SECTION 11000 TARGETED TAX AREA NET OPERATING LOSS

References 17276.1(a); 17276.6(a); 24416.1(a); 24416.6(a)

Taxpayers are required to annually report their income and expenses. Due to possible fluctuations in income and expenses, a taxpayer may have substantial profits in one year, while losses in another. In years where expenses exceed income, a net operating loss (NOL) occurs.

A qualified taxpayer engaged in a trade or business within the designated Targeted Tax Area (TTA) may elect to carry forward 100% of its NOLs for a 15 year period.

A TTA NOL cannot be generated until the first taxable year beginning on or after the official TTA designation date (November 1, 1998).

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11100 Geographic Boundaries and Designation Date

For a listing of TTA cities, see "*TTA Locations and Designation Date*" EDAM 1340. To verify an address, refer to EDAM1300.

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11200 Qualified Taxpayer

References 17276.6(a)(1)-(2); 24416.6(a)(1)-(2)

EDAM 11210 Pass-Through Entities
EDAM 11211 S Corporations

For purposes of the TTA NOL deduction, a qualified taxpayer includes a person or entity engaged in a trade or business within the TTA, and is described in the following Standard Industrial Classification (SIC) Manual (1987 edition) code sections:

- Codes 2000 through 2099
- Codes 2200 through 3999
- Codes 4200 through 4299
- Codes 4500 through 4599
- Codes 4700 through 5199

Taxpayers doing business in an area that was previously *not* a qualified area, but later designated as qualified, are allowed to utilize the special tax incentives for the taxable year beginning on or after the date the area receives its TTA designation.

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11210 Pass-Through Entities

References 17087.5; 17087.6; 17276.6(a)(2); 17851; 23800; 24271; 24416.6(a)(2)

In the case of any "pass-through entity", the determination of whether a taxpayer is a qualified taxpayer is made at the entity level.

The income and loss that will flow through to a shareholder, beneficiary, partner, or member, retains the same characteristics as it had with the pass-through entity.

The election to claim an NOL (see EDAM 11300) is made by the entity and each investor on their respective returns. The election by the entity to utilize the TTA NOL does not extend to, or bind the investor to utilizing the TTA NOL. Further, the investor may utilize the TTA NOL if the entity utilized the general NOL provisions, or had no NOL. Each taxpayer must determine if they in fact have a NOL, and then decide whether to utilize the general or TTA NOL.

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11211 S Corporations

References 23802(d)(1)-(2)

For qualified taxpayers electing S corporation status *after* the designation of the TTA, the qualified NOL attributed to the C corporation years cannot offset S corporation net income.

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11300 Making the Election

References 17276.1(b); 17276.6(c); 24416.1(c); 24416.6(c)

Qualified taxpayers must make an election to claim the TTA NOL. The election must be timely filed with the original return, and be for the taxable year in which the NOL is incurred. The election is irrevocable.

If the taxpayer is eligible to qualify for an NOL under more than one section (operation in more than one economic development area, new small business etc.), the taxpayer must choose which section to elect. Except for the loss incurred under the subdivision elected, taxpayers are prohibited from carrying over any other type of NOL from the same taxable year.

Failure to elect to compute the NOL deduction under CR&TC § 17276.1 or 24416.1 will cause the NOL to be subject to the limitations and restrictions under CR&TC § 17276 or 24416 (general NOL).

A taxpayer makes the election by filing:

- Form FTB 3809 – Targeted Tax Area Deduction and Credit Summary.

In addition, the form FTB 3809 must be filed for each year in which the NOL deduction is taken.

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11400 TTA NOL Computation - General Provisions

References 17276.1; 17276.6(b)(2); 24416.1; 24416.6(b)(2)

EDAM 11410 TTA NOL Limited by General NOL

A TTA NOL is the loss attributable to the qualified taxpayer's business activities within the TTA, prior to the TTA expiration date. TTA NOLs are determined under IRC § 172, as modified by California Revenue & Taxation Code Sections 17276.1, 17276.6, 24416.1, and 24416.6

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11410 TTA NOL Limited by General NOL

References 17276; 24416

The TTA NOL, as computed under EDAM 11500, is compared to the NOL computed under the general NOL provisions of CR&TC §17276 / 24416, prior to the 50% reduction. The TTA NOL carryover is limited to the lesser of the TTA NOL or the general NOL (prior to the 50% reduction). **NOTE**: If the TTA NOL is limited by the general NOL amount, (prior to the 50% reduction), the amount can still be characterized as an TTA NOL and allowed to be carried over at 100% for 15 years. An election must be made to characterize the NOL as a TTA NOL.

