SECTION 25000 PROGRAM AREA NET OPERATING LOSS

References 17276.1(a); 24416.1(a); Repealed Sections 17276.2(a); 24416.2(a)

To claim Program Area incentives, taxpayers had to be certified by the California Trade and Commerce Agency or TCA. TCA could certify a taxpayer to take the hiring credit only or all five Program Area incentives. The type of certification can be determined from the certification letter. A taxpayer certified by TCA to claim all five Program Area tax incentives, and operating in a Program Area, may claim the Program Area net operating loss (NOL) deduction.

Certification was generally valid for three years. After three years, the taxpayer would have to be re-certified. De-certification could occur if a company failed to meet the requirements.

Taxpayers are required to annually report their income and expenses. Possible fluctuations in income and expenses may create substantial profits in one year, while losses in another. In years where expenses exceed income, an NOL occurs.

A qualified taxpayer (certified) engaged in a trade or business within the designated Program Area may elect to carry forward 100% of its NOL for a period of 15 years.

A Program Area NOL cannot be generated until the first taxable or income year beginning on or after the area has been officially designated as a Program Area.

NOTE: For income and taxable years beginning on or after January 1, 1997, Program Areas were converted to Enterprise Zones (EZs) and are entitled to the benefits available to EZs. The following Program Area discussion relates to income and taxable years beginning prior to January 1, 1997. Relevant CR&TC § are:

- 17276 - 17276.3
- 24416 - 24416.3

25100 Geographic Boundaries and Designation Dates

For a listing of Program Areas and designation dates, refer to EDAM 1360. To verify an address, refer to EDAM 1300.

25200 Qualified Taxpayer

References (Repealed Sections) 17276.2(a); 24416.2(a)

EDAM 25210 Pass-Through Entities
EDAM 25211 S Corporations

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

Qualified 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 or income year beginning on or after the date the area receives designation as a Program Area.

25210 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.

25211 S Corporations

References 17087.5; 17087.6; 17851; 23800; 23802(d)(1)-(2); 24271

For qualified taxpayers electing S corporation status *after* the designation of the Program Area, the qualified NOL attributed to the C corporation years cannot offset S corporation net income. 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 (EDAM 25300) to claim an NOL is made by the entity and each investor on their respective returns. The election by the entity to utilize the Program Area NOL does not extend to, or bind the investor to utilizing the Program Area NOL. Further, the investor may utilize the Program Area
NOL if the entity utilized the general NOL provisions, or had no NOL. Each taxpayer must determine if they in fact have an NOL, and then decide whether to utilize the general or Program Area NOL.

25300 Making the Election

References 17276.1(a)-(b); 24416.1(a) & (c); Repealed Sections 17276.2(e)-(g); 24416.2(e)-(g)

Qualified taxpayers must make an election to claim the Program Area 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.

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 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 3805Z – Enterprise Zone/ Program Area Deduction and Credit Summary.

In addition, the form FTB 3805Z must be filed for each year in which the NOL deduction is taken.

25400 Program Area NOL Computation - General Provisions

References 17276.1(a); 24416.1(a); Repealed Sections 17276.2(a)(2)(A); 24416.2(a)(2)(A)

EDAM 25410 Program Area NOL Limited by General NOL

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

- 17276.1
- 17276.2
- 24416.1
- 24416.2

25410 Program Area NOL Limited by General NOL

References 17276; 24416

The Program Area NOL as computed under EDAM 25500 is compared to the NOL computed under the general NOL provisions of CR&TC §17276 / 24416, *prior to the 50% reduction*. The Program Area NOL carryover is limited to the lesser of the Program Area NOL or the general NOL (prior to the 50% reduction). **NOTE**: If the Program Area NOL is limited by the general NOL amount, (prior to the 50% reduction), the amount can still be characterized as a Program Area NOL and allowed to be carried over at 100% for 15 years. An election must be made to characterize the NOL as a Program Area 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 Program Area business operations, do the following:

1. Determine NOL per CR&TC §24416 (prior to 50% reduction);
2. Determine NOL per CR&TC § 24416.2 (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 Program Area NOL - exclude non-business income/loss

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

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

Assume Corp. B conducts 40% of its total business operations in the Program Area as computed under EDAM 25500. Because Corp. B only has 40% of its business operation in the Program Area, the $29,000 business loss must be apportioned before comparing it to the "general" NOL. In this example, the Program Area loss is $11,600 ($29,000 x 40%). Corp. B is allowed to carry over the lesser of the "general" NOL, or the Program Area NOL; in this case, $11,600.

