
**SECTION 20000 LOS ANGELES REVITALIZATION ZONE NET OPERATING
LOSS**

References 17276.1(a); 24416.1(a); Repealed Sections 17276.4(a)(1); 24416.4(a)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.

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.

For entities conducting business within the LARZ, a qualified taxpayer may elect to carry forward 100% of its NOLs for a 15-year period.

A LARZ NOL cannot be generated until the first taxable or income year beginning on or after the area was officially designated the LARZ.

NOTE: The LARZ NOL may not be generated in taxable or income years beginning on or after January 1, 1998. Taxpayers that report an operating loss attributed to the LARZ from a pass through entity, in their taxable or income year beginning on or after January 1, 1998, from a 1997 fiscal year pass-through entity *may not* claim the LARZ NOL in their taxable or income year beginning on or after January 1, 1998. Each taxpayer must determine and elect the NOL treatment.

Prior to January 1, 1998, the applicable LARZ NOL code sections were:

- 17276 - 17276.1, 17276.2(b), 17276.3
- 24416 - 24416.1, 24416.2(b), 24416.3

For taxable or income years beginning on or after January 1, 1998, the LARZ NOL code sections are:

- 17276 - 17276.1, 17276.3, 17276.4
- 24416 - 24416.1, 24416.3, 24416.4

The following references are to the new code section numbers.

EDAM 20000 LOS ANGELES REVITALIZATION ZONE NET OPERATING

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EDAM 20100	GEOGRAPHIC BOUNDARIES
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EDAM 20500	LARZ NOL - LOSS ATTRIBUTED TO BUSINESS ACTIVITY
EDAM 20600	CARRYOVER / CARRYBACK
EDAM 20700	LARZ NOL DEDUCTION - GENERAL PROVISIONS
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20100 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 net operating loss 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.

20200 Qualified Taxpayer

References (Repealed Sections) 17276.4(a); 24416.4(a)

EDAM 20210 Pass-Through Entities

EDAM 20211 S Corporations

For purposes of the LARZ NOL, a qualified taxpayer includes a person or entity that is engaged in a trade or business within the LARZ.

Taxpayers doing business in an area that was previously not a qualified area, but later designated as qualified, are allowed to utilize the LARZ NOL for the taxable or income year beginning on or after the date the area is designated as part of the LARZ.

20210 Pass-Through Entities

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

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20211 S Corporations

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

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

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20300 Making the Election

References 17276.1(a)-(b); 24416.1(a) & (c); Repealed Sections 17276.4(c)-(e); 24416.4(c)-(e)

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

NOTE: For LARZ businesses, the election to compute the loss under CR&TC § 17276.1 or 24416.1 could have been made on an amended return for the 1992 income year only. The amended return had to be filed by June 30, 1994. [FTB Notice 94-1](#), March 18, 1994.

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 tax year.

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

The taxpayer makes the election by using:

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

In addition, the form FTB 3806 must be filed for each year in which the NOL deduction is taken.

20400 LARZ NOL Computation - General Provisions

References 17276.1(a); 24416.1(a); Repealed Sections 17276.4(a)(2); 24416.4(a)(3)

EDAM 20410 LARZ NOL Limited by General NOL

A LARZ NOL is the loss attributable to the qualified taxpayer's business activities within the LARZ, prior to the LARZ expiration date. LARZ NOLs are determined under IRC § 172, as modified by the following CR&TC §:

- 17276.1
- 17276.4
- 24416.1
- 24416.4

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20410 LARZ NOL Limited by General NOL

References 17276; 24416

The LARZ NOL is compared to the NOL computed under the general NOL provisions of section 17276 / 24416, *prior to the 50% reduction*. The LARZ NOL carryover is limited to the lesser of the LARZ NOL or the general NOL (prior to the 50% reduction). **NOTE:** If the LARZ NOL is limited by the general NOL amount, (prior to the 50% reduction), the amount can still be characterized as a LARZ NOL and allowed to be carried over at 100% for 15 years. An election must be made to characterize the NOL as a LARZ 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	<u>(189,000)</u>
Net loss	<u>(\$14,000)</u>

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

1. Determine NOL per CR&TC § 24416 (prior to 50% reduction)
2. Determine NOL per CR&TC § 24416.4 (remove non-business items)