Example: Corp. B incurred the following loss:

Income from business operations	$160,000
Interest from investment which is unrelated to Corp. B's business operations	15,000
Expenses of business operations	(189,000)
Net loss	*($14,000)*

To determine the NOL carryover attributed to the TTA business operations, the following must be done:

- Determine NOL per CR&TC §24416 (prior to 50% reduction)
- Determine NOL per CR&TC §24416.6 (remove non-business items)

The NOL carryover is limited to the lesser of item 1 or item 2 above.

CR&TC § 24416 "general" NOL - prior to 50% reduction

Net loss of Corp. B	($14,000)

CR&TC § 24416.6 TTA NOL - exclude non-business income/loss

Income from operations	$160,000
Expenses of operations	(189,000)
Net loss of Corp. B (TTA)	($29,000)

Pattern 1: Assume Corp. B operates entirely within the TTA. Corp. B is allowed to carry over the lesser of the "general" NOL, or the TTA NOL; in this case $14,000.

Pattern 2: Assume Corp. B conducts 40% of its total business operations in the TTA, as computed under EDAM 11500. Because Corp. B only has 40% of its business operation in the TTA, the $29,000 business loss must be apportioned before comparing it to the "general" NOL. In this example, the

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TTA loss is $11,600 ($29,000 x 40%). Corp. B is allowed to carry over the lesser of the "general" NOL, or the TTA NOL; in this case, $11,600.

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11500 TTA NOL - Loss Attributed to Business Activity

References 17276.6(b)(2); 24416.6(b)(2)

EDAM 11510	Property Factor – Loss Apportionment
EDAM 11520	Payroll Factor – Loss Apportionment
EDAM 11530	Apportionment – Combined Groups
EDAM 11540	Apportioning for Personal Income Tax Taxpayers

A TTA NOL is the loss attributable to the qualified taxpayer's business activities within the TTA prior to the TTA expiration date. Non-business income and/or loss are excluded from the calculation of the TTA NOL.

If a business is located within and outside of the TTA, the taxpayer must determine the portion of the total business loss attributable to the TTA.

- Business loss is defined under the provisions of the Uniform Division of Income for Tax Purposes Act (UDITPA).
- Components of the factors are defined under the provisions of UDITPA.

For taxpayers conducting business operations within and without a TTA, business loss is apportioned to the TTA by multiplying the worldwide business loss by a fraction, the numerator of which is the property factor plus the payroll factor, and the denominator of which is two (2).

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11510 Property Factor – Loss Apportionment

The property factor is a fraction.

- The numerator of the property factor is the average value of the real and tangible personal property owned or rented and used or available for use by the taxpayer *within the TTA* during the taxable year.
- The denominator is the average value of all real and tangible personal property owned or rented and used or available for use during the taxable year *worldwide.*

Rented property is valued at eight (8) times the net annual rental rate. The net annual rental rate is the total rent paid for the property, less any subrental rates paid by subtenants.

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11520 Payroll Factor – Loss Apportionment

The payroll factor is a fraction.

- The numerator of the payroll factor is the total compensation paid to the taxpayer's employees working within the TTA during the taxable year.
- The denominator is the total compensation paid to employees working *worldwide* during the taxable year.

Example - Two-factor apportionment: For the taxable year 12/31/99, Corp. A operates within and outside a TTA. Corp. A's business loss of $13,000 needs to be apportioned to the TTA. The following amounts apply to Corp. A's property and payroll:

TTA Property	$40,000
Worldwide (WW) Property	$100,000
TTA Payroll	$5,000
WW Payroll	$10,000

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

Business loss	$(13,000)
Apportionment Factor	x 0.45
TTA NOL	$(5,850)

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11530 Apportionment – Combined Groups

For members of a combined group, the TTA NOL calculation will be based on the combined groups worldwide business loss (before CA apportionment). The numerator of the apportionment formula will be based on each TTA taxpayer's separate TTA payroll and property amounts, and the denominator will be based on the combined groups worldwide payroll and property amounts.

