA tax incentive provisions of the R&TC and would eliminate the carryover of unused GTEDA credits.

This provision would recalculate any unused GTEDA net operating loss (NOL) as if the underlying loss had been subject to the general NOL carryover provisions in effect for the year the loss was generated. The recalculated amount, if greater than zero, could be carried forward for the remainder of the carryforward period allowed for the year the underlying loss was generated, if any.

GTEDA NOL carryover amounts deducted in prior years would be unaffected by the changes that this provision would make.

IMPLEMENTATION CONSIDERATIONS

Implementing this provision would require changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

GTEDA hiring and sales and use tax credits are allowed in lieu of otherwise allowable deductions, e.g., reporting a hiring credit would require that the wage deduction be reduced for the wages upon which the credit is based. Because amended returns may be filed so long as the underlying statute of limitations remains open, eliminating the carryforward of unused GTEDA credits could result in an increased volume of amended returns being filed to reduce unused credit carryovers that this bill would render useless in favor of the foregone deductions.

TECHNICAL CONSIDERATION

On page 111, line 33, the unnecessary reference to former Section 17276 should be struck out. An amendment is provided.

On page 186, line 30, the unnecessary reference to former Section 24416 should be struck out. An amendment is provided.

**LEGISLATIVE HISTORY**

SB 79 (Senate Budget & FR, 2011/2012) is identical to AB 103 and would make the same changes to the GTEDA incentives that this bill would make. SB 79 is currently pending before the Assembly Committee on Budget.

AB 1452 (Committee on Budget, Stats. 2008, Ch. 763) among other things, limited the allowable business credit to 50 percent of the total tax prior to application of any credits and suspended the NOL for taxpayers with business income equal to or greater than $500,000 for taxable years 2008 and 2009. The carryforward period for any disallowed credit or suspended NOL was extended for a period equal to the suspension period.

ABX3 35 (Calderon, 2007/2008) would have suspended the operation of the EZ special tax incentive provisions for taxable years beginning on or after January 1, 2009. AB X3 35 failed to pass prior to the adjournment of the third extraordinary session of 2007/2008.

**OTHER STATES' INFORMATION**

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota,* and *New York.* These states were selected due to their similarities to California's economy, business entity types, and tax laws.

*Florida* allows several incentive provisions to encourage businesses in the revitalization of enterprise zones. The Florida Enterprise Zone Act and various tax incentive provisions are set to expire on December 31, 2015.

*Illinois* has 95 enterprise zones, *Massachusetts* has an Economic Development Incentive Program*, Michigan* has in excess of 150 geographic areas designated as Renaissance Zones, and *Minnesota* has 5 zone-based tax incentive programs, and *New York* has 72 Empire Zones.

*New York's* Empire Zone program sunset as of June 30, 2010. Businesses certified in the program prior to the sunset date remain in the program, and continue to be eligible for all the Empire Zone benefits, for the rest of their benefit period as long as they remain in compliance with the law and Empire Zone regulations.

**FISCAL IMPACT**

Initially, eliminating the GTEDA tax incentives and revising unused GTEDA NOL carryforward amounts would require eliminating various forms and booklets, creating new NOL forms and instructions, programming changes to computer systems, and could result in an increase in taxpayer phone calls and correspondence with the department regarding the impact of eliminating the incentives, and filing errors to the extent that credits and deduction that would no longer be allowed continue to be reported. The costs to administer these provisions have not been determined but are expected to be minor, and any increase in volumes would be incorporated in to existing workloads.

Any savings that might result from this proposal would be re-directed towards other revenue producing programs.

**ECONOMIC IMPACT**

| Estimated Revenue Impact of Provision 1 of AB 103<br>As Amended March 24, 2011<br>Repeal GTEDA Tax Incentives<br>Effective for Taxable Years Beginning On or After 1/1/2011<br>Enactment Assumed On or Before 4/15/2011<br>($ in Millions) | | | | |
|---|---|---|---|---|
| 2010-11 | 2011-12 | 2012-13 | 2013-14 | 2014-15 |
| $43 | $650 | $650 | $600 | $600 |

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

**SUPPORT/OPPOSITION**

Support: None identified to date

Opposition: None identified to date

**ARGUMENTS**

Pro: Proponents would argue that GTEDA programs are among the few incentives available in local communities to attract businesses and retain jobs.

Con: Opponents would argue that the best available independent research finds that the state's GTEDA programs fail to create jobs or new businesses–key goals of the programs.