25500 Program Area NOL - Loss Attributed to Business Activity

References (Repealed Sections) 17276.2(a)(2)(A); 17276.2(a)(2)(A)(i); 24416.2(a)(2)(A); 24416.2(a)(2)(A)(i)

EDAM 25510 Property Factor – Loss Apportionment
EDAM 25520 Payroll Factor – Loss Apportionment
EDAM 25530 Sales Factor – Loss Apportionment
EDAM 25540 Apportionment – Combined Groups
EDAM 25550 Apportioning for Personal Income Tax Taxpayers

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

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

- 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 income or taxable years beginning after January 1, 1996 and before January 1, 1997 (1996 fiscal year taxpayers), business loss is apportioned to the Program Area by use of a four-factor apportionment formula. Worldwide business loss is multiplied by a fraction, the numerator of which is the property factor, payroll factor, and the double-weighted sales factor. The denominator is four (4).

For income or taxable years beginning on or after January 1, 1991, and ending on or before December 31, 1996 (1991 - 1995 year taxpayers and 1996 calendar year taxpayers), business loss is apportioned to the Program Area 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).

For income or taxable years beginning before January 1, 1991, business loss attributed to a Program Area is determined by multiplying worldwide business loss by a fraction, the numerator of which is the property factor, payroll factor, and sales factor, the denominator of which is three (3).

25510 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 Program Area* 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.

25520 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 Program Area* during the income or taxable year.
- The denominator is the total compensation paid to employees working *worldwide* during the income or taxable year.

25530 Sales Factor – Loss Apportionment

The sales factor is a fraction.

- The numerator of the sales factor is composed of the gross receipts as defined under the provisions of CR&TC §25134 - 25136, derived during the taxable or income year from transactions and activities occurring within the taxpayers trade or business in the Program Area.
- The denominator is composed of the gross receipts as defined under the provisions of CR&TC §25134 - 25136, derived during the taxable or income year from transactions and activities related to worldwide operations

General rules regarding the double weighting of the sales factor are applicable.

Example - Two-factor apportionment: For the income year ending 12/31/95, Corp. A operates within and outside a Program Area. Corp. A's business loss of $13,000 needs to be apportioned to the Program Area. The following amounts apply to Corp. A's property and payroll:

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

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

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

NOTE: The four-factor apportionment formula is as follows:

Zone income = (property, payroll, & sales factors/ 4) x worldwide business income.

Property factor = zone property/worldwide property
Payroll factor = zone payroll/worldwide payroll
Sales Factor = zone sales/worldwide sales x 2

25540 Apportionment – Combined Groups

For members of a combined group, the Program Area 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 Program Area taxpayer's separate Program Area payroll and property amounts (and sales as discussed in EDAM 25530), and the denominator will be based on the combined groups worldwide payroll and property amounts (and sales as discussed in EDAM 25530).

Example: For the income year ending 12/31/95, Parent Corporation A has two subsidiaries, B and C. Corporations A and B operate within a Program Area. 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 Program Area was determined as follows:

	A	**B**	**C**	**Combined**
<u>Property Factor</u>				
Program Area Property	$2,000,000	$1,000,000	$0	$3,000,000
Worldwide Property				$5,000,000
Apportionment %	40%	20%		60%
Payroll Factor				
Program Area 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)
Program Area NOL	$(450,000)	$(200,000)		$(650,000)

25550 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 Program Area and one outside the Program Area. Eighty percent (80%) of the S corporation's business is attributable to the Program Area. (**NOTE**: This percentage was determined by the S corporation, using Worksheet V from the FTB 3805Z 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 Program Area.

Ray and Mary Smith have the following 1996 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
Program Area	
Business expense deduction	(5,000)*
Ray's unreimbursed employee expenses from Schedule A	(2,000)

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

The Smith's Program Area loss is computed as follows:

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

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

25600 Carryover / Carryback

References 17276.1(a); 24416.1(a); Repealed Sections 17276.2(a)(1); 24416.2(a)(1)

For each income or taxable year, a qualified taxpayer, engaged in a trade or business within a designated Program Area, 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 remained at the time the Program Areas were repealed and converted to Enterprise Zones (effective 1/1/97), the carryover amount is now classified as an Enterprise Zone NOL carryover. If an Enterprise Zone NOL carryover remains after the Enterprise Zone designation has expired, the Enterprise Zone is deemed to remain in existence for purposes of computing the Enterprise Zone income limitation, and for purposes of allowing the Enterprise Zone NOL deduction.

