

Frequently Asked Questions About Enterprise Zone Tax Incentives



CALIFORNIA FORM 3805Z
Social security or California corporation number

Enterprise Zone Deduction and Credit Summary

YEAR **2002**
Attach to your California tax return.

Name(s) as shown on return

A. Check the appropriate box for your entity type: Individual Exempt organization Estate Trust C corporation Limited liability company S corporation Partnership Limited liability partnership

B. Enter the name of the enterprise zone business:

C. Enter the address (actual location) where the enterprise zone business is conducted:

Activity Code number of the enterprise zone business

from the Principal Business Activity Code from the chart. For the Long Beach Enterprise Zone

with Standard Industrial Classification (SIC) code number from the chart.

of the hiring credit, if claimed

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Frequently Asked Questions About Enterprise Zone Tax Incentives

What is an Enterprise Zone?

The California Technology, Trade and Commerce Agency designates economically depressed areas in California. They establish Enterprise Zones to encourage and stimulate growth, development, and investment in the area. Taxpayers who invest, operate, or locate a trade or business within an Enterprise Zone may be eligible for special tax incentives.

How do I know if I am located in an Enterprise Zone?

To verify whether your business is located within an Enterprise Zone, you may contact the California Technology, Trade and Commerce Agency at:

**ENTERPRISE ZONE PROGRAMS
CALIFORNIA TECHNOLOGY, TRADE AND
COMMERCE AGENCY
1102 Q STREET SUITE 6000
SACRAMENTO CA 95814**

Telephone: (916) 324-8211

FAX: (916) 322-3524

Internet Website: www.commerce.ca.gov

What are the available Enterprise Zone tax incentives and who is qualified to take those incentives?

There are five tax incentives available to taxpayers that invest in or operate a trade or business located within an Enterprise Zone. The tax incentives are the:

- Hiring credit.
- Sales or use tax credit.
- Business expense deduction.
- Net interest deduction.
- Net operating loss (NOL) deduction.

For information about each tax incentive, refer to the *Enterprise Zone Business Booklet* (FTB 3805Z Booklet), or the *Guidelines for Businesses Claiming Economic Development Area Tax Incentives* (FTB Pub. 1158).

A tax credit is also available to employees that earn wages within an Enterprise Zone. See the *Enterprise Zone Employee Credit* form (FTB 3553).

How do I claim Enterprise Zone tax incentives?

Use the *Enterprise Zone Deduction and Credit Summary* form (FTB 3805Z), found in the *Enterprise Zone Business Booklet* (FTB 3805Z Booklet). File this form with your

California franchise or income tax return to claim the Enterprise Zone tax incentives. For those tax incentives that require an election, make the election on this form.

The *hiring credit*, *sales or use tax credit*, and *net interest deduction* do not require an election, and can be claimed on either an original return or an amended return.

Make your election to claim the *business expense deduction* on the original return for the year you place the property in service. You cannot make the election on an amended return, and you can only revoke the election with the written consent of the Franchise Tax Board.

Make your election to claim an Enterprise Zone *NOL deduction* on the original return for the year that you incur the NOL. You cannot make the election on an amended return, and you can only revoke the election with the written consent of the Franchise Tax Board.

Do I have to include the form FTB 3805Z with my tax return?

Yes. The Franchise Tax Board is required to annually summarize and provide the information on this form to the California Legislature or the California Technology, Trade and Commerce Agency. The information may be used to evaluate the usefulness of the incentives, to improve the program, or to make future decisions about continuation of the program.

Which employees qualify me for the hiring credit?

For taxable years beginning on or after January 1, 1997, you may qualify for the hiring credit if you hire an employee after an area is officially designated as an Enterprise Zone and before the designation expires.