## PROVISION NO. 2: MODIFY THE APPORTIONING RULES FOR MULTISTATE TAXPAYERS.

### ANALYSIS

STATE LAW

Current state law provides the following general rules to determine the amount of income reportable to California for entities that conduct business both within and outside of California.

Doing Business in California

In 2009, California established a bright-line test to determine if a taxpayer is doing business in California. The test is met if any of the following are satisfied.[1]

- The taxpayer is organized or commercially domiciled in California.
- The taxpayer's sales in California exceed the lesser of $500,000 or 25 percent of the taxpayer's total sales, including sales by an agent or independent contractor.
- The real and tangible personal property owned or rented by the taxpayer in California exceeds the lesser of $50,000 or 25 percent of the total owned or rented real and tangible personal property.
- The amount of compensation paid to an employee by the taxpayer in California exceeds the lesser of $50,000 or 25 percent of the total compensation paid by the taxpayer.

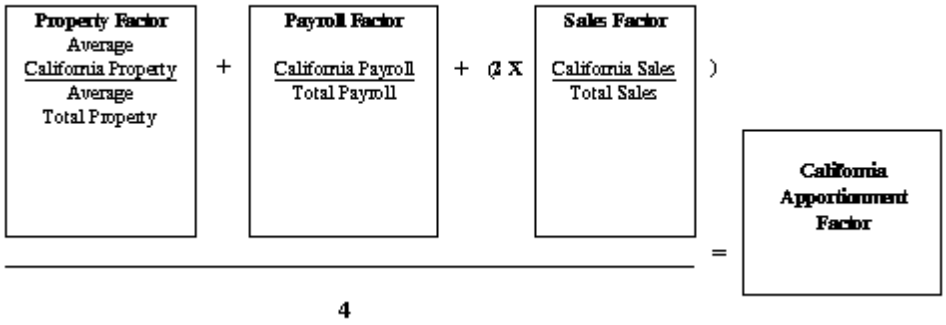
If the taxpayer meets the bright-line test, then it must apportion its income to California using the applicable apportionment formula.

Apportionment Formula

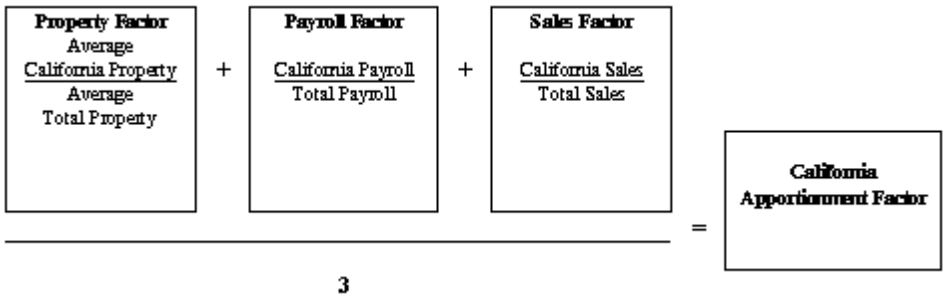
State law uses an apportionment formula to determine the amount of "business" income attributable to California.[2] The apportionment formula consists of property, payroll, and sales factors. Each of these factors is a fraction: the numerator is the value of the item in California and the denominator is the value of the item everywhere. The property factor generally includes tangible property owned or rented during the taxable year; the payroll factor includes all forms of compensation paid to employees; and the sales factor generally includes all gross receipts from the sale of tangible and intangible property.

[1] Federal law commonly referred to by tax practitioners as PL 86-272, still applies to sellers of tangible personal property. As a result, if a taxpayer's activities in California stay within the protections of PL 86-272, a taxpayer also remains protected from the imposition of those taxes that are computed based on net income, namely, the California franchise and income tax. Nevertheless, if a taxpayer is considered doing business in California under Revenue and Taxation Code (R&TC) Section 23101(a) or (b), it still has a filing requirement and will be subject to the minimum tax because that tax is not computed based on net income and therefore is not subject to the protections of PL 86-272.

[2] "Business income attributable to California" is a taxpayer's "business income" multiplied by its California apportionment formula. R&TC section 25120(a) defines "business income" as income arising from transactions and activities in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.




For taxable years beginning on or after January 1, 1993, the apportionment formula for most taxpayers has been a three-factor apportionment formula consisting of property, payroll, and double-weighted sales (three-factor, double-weighted sales,[3] illustrated above). An exception to this rule exists for taxpayers of an apportioning trade or business that derive more than 50 percent of its gross business receipts from conducting a "qualified business activity."[4] These "qualified business activity" taxpayers are required to use a three-factor, single-weighted sales[5] apportionment formula (illustrated below).