25700 NOL Deduction - General Provisions

References (Repealed Sections) 17276.2(a)(2)(B); 24416.2(a)(2)(B)

EDAM 25710	Business Income Activity Limitation
EDAM 25711	Property Factor – Income Apportionment
EDAM 25712	Payroll Factor – Income Apportionment
EDAM 25713	Sales Factor – Income Apportionment
EDAM 25714	Apportionment – Combined Groups
EDAM 25715	Apportioning for Personal Income Tax Taxpayers

The Program Area NOL carryover can only offset business income attributable to operations of the taxpayer within the designated Program Area. Non-business income/loss is excluded from the calculation of business income from the qualified area.

In the event a Program Area NOL carryover is allowable for any taxable or income year after the Program Area designation has expired, the Program Area is deemed to remain in existence for the purpose of computing the business income limitation and allowing an NOL deduction.

25710 Business Income Activity Limitation

References (Repealed Sections) 17276.2(a)(2)(A); 17276.2(a)(2)(B)(i); 24416.2(a)(2)(A); 24416.2(a)(2)(B)(i)

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

- 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 after January 1, 1996 and before January 1, 1997 (1996 fiscal year taxpayers), business income is apportioned to the Program Area by use of a four-factor apportionment formula. Worldwide business income is multiplied by a fraction, the numerator of which is the property factor, payroll factor, and the double-weighted sales factor. The denominator is four (4).

For income or taxable years beginning on or after January 1, 1991, and ending on or before December 31, 1996 (1991- 1995 year taxpayers and 1996 calendar year taxpayers), business income is apportioned to the Program Area 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).

For income or taxable years beginning before January 1, 1991, business income attributed to a Program Area is determined by multiplying worldwide business income by a fraction, the numerator of which is the property factor, payroll factor, and sales factor, the denominator of which is three (3).

25711 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 Program Area* 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.

25712 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 Program Area* during the income or taxable year.
- The denominator is the total compensation paid to employees working *worldwide* during the income or taxable year.

25713 Sales Factor – Income Apportionment

The sales factor is a fraction.

- The numerator of the sales factor is composed of the gross receipts as defined under the provisions of CR&TC §25134 - 25136, derived during the taxable or income year from transactions and activities occurring within the taxpayers trade or business in the Program Area.
- The denominator is composed of the gross receipts as defined under the provisions of CR&TC §25134 - 25136, derived during the taxable or income year from transactions and activities related to worldwide operations

General rules regarding the double weighting of the sales factor are applicable.

Example - Two-factor apportionment: For the income year ending 12/31/95, Corp. A operates within and outside a Program Area. Corp. A's business income of $13,000 needs to be apportioned to the Program Area. The following amounts apply to Corp. A's property and payroll:

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

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

Business income	$13,000
Apportionment Factor	x 0.45
Program Area income	$5,850

NOTE: The four-factor apportionment formula is as follows:

Zone income = (property, payroll, & sales factors/ 4) x worldwide business income.

Property factor = zone property/worldwide property
Payroll factor = zone payroll/worldwide payroll
Sales Factor = zone sales/worldwide sales x 2

25714 Apportionment – Combined Groups

For members of a combined group, the Program Area business income calculation will be based on the combined groups worldwide business income (before CA apportionment). The numerator of the apportionment formula will be based on each Program Area taxpayer's separate Program Area payroll and property amounts (and sales as discussed in EDAM 25713), and the denominator will be based on the combined groups worldwide payroll and property amounts (and sales as discussed in EDAM 25713).

Example: For the income year ending 12/31/95, Parent Corporation A has two subsidiaries, B and C. Corporations A and B operate within a Program Area. The combined group operates within and outside California and apportions its income or loss to California using Schedule R. The combined group's business income is $1,000,000.

Business income apportioned to the Program Area was determined as follows:

	A	**B**	**C**	**Combined**
Property Factor				
Program Area Property	$2,000,000	$1,000,000	$0	$3,000,000
Worldwide Property				$5,000,000
Apportionment %	40%	20%		60%
Payroll Factor				
Program Area 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 Income				$(1,000,000)
Program Area Business Income	$(450,000)	$(200,000)		$(650,000)

25715 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 Program Area and one outside the Program Area. Eighty percent (80%) of the S corporation's business is attributable to the Program Area. (**NOTE**: This percentage was determined by the S corporation, using Worksheet V from the FTB 3805Z 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 Program Area.

Ray and Mary Smith have the following 1996 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	40,000
Program Area business expense deduction	(5,000)*
Ray's unreimbursed employee expenses from Schedule A	(2,000)

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

The Smith's Program Area income is computed as follows:

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

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

25800 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 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.

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

25900 Alternative Minimum Tax

References 17062; 23456

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