A qualified employee is an employee who immediately before starting to work for you, is any of the following:

1. An employee who qualified for the former Program Area hiring credit;
 2. A person receiving or eligible to receive subsidized employment, training, or services funded by the federal Job Training Partnership Act (JTPA), or its successor;
 3. A person eligible to be a voluntary or mandatory registrant under the Greater Avenues for Independence Act of 1985 (GAIN), or its successor;
 4. An economically disadvantaged individual 14 years of age or older;
 5. A qualified dislocated worker;
 6. A disabled individual eligible for, enrolled in, or who has completed a state rehabilitation plan;
 7. A service-connected disabled veteran;
 8. A veteran of the Vietnam era;
 9. A veteran who recently separated from military service;
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10. An ex-offender;
 11. A person eligible for, or a recipient of:
 - Federal Supplemental Security Income (SSI) benefits;
 - Aid to Families with Dependent Children (AFDC);
 - Food stamps; or
 - State and local general assistance;
 12. A Native American;
 13. A resident of a Targeted Employment Area (TEA); or
 14. For employees hired during taxable years beginning on or after 1/1/1998, a member of a targeted group as defined in the federal Work Opportunity Tax Credit (as in effect January 1, 2001, in Internal Revenue Code Section 51).

In addition, at least 90 percent of the employee's work must be directly related to a trade or business activity located in the Enterprise Zone and at least 50 percent of the employee's work must be performed inside the boundaries of the Enterprise Zone.

To determine which employees qualify you for the hiring credit for taxable years beginning *before* January 1, 1997, get the *Enterprise Zone Business Booklet* (FTB 3805Z Booklet) or the *Guidelines for Businesses Claiming Economic Development Area Tax Incentives* (FTB Pub. 1158), for the year in question.

How long must an employee work for a taxpayer to avoid the recapture rules of the hiring credit?

You must recapture the hiring credit if you terminate the employee before the end of the longer of the following two periods:

- The first 270 days of employment (whether or not consecutive); or
- Ninety (90) days of employment plus 270 calendar days.

A "day of employment" includes any day the employee receives compensation (including paid holidays, sick days, and vacation days). The *Enterprise Zone Business Booklet* (FTB 3805Z Booklet) and the *Guidelines for Businesses Claiming Economic Development Area Tax Incentives* (FTB Pub. 1158) discuss exceptions to the recapture rules.

Can I take the sales or use tax credit if the property purchased was exempt from sales or use tax when purchased?

No. You can only take the sales or use tax credit for sales or use tax you actually paid or incurred on the purchase of qualified property. If the property was exempt from sales or use tax at the time of purchase, no sales or use tax was paid or incurred.

Do leases qualify for the business expense deduction or the sales or use tax credit?

Yes. If you acquired the property through a leasing arrangement that constitutes a financial (conditional sales) contract, the property may qualify for the business expense deduction or the sales or use tax credit, or both.

To determine whether the lease qualifies as a financial (conditional sales) contract, refer to IRS Revenue Ruling 55-540, 1955-2 C.B. 39, and FTB Legal Ruling 94-2, March 23, 1994.

What type of loan qualifies a creditor for the net interest deduction?

Loans that may qualify for the net interest deduction include business loans and mortgage loans from commercial or noncommercial sources. To qualify, you must meet **all** of the following:

- The funds must be loaned after the Enterprise Zone was designated, and before the designation expires.
- The loan must be made to a trade or business located solely within an Enterprise Zone.
- The loan proceeds must be used only for the trade or business activities within the Enterprise Zone.

Additionally, the lender may not have any type of ownership interest in the borrower's trade or business.

Is the net interest deduction allowed for the life of the loan?

No. The net interest deduction is only allowed as long as the borrower's trade or business is located in an Enterprise Zone. Once the Enterprise Zone designation expires or the borrower moves out of the Enterprise Zone the net interest deduction is no longer allowed.

Is the carryover of the net operating loss (NOL) deduction to future years limited?