For taxable years beginning on or after January 1, 2011, an apportioning trade or business (other than an apportioning trade of business that derives more than 50 percent of its gross business receipts from conducting a qualified business activity), is allowed to make an annual, irrevocable election to utilize a single factor, 100 percent sales (single sales factor), apportionment formula instead of the three-factor, double-weighted sales apportionment formula.

California Sales / Total Sales equals California apportionment factor

The election must be on a timely-filed original return in the manner and form prescribed by the FTB.

[3] This formula is sometimes referred to as the "four-factor" formula because of double weighting of the sales and the denominator used is "4."

[4] Extractive, agriculture, savings and loan, and banks and financials.

[5] This formula is sometimes referred to as the "three-factor" formula because the sales are single weighted and the denominator used is "3."

Assignment of Sales Rules

California has two basic rules for assigning sales.

An apportioning trade or business that has not made an election to utilize the single sales factor apportionment formula must use the pre-2011 income producing activity/cost of performance rules (see below) to assign all sales other than sales of tangible personal property, regardless of taxable year.

If the single sales factor election is made inoperative by future legislation, all apportioning trades or businesses would be required to use the pre-2011 rules (see below) for assigning all sales other than sales of tangible personal property, commonly called ”cost of performance.”

An apportioning trade or business that has made a single sales factor election must utilize the post-2010 rules (see below) operative for years beginning on or after January 1, 2011, commonly referred to as the “market rule,” to assign all sales other than sales of tangible personal property, namely sales of intangibles and services.

**Pre-2011 Rules For Assigning Sales**

Sales of Tangible Personal Property before 2011 (Joyce Rule)

- Sales of tangible personal property are assigned to California if the product is delivered or shipped to a purchaser in this state, and the taxpayer (seller) is taxable in this state.
- Sales of tangible personal property are assigned to California if the product is delivered or shipped from California to a purchaser out of state, and the taxpayer (seller) is not taxable in the state of destination.
- Sales of tangible personal property to the U.S. Government are assigned to California if the goods are shipped from California.

This is commonly called the Joyce rule because the rule was declared in a decision of the Board of Equalization.[6]

Sales of Other Than Tangible Personal Property (Intangibles and Services)

- Sales from intangibles and all other services are assigned to California if the income producing activity that gave rise to the receipts is performed wholly within California. If the income producing activity is performed within and outside the state, the sales from intangibles and all other services are assigned to California if the greater cost of performance of the income producing activity is performed in this state. For example, a taxpayer provides non-personal services to a client in California. The taxpayer incurs direct costs (salaries, equipment costs, etc.) to provide the service in Oregon and California. The total costs are $10,000. The Oregon costs are $4,800 (48%). The California costs are $5,200 (52%). Based on the greater cost of performance, 100 percent of the receipts for the service provided to the California client would be assigned to California.

[6] *Appeal of Joyce*, 66-SBE-069, November 23, 1966

- Sales from the performance of personal services are assigned to California if the services are performed in California. If personal services are performed in more than one state, the receipts from the services are assigned to California based on the ratio of time spent performing such services in the state to total time spent in performing such services everywhere. For example, a taxpayer provides personal services for a single client in Oregon, Nevada, and California. The total time spent is 1,000 hours for all of the services. The hours are divided between the states as follows: 600 hours in Oregon, 100 hours in Nevada, and 300 hours in California. The total receipts for the services for the client are $20,000. Based on the ratio of time spent, the amount assigned to California is $6,000, which is 30 percent of the total time.

- Sales from the sale, rental, lease, or licensing of real property and the receipts derived from the rental, lease, or licensing of tangible personal property are assigned to California if the property is located in California.

**Post-2010 Rules For Assigning Sales**

Sales of Tangible Personal Property (Finnigan Rule)

- Sales of tangible personal property are assigned to California if the product is delivered or shipped to a purchaser in this state, and the taxpayer (seller) or any member of the taxpayer's combined reporting group[7] is taxable in this state.
- Sales of tangible personal property are assigned to California if the product is delivered or shipped to a purchaser out of state and neither the taxpayer (seller) nor any other member of the combined reporting group is taxable in the state of destination.
- Sales of tangible personal property to the U.S. Government are assigned to California if the goods are shipped from California.

Sales of Other Than Tangible Personal Property (Intangibles and Services)

- Sales from services are assigned to California to the extent the purchaser of the service receives the benefit of the service in California. (Market Rule)
- Sales from intangible property are assigned to California to the extent the property is used in California. In the case of marketable securities, sales are assigned to California if the customer is in California. (Market Rule)
- Sales from the sale, lease, rental, or licensing of real property are assigned to California if the real property is located in California.
- Sales from the rental, lease, or licensing of tangible personal property are assigned to California if the property is located in California.