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

1. CR&TC § 24416 "general" NOL - prior to 50% reduction
Net loss of Corp. B (\$14,000)
2. CR&TC § 24416.2 LARZ NOL - exclude non-business income/loss
Income from operations \$160,000
Expenses of operations (189,000)
Net loss of Corp. B (LARZ) (\$29,000)

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

Pattern 2: Assume Corp. B conducts 40% of its total business operations in the LARZ. Because Corp. B only has 40% of its business operation in the LARZ, the \$29,000 business loss must be apportioned before comparing it to the "general" NOL. In this example, the LARZ loss is \$11,600

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

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20500 LARZ NOL - Loss Attributed to Business Activity

References (Repealed Sections) 17276.4(a)(2); 24416.4(a)(3)

EDAM 20510	Property Factor – Loss Apportionment
EDAM 20520	Payroll Factor – Loss Apportionment
EDAM 20530	Apportionment – Combined Groups
EDAM 20540	Apportioning for Personal Income Tax Taxpayers

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

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

- 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 the LARZ, business loss is apportioned to the LARZ 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).

20510 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 LARZ* during the income or 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 income or 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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20520 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 LARZ during the income or taxable year.
- The denominator is the total compensation paid to employees working *worldwide* during the income or taxable year.

Example - Two-factor apportionment: For the income year ending 12/31/96, Corp. A operates within and outside an LARZ. Corp. A's business loss of \$13,000 needs to be apportioned to the LARZ. The following amounts apply to Corp. A's property and payroll:

LARZ Property	\$40,000	
Worldwide (WW) Property	\$100,000	
LARZ Payroll	\$5,000	
WW Payroll	\$10,000	
LARZ Property/WW Property	=.40	
LARZ Payroll/WW Payroll	= $\frac{.50}{.90/2}$ = .45	
		LARZ Apportionment Factor
Business loss		\$(13,000)
Apportionment Factor		<u>x 0.45</u>
LARZ NOL		\$(5,850)

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20530 Apportionment – Combined Groups

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

Example: For the income year ending 12/31/96, Parent Corporation A has two subsidiaries, B and C. Corporations A and B operate within the LARZ. 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 LARZ was determined as follows:

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

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20540 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 the LARZ and one outside the LARZ. Eighty percent (80%) of the S corporation's business is attributable to the LARZ. (**NOTE:** This percentage was determined by the S corporation, using Worksheet V from the FTB 3806 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 LARZ.

Ray and Mary Smith have the following 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
LARZ business expense deduction	(5,000)*
Ray's unreimbursed employee expenses from Schedule A	(2,000)

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

The Smith's LARZ loss is computed as follows:

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

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

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20600 Carryover / Carryback

References 17276.1(a); 24416.1(a); Repealed Sections 17276.4(a)(1); 17276.4(a)(4); 24416.4(a)(1); 24416.4(a)(2); 24416.4(a)(5)

For each income or taxable year a qualified taxpayer engaged in a trade or business within the designated LARZ may elect to carryover 100% of its NOL. No NOL carrybacks are allowed.

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

20700 LARZ NOL Deduction - General Provisions

References (Repealed Sections) 17276.4(a)(3); 17276.4(a)(4); 24416.4(a)(4); 24416.4(a)(5)

EDAM 20710	Business Income Activity Limitation
EDAM 20711	Property Factor – Income Apportionment
EDAM 20712	Payroll Factor – Income Apportionment
EDAM 20713	Apportionment – Combined Groups
EDAM 20714	Apportioning for Personal Income Tax Taxpayers
EDAM 20715	Flow-through Losses

The LARZ NOL deduction can only offset business income attributable to operations of the taxpayer within the designated LARZ.

In the event a LARZ NOL deduction is allowable for any taxable or income year after the LARZ designation has expired, or for taxpayers operating in the portion of the LARZ that was eliminated during the downsizing, the LARZ will be deemed to remain in existence for the purpose of computing the business income limitation and allowing an NOL deduction.

20710 Business Income Activity Limitation

References (Repealed Sections) 17276.4(a)(5); 17276.4(a)(5)(A); 24416.4(a)(6); 24416.4(a)(6)(A)

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

- 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.