Yes. You may carry an Enterprise Zone NOL forward for 15 years, or until exhausted, whichever occurs first. In addition, if your business operates both within and outside the Enterprise Zone, or is part of a unitary group, you must determine your Enterprise Zone NOL deduction by using the Enterprise Zone apportionment formula. The carryover deduction can only offset business income attributed to the Enterprise Zone. See the *Enterprise Zone Business Booklet* (FTB 3805Z Booklet).

What is the maximum amount of Enterprise Zone credits I can take in any one year?

The total of all Enterprise Zone credits that you can take in any taxable year may not exceed the lesser of the Enterprise Zone tax limitation or the:

- "net tax" limitation for individuals, or
- "tax" limitation for corporations.

California Revenue and Taxation Code sections 17039 and 23036 define "net tax" and "tax" respectively.

What are the “zone income” or “zone tax” limitations on the Enterprise Zone tax incentives?

The maximum amount of Enterprise Zone credits that you can take each year is limited to the tax on your business income attributed to the Enterprise Zone. Determine the amount of such tax by considering ALL your business activities conducted in the Enterprise Zone. The total Enterprise Zone credit is the combined amount of the current year’s hiring credit and the sales or use tax credit, and any prior year carryovers of these credits.

The Enterprise Zone net operating loss (NOL) is limited to the Enterprise Zone business loss. The Enterprise Zone NOL deduction is limited to the Enterprise Zone income.

To determine “zone income”, you must add the business income or loss from all of the trade or business activities you conduct in the Enterprise Zone. Exclude nonbusiness income from the calculation. For taxable years beginning on or after January 1, 1998, if you operate within and outside of an Enterprise Zone, you must figure the total business income or loss apportioned to the Enterprise Zone by use of a property and payroll apportionment factor. If you have wages earned from a business located within and outside an Enterprise Zone, determine your total Enterprise Zone business income or loss by adding income or loss attributed to Enterprise Zone activities. The *Enterprise Zone Business Booklet* (FTB 3805Z Booklet) provides the Income or Loss Worksheet for individuals.

The “zone tax” is determined on this “zone income” as if this amount was your total income or loss for the year.

How are Enterprise Zone tax incentives claimed when passed-through to partners, shareholders, or members?

The “zone tax” or “zone income” limitations apply at the individual level as well as the pass-through entity level. You must first determine your Enterprise Zone business income from ALL business activities you conduct in the Enterprise Zone to determine the amount of Enterprise Zone credits you can claim in the current year. First calculate the apportionment factor determined at the

pass-through entity level. Then, apply that apportionment factor to your distributive share of your income or loss. For example, if Partnership A operates 80 percent in the Enterprise Zone and your distributive share of partnership income is \$100,000, your Enterprise Zone income from this activity is \$80,000. Also consider wages, paid by the pass-through entity, as business income. Apportion the wages to the Enterprise Zone based on the percentage of your services performed within the Enterprise Zone.

RELATED FTB FORMS AND PUBLICATIONS

Guidelines for Businesses Claiming Economic Development Tax Incentives (FTB Pub. 1158)

Enterprise Zone Business Booklet (FTB 3805Z Booklet)

Economic Development Areas Manual on our Website at: www.ftb.ca.gov

Where To Get Tax Forms and Publications

By Internet – You can download, view, and print California tax forms and publications from our Website at: www.ftb.ca.gov

By Phone – Use our automated toll-free service. Call (800) 338-0505 and follow the recorded instructions. Please allow up to three weeks to receive your order.

Telephone and Internet Assistance

From within the United States, call (800) 852-5711
From outside the United States,
call (not toll-free) (916) 845-6500

Website at: www.ftb.ca.gov

Assistance for persons with disabilities: We comply with the Americans with Disabilities Act. Persons with hearing or speech impairments please call TTY/TDD (800) 822-6268.

By Mail – Write to:

TAX FORMS REQUEST UNIT
FRANCHISE TAX BOARD
PO BOX 307
RANCHO CORDOVA CA 95741-0307