[7] A combined report is a report (a single tax form for the group) in which the business income and apportionment factors of a unitary group of corporations are combined for purposes of determining each taxpayer's share of the California unitary business income. A combined reporting group would be all of the taxpayers included in a single combined report.

THIS PROVISION

This provision would do the following:

- Make the single sales factor apportionment formula mandatory for all taxpayers, except those in a qualified business activity (extractive, agricultural, savings and loans, and banks and financials) for taxable years beginning on or after January 1, 2011.
- Repeal the elective single sales factor provisions.
- Remove references to the provisions of the repealed elective single sales factor.
- Revise the provision that determines how to assign sales of other than tangible personal property, to require all taxpayers, including those businesses in a qualified activity, to use the "market rule" for assigning sales of other than tangible personal property to California for taxable years beginning on or after January 1, 2011.

IMPLEMENTATION CONSIDERATIONS

Implementing this provision would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

**LEGISLATIVE HISTORY**

AB 116 (DeLeon, 2011/2012) would mandate the use of the single sales formula for all companies except for those in a qualified business activity, which, as under current law, would continue to use the three-factor formula. This bill is currently on the Senate floor.

SB 79 (Senate Budget & FR, 2011/2012) is identical to AB 103 and would make the same changes to the apportioning rules that this bill would make. SB 79 is currently pending before the Assembly Committee on Budget.

AB 1935 (DeLeon, 2009/2010) would have mandated the use of the single sales formula for all companies except for financial institutions and oil companies, which, as under current law, would continue to use the three-factor formula. This bill moved from the Assembly Appropriations Committee without further action.

SB 858 (Stats. 2010, Ch. 721, Committee on Budget and Fiscal Review), among other things, reinstated the "cost of performance" rules for assigning the sales of intangibles and services for non-electors of the single sales factor formula.

SBX3 15 (Stats. 2009/2010 Third Extraordinary Session, Ch. 17, Calderon), allowed specific entities to elect to utilize a sales only formula to apportion its income subject to franchise or income tax and modified the rules for assigning certain receipts for inclusion in the sales factor.

SBX6 18 (Steinberg and Alquist, 2009/2010) would have required the use of the single sales factor formula for apportioning income for taxpayers not in a qualified activity. No hearing was held for the bill.

## OTHER STATES' INFORMATION

In addition to California, 24 states have implemented or are in the process of phasing-in the single factor apportionment method. Of these, 18 states require use of the single sales factor: *Colorado, Georgia, Illinois, Indiana, Iowa, Louisiana, Maine, Massachusetts, Michigan, Minnesota, Mississippi, Nebraska, New York, Oregon, South Carolina, Texas, Washington*, and *Wisconsin*. Moreover, only one state (*Missouri*) is like California's law, which allows corporations to annually elect which formula they prefer.

## FISCAL IMPACT

This provision would not significantly impact the department's costs.

## ECONOMIC IMPACT

| Estimated Revenue Impact of Provision 2 of AB 103<br>As Amended March 24, 2011<br>Modify The Apportioning Rules For Multistate Taxpayers.<br>Effective for Taxable Years Beginning On or After January 1, 2011<br>Enactment Assumed On or Before April 15, 2011<br>($ in Millions) | | | | |
|---|---|---|---|---|
| 2010-11 | 2011-12 | 2012-13 | 2013-14 | 2014-15 |
| $300 | $1,000 | $1,100 | $1,100 | $1,000 |

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

## SUPPORT/OPPOSITION

Support: Northern California Life Sciences Association
Health and Human Services Network

Opposition: California Manufacturing and Technology Affiliation
California Tax Reform Association
California Chamber of Commerce

## ARGUMENTS

Pro: Proponents would argue that the use of a mandatory single sales factor removes any unintended advantage an out-of-state company could receive from the ability to annually choose the apportioning method that results in the least amount of state tax.

Con: Proponents would argue that allowing businesses to choose the best formula to operate, employ and sell in the state charts the greatest path towards California's economic recovery.

## LEGISLATIVE STAFF CONTACT

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# FRANCHISE TAX BOARD'S PROPOSED AMENDMENTS TO AB 103

## AMENDMENT 1

On page 111, line 33, strikeout "17276,".

## AMENDMENT 2

On page 186, line 30, strikeout "24416,".