Example: For the taxable year ending 12/31/99, Parent Corporation A has two subsidiaries, B and C. Corporations A and B operate within a TTA. The combined group operates within and outside California and apportions its income or loss to California using Schedule R. The combined group's business loss is $1,000,000.

Business loss apportioned to the TTA was determined as follows:

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

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11540 Apportioning for Personal Income Tax Taxpayers

The following examples show the application of the apportioning rules to personal income tax taxpayers.

Example: Ray Smith is vice president of an S corporation that has two locations, one within a TTA and one outside the TTA. Eighty percent (80%) of the S corporation's business is attributable to the TTA. (**NOTE**: This percentage was determined by the S corporation, using Worksheet V from the FTB 3809 Business Booklet, at the time the S corporation return was prepared). Ray divides his time equally (50% & 50%) between the two offices of the S corporation.

Mary Smith (Ray's spouse) works for the S corporation at its office located in the TTA.

Ray and Mary Smith have the following 1999 items of California income and expense:

Ray's salary from the S corp.	$100,000
Mary's salary from the S corp.	75,000
Interest on savings account	1,000
Dividends	3,000
Schedule K-1(100S) from the S corp.	
Ordinary Loss	200,000
TTA business expense deduction	(5,000)*
Ray's unreimbursed employee expenses from Schedule A	(2,000)

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

The Smith's TTA loss is computed as follows:

Ray's TTA salary ($100,000 x 50%)	$50,000
Mary's TTA salary ($75,000 x 100%)	75,000
Pass-through ordinary loss from the S-Corp. ($200,000 x 80%)	(160,000)
TTA business expense deduction from the S-Corp.	(5,000)
Ray's unreimbursed employee business expenses (2,000 x 50%)	(1,000)
Total TTA loss	$(41,000)

NOTE: The standard deduction and personal or dependency exemptions are not included in the computation of TTA NOL since they are not related to trade or business activities.

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11600 Carryover / Carryback

References 17276.1(a); 17276.6(b)(1) – (2); 17276.6(e); 24416.1(a); 24416.1(a)(3); 24416.6(b)(1) - (2); 24416.6(f)

For each taxable year beginning on or after January 1, 1998, a qualified taxpayer engaged in a trade or business within the designated TTA may elect to carryover 100% of its NOL. No NOL carrybacks are allowed.

The NOLs may be carried over to each of the 15 taxable years following the year of loss, or until exhausted, whichever occurs first. If an NOL carryover remains after the TTA designation has expired, the TTA is deemed to remain in existence for purposes of computing the TTA income limitation, and for purposes of allowing the TTA NOL deduction.

NOTE: Financial institutions. As defined in IRC § 585, 586, or 593, using bad debt reserve methods may carry the loss forward for a maximum of 5 taxable years.

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11700 TTA NOL Deduction - General Provisions

References 17276.6(b)(3); 17276.6(b)(4); 24416.6(b)(3); 24416.6(b)(4)

EDAM 11710	Business Income Activity Limitation
EDAM 11711	Property Factor – Income Apportionment
EDAM 11712	Payroll Factor – Income Apportionment
EDAM 11713	Apportionment – Combined Groups
EDAM 11714	Apportioning for Personal Income Tax Taxpayers

The TTA NOL carryover can only *offset business income attributable to operations of the taxpayer within the designated TTA*.

In the event that a TTA NOL carryover is allowable for any taxable year after the TTA designation expires, is revoked, is no longer binding, or becomes inoperative, the TTA is deemed to remain in existence for the purpose of computing the business income limitation and allowing a TTA NOL deduction.

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11710 Business Income Activity Limitation

References 17276.6(b)(4); 17276.6(b)(4)(A); 24416.6(b)(4); 24416.6(b)(4)(A)

If a business is located within and outside of the TTA, the taxpayer must determine the portion of the total business income that is attributable to the TTA.

- Business income is defined under the provisions of the Uniform Division of Income for Tax Purposes Act (UDITPA).
- Components of the factors are defined under the provisions of UDITPA.

Business income is apportioned to the TTA by multiplying the taxpayer's total California source business income by a fraction, the numerator of which is the property factor plus the payroll factor, and the denominator of which is two (2).