For income or taxable years beginning on or after January 1, 1994, business income is apportioned to the LARZ 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).

For income or taxable years beginning on or after January 1, 1992, and before January 1, 1994, business income is apportioned to the LARZ by multiplying the worldwide 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).

20711 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 LARZ* during the income or taxable year.

- For income or taxable years beginning on or after January 1, 1994, 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 income or taxable year *within California*.
- For income or taxable years beginning before January 1, 1994, the denominator is the average value of all real and tangible personal property owned or rented and used or available for use during the income or 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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20712 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 LARZ during the income or taxable year.

- For income or taxable years beginning on or after January 1, 1994, the denominator is the total compensation paid to employees working for the taxpayer *in California* during the income or taxable year.
- For income or taxable years beginning before January 1, 1994, the denominator is the total compensation paid to employees working *worldwide* during the income or taxable year.

Example: Two-factor apportionment: For the income year ending 12/31/97, Corp. A operates within and outside an LARZ. California business income of \$13,000 needs to be apportioned to the LARZ. The following amounts apply to Corp. A's property and payroll:

LARZ Property	\$40,000	
CA Property	\$100,000	
LARZ Payroll	\$5,000	
CA Payroll	\$10,000	
LARZ Property/CA Property	=.40	
LARZ Payroll/CA Payroll	= <u>.50</u>	
	.90/2 = .45	LARZ Apportionment Factor
Business income	\$13,000	
Apportionment Factor	<u>x 0.45</u>	
LARZ Business Income	\$5,850	

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20713 Apportionment – Combined Groups

For income or taxable years beginning before January 1, 1994: For members of a combined group, the income limitation will be based on the combined groups worldwide business income (before CA apportionment). The numerator of the apportionment formula will be based on each LARZ taxpayer's separate LARZ payroll and property amounts, and the denominator will be based on the combined groups worldwide payroll and property amounts.

For an example of apportionment under this method refer to EDAM 23440.

For income or taxable years beginning on or after 1/1/1994: For members of a combined group, the limitation will be based on the intrastate apportioned business income for each taxpayer doing business within the LARZ. The numerator of the apportionment formula will be based on each LARZ taxpayer's separate LARZ property and payroll amounts and the denominator will be based on each LARZ taxpayer's separate California property and payroll amounts.

Example: For the income year ending 12/31/97, parent corporation A has two subsidiaries, B and C. Corporations A and B operate within the LARZ. 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 LARZ and separate California property and payroll factor amounts are shown below.

Business income apportioned to the LARZ was determined as follows:

	A	B
<u>Property Factor</u>		
LARZ Property	\$1,000,000	\$ 800,000
California Property	\$1,000,000	\$1,200,000
Apportionment %	100%	66.66%
<u>Payroll Factor</u>		
LARZ Payroll	\$800,000	\$ 800,000
California Payroll	\$800,000	\$1,000,000
Apportionment %	100%	80%
Average Apport. %	100%	73.33%
(Property + Payroll Factors)/2		

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Apportioned Business Income	\$228,000	\$250,000
LARZ Income	\$228,000	\$183,333

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20714 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 an LARZ and one outside the LARZ. Eighty percent (80%) of the S corporation's business is attributable to the LARZ. (**NOTE:** This percentage was determined by the S corporation, using Worksheet V from the FTB 3806 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 LARZ.

Ray and Mary Smith have the following 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
LARZ business expense deduction	(5,000)*
Ray's unreimbursed employee expenses from Schedule A	(2,000)

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

The Smith's LARZ income is computed as follows:

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

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

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20715 Flow-through Losses

References 17087.5; 17087.6; 17851; 23800; 24271

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 must be made by the entity and each investor on their respective returns. The election by the entity to utilize the LARZ NOL does not extend to, or bind the investor to utilizing the LARZ NOL. Further, the investor may utilize the LARZ 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 the general or LARZ NOL will be utilized.

20800 NOL Suspensions

References 17276.3(c); 24416.3(c)

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

NOLs incurred by qualified taxpayers are *not* suspended for taxable or income years beginning in 1991 and 1992.

20900 Alternative Minimum Tax

References 17062; 23456

Taxpayers claiming an LARZ NOL deduction must also determine their NOL for alternative minimum tax purposes.