Attachment A
AB 103
As Amended March 14, 17, & 24, 2011

## Sales or Use Tax Credit

The sales or use tax credit is allowed for an amount equal to the sales or use taxes paid on the purchase of qualified machinery purchased for exclusive use in an economic development area (except a Manufacturing Enhancement Area (MEA)). The amount of the credit is limited to the tax attributable to economic development area income. Qualified property is defined as follows:

**Enterprise Zone or Targeted Tax Area (TTA):**

- machinery and machinery parts used for:
  - manufacturing, processing, assembling, or fabricating;
  - producing renewable energy resources; or
  - air or water pollution control mechanisms.
- data processing and communication equipment.
- certain motion picture manufacturing equipment.

**Local Agency Military Base Recovery Area (LAMBRA):**

- high-technology equipment (e.g., computers);
- aircraft maintenance equipment;
- aircraft components; or
- certain depreciable property.

In addition, qualified property must be purchased and placed in service before the economic development area designation expires. The maximum value of property that may be eligible for the enterprise zone, LAMBRA, and TTA sales or use tax credit is $1 million for individuals and $20 million for corporations.

## Hiring Credit

A business located in an economic development area may reduce tax by a percentage of wages paid to qualified employees. A qualified employee must be hired after the area is designated as an economic development area and meet certain other criteria. At least 90 percent of the qualified employee's work must be directly related to a trade or business located in the economic development area and at least 50 percent must be performed inside the economic development area. The business may claim up to 50 percent of the wages paid to a qualified employee as a credit against tax imposed on economic development area income.

The credit is based on the lesser of the actual hourly wage paid or 150 percent of the current minimum hourly wage (under special circumstances for the Long Beach enterprise zone, the maximum is 202 percent of the minimum wage). The amount of the credit must be reduced by any other federal or state jobs tax credits, and the taxpayer's deduction for ordinary and necessary trade or business expenses must be reduced by the amount of the hiring credit. Certain criteria regarding who may be qualified employees and certain limitations differ between the various economic development areas.

## Business Expense Deduction

A business located in an economic development area (except an MEA) may elect to deduct as a business expense a specified amount of the cost of qualified property purchased for exclusive use in the economic development area. The deduction is allowed in the taxable year in which the taxpayer places the qualified property in service. For LAMBRA businesses, the amount of the deduction is added back to the taxpayer's income if at the close of the second year the taxpayer does not have a net increase of one or more jobs (defined as 2,000 paid hours per employee per year). The property's basis must be reduced by the amount of the deduction. For enterprise zones, LAMBRAs, and the TTA the maximum deduction for all qualified property is the lesser of 40 percent of the cost or the following:

If the property was placed in service:

| Months After Designation | Maximum Deduction |
|---|---|
| 0 to 24 | $40,000 |
| 25 to 48 | 30,000 |
| 48 and over | 20,000 |

## Net Operating Loss Deduction

A business located in an economic development area may elect to carry over 100 percent of the economic development area net operating losses (NOLs) to deduct from economic development area income of future years. The election must be made on the original return for the year of the loss. The NOL carryover is determined by computing the business loss that results from business activity in the economic development area.

## Net Interest Deduction

A deduction from income is allowed for the amount of net interest earned on loans made to a trade or business located in an enterprise zone. Net interest is defined as the full amount of the interest less any direct expenses (e.g., commission paid) incurred in making the loan. The loan must be used solely for business activities within the enterprise zone, and the lender may not have equity or other ownership interest in the enterprise zone trade or business. This incentive is not available for LAMBRAs, the TTA, or MEAs.

## Enterprise Zone Employee Wage Credit

Certain disadvantaged individuals are allowed a credit for wages received from an enterprise zone business. Public employees are not eligible for the credit. The amount of the credit is 5 percent of "qualified wages," defined as wages subject to federal unemployment insurance. For each dollar of income received by the taxpayer in excess of qualified wages, the credit is reduced by nine cents. The credit is not refundable and cannot be carried forward. The amount of the credit is limited to the amount of tax that would be imposed on income from employment in the enterprise zone, computed as though that income represented the taxpayer's entire taxable income. This incentive is not available for LAMBRAs, the TTA, or MEAs.

Apportioning

For businesses operating inside and outside an economic development area, the amount of credit that may be claimed is limited by the amount of tax on income attributable to the economic development area. Income is first apportioned to California using the same formula as that used by all businesses that operate inside and outside the state (property, payroll, a double-weighted sales factor for taxable years beginning on or after January 1, 2011, certain corporations may elect to use a single factor, 100 percent sales apportionment formula). This income is further apportioned to the economic development area using a two-factor formula based on the property and payroll of the business.