

Taking Advantage of Your Company's Location:

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## The California Enterprise Zone Program

### ⚙ Background

The California Legislature originally authorized the Enterprise Zone Program with the goal of stimulating growth and development in some of the more economically distressed areas in the state. Businesses are encouraged to do business within designated Enterprise Zones through various tax credits and other benefits. Below is a summary of the Program, its benefits, and information on how to get a region designated as a Zone.

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### ⚙ Location of Enterprise Zones

There are currently 42 Enterprise Zones in California. No special application is needed to be included as a business under an Enterprise Zone. If a business is located within an Enterprise Zone, it automatically qualifies for the incentives described below.

The best way to determine whether a company's location or locations are in Enterprise Zones is to contact the Department of Housing and Community Development or the individual Zone administrator in which a company may have a location (<http://www.caez.org/About-Enterprise-Zones/Zone-Managers-Directory/index.html>). Additionally, the state has made available a list of Zone maps that give an idea of the neighborhoods covered under the Enterprise Zone Program (<http://www.hcd.ca.gov/fa/cdbg/ez/enterprise/>).

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### Description of the Program's Benefits

The California Enterprise Zone Program was created by the Department of Housing and Community Development to help encourage economic development in economically disadvantaged areas. Businesses that are located within an Enterprise Zone are eligible for significant State tax credits and benefits:

- Hiring Tax Credit
- Sales or Use Tax Credit
- Increased Expense Deduction
- Net Operating Loss Carryforward
- Net Interest Deduction For Lenders
- State Preference Points

Each of these benefits is described in detail below. Additionally, certain Enterprise Zones have additional benefits available to business within that Zone.

#### **Hiring Tax Credit**

The hiring tax credit is available to companies for each hourly employee hired to work in an Enterprise Zone. Employers are allowed to claim a tax credit equal to 50% of an employee's wages the first year of employment. The tax credit decreases by 10% for each subsequent year, and is available for a total of five years. The employee's wages are determined as the smaller of the actual hourly rate paid or incurred by the employer or 150% of the minimum hourly wage in California.

Certain Economic Zones provide additional hiring incentives, and others have additional limitations, so you should speak with the specific Zone representative. This tax credit and other Economic Zone credits are accounted for on a special State tax form, 3805Z.

#### **Sales or Use Tax Credit**

Entities operating in Economic Zones can claim a credit equal to the sales or use tax paid to purchase up to \$20 million of qualified property. In order to deduct the use tax, property purchased must be manufactured in the state of California, unless such property of a comparable quality and price was not available from a California manufacturer. Note that the sales tax paid on leased property qualifies under this tax credit as well.

#### **Increased Expense Deduction**

A business operating or investing within an Enterprise Zone can elect to deduct the cost of qualified property purchased in the Zone as a business expense in the first year the property is placed in

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service. This can provide additional up-front cash to a company, since such expenses are normally depreciated over several years. The maximum allowable deduction is the lesser of 40% of the cost of the deduction or \$40,000.

### **Net Operating Loss Carryforward**

A net operating loss deduction is defined as the excess of business deductions over gross income in a particular tax year. A deduction is allowed for that loss, through a net operating loss carryover in which gross income exceeds business deductions. You may carry over 100% of the business loss from your business activity within the Zone until the deduction is exhausted or for up to 15 years.

### **Net Interest Deduction for Lenders**

The purpose of this benefit is to help incentivize lenders to provide business loans to entities operating in Enterprise Zones. Lenders can take a deduction for the amount of net interest received on loans made to businesses located in Enterprise Zones. This applies to business loans, mortgages and loans from non-commercial sources. Note that this incentive applies to loans made to business that are located solely in an Enterprise Zone.

### **State Preference Points**

Some companies have found it profitable to sell their services and/or products to the California state government. The Procurement Division provides a 5 percent bid preference on service and commodity contracts valued at more than \$100,000 if the business work site is located in an Enterprise Zone.

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## Next Steps

If a company thinks it may have business locations in a qualifying Zone, it should first determine which of its stores are located within Enterprise Zones using the above links. Also, it should check with its tax advisor to determine whether it is taking full advantage of this program, as most of the Enterprise Zone incentives involve tax credits.

If a company not located in an Enterprise Zone has reason to believe that the area should qualify as one, it should consider talking to local government representatives to begin the application process to become an Enterprise Zone. The Department of Housing and Community Development has put out a guidebook explaining the

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process of applying to become a regional Enterprise Zone ([http://www.hcd.ca.gov/fa/cdbg/ez/EZ\\_Guidebook\\_11\\_3\\_08.pdf](http://www.hcd.ca.gov/fa/cdbg/ez/EZ_Guidebook_11_3_08.pdf)). This is a competitive process, and any entity that wishes to take on this endeavor should involve the other businesses in the area, as well as community groups and local or municipal government representatives.

The Department of Housing and Community Development uses a points system, and an applicant must meet a minimum number of points to be eligible. While the economic situation of the proposed Zone is material, more important is that the proposed Enterprise Zone has a viable marketing strategy and plan, available properties, existing businesses, and a job development plan.

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### More Information

In addition to the above, Carr & Ferrell maintains information on other alternative funding and financing sources, and continually updates its materials on such opportunities. For more information, or if we can be of assistance in any of your funding or other corporate needs, please contact Barry Carr, Jill Fishbein or Rob Keller of Carr & Ferrell's Corporate Group at 650-812-3400.