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11711 Property Factor – Income Apportionment

The property factor is a fraction.

- The numerator of the property factor is the average value of the real and tangible personal property owned or rented and used or available for use by the taxpayer *within the TTA* during the taxable year.
- The denominator is the average value of all real and tangible personal property owned or rented and used or available for use by the taxpayer during the taxable year *within California*.

Rented property is valued at eight (8) times the net annual rental rate. The net annual rental rate is the total rent paid for the property, less any subrental rates paid by subtenants.

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11712 Payroll Factor – Income Apportionment

The payroll factor is a fraction.

- The numerator of the payroll factor is the total compensation paid to the taxpayer's employees working within the TTA during the taxable year.
- The denominator is the total compensation paid to employees working for the taxpayer *in California* during the taxable year.

Example: Corp. A operates within and outside the TTA. California business income of $13,000 needs to be apportioned to the TTA. The following amounts apply to Corp. A's property and payroll:

TTA Property	$40,000
CA Property	$100,000
TTA Payroll	$5,000
CA Payroll	$10,000

TTA Property/CA Property	=.40	
TTA Payroll/CA Payroll	=.50	
	.90/2 = .45	TTA Apportionment Factor

Business income	$13,000
Apportionment Factor	x 0.45
TTA Business Income	$5,850

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11713 Apportionment – Combined Groups

For members of a combined group, the limitation is based on the intrastate apportioned business income for each taxpayer doing business within the TTA. The numerator of the apportionment formula is based on each TTA taxpayer's separate TTA property and payroll amounts and the denominator will be based on each TTA taxpayer's separate California property and payroll amounts.

Example: For taxable year ending 12/31/99, parent corporation A has two subsidiaries, B and C. Corporations A and B operate within the TTA. The combined group operates within and outside California and apportions its income to California using Schedule R. The combined group's business income apportioned to California was $1,000,000. Corporation A and B's share of California business income is $228,000 and $250,000 respectively. Corporation A and B's separate TTA and separate California property and payroll factor amounts are shown below.

Business income apportioned to the TTA was determined as follows:

	A	B
Property Factor		
TTA Property	$1,000,000	$ 800,000
California Property	$1,000,000	$1,200,000
Apportionment %	100%	66.66%
Payroll Factor		
TTA Payroll	$800,000	$ 800,000
California Payroll	$800,000	$1,000,000
Apportionment %	100%	80%
Average Apport. % (Property + Payroll Factors)/2	100%	73.33%
Apportioned Business Income	$228,000	$250,000
TTA Income	$228,000	$183,333

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11714 Apportioning for Personal Income Tax Taxpayers

The following examples show the application of the apportioning rules to personal income tax taxpayers.

Example: Ray Smith is vice president of an S corporation that has two locations, one within a TTA and one outside the TTA. Eighty percent (80%) of the S corporation's business is attributable to the TTA. (**NOTE**: This percentage was determined by the S corporation, using Worksheet V from the FTB 3809 Business Booklet, at the time the S corporation return was prepared). Ray divides his time equally (50% & 50%) between the two offices of the S corporation.

Mary Smith (Ray's spouse) works for the S corporation at its office located in the TTA.

Ray and Mary Smith have the following 1999 items of California income and expense:

Ray's salary from the S corp.	$100,000
Mary's salary from the S corp.	75,000
Interest on savings account	1,000
Dividends	3,000
Schedule K-1(100S) from the S corp.	
Ordinary income	40,000
TTA business expense deduction	(5,000)*
Ray's unreimbursed employee expenses from Schedule A	(2,000)

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

The Smith's TTA income is computed as follows:

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

NOTE: The standard deduction and personal or dependency exemptions are not included in the computation of TTA income since they are not related to trade or business activities.

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11800 NOL Suspensions

References 17276.3(c); 24416.3(c)

For taxable years beginning in 2002 and 2003, California suspended the Net Operating Loss (NOL) carryover deduction. Taxpayers may continue to compute and carryover an NOL during the suspension period. 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. The deduction for disaster losses is not affected by the NOL suspension rules.

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11900 Alternative Minimum Tax

References 17062; 23456

Taxpayers claiming a TTA NOL deduction must also determine their NOL for alternative minimum tax purposes.

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