

projects of identified borrowers to be financed initially with \$4,000,000 of the proceeds of the bonds. The applicable elected representative of L approved issuance of the bonds subsequent to the public hearing. The loan agreement between L and M provides that the other proceeds of the bonds will be held by M and loaned to borrowers that qualify as enterprise zone businesses, following a public hearing and approval by the applicable elected representative of L of each loan by M to an enterprise zone business. None of the loans will be in principal amounts in excess of \$3,000,000. The loans by M will otherwise meet the requirements of section 1394. The bonds will be enterprise zone facility bonds.

Example 7. Original use requirement for purposes of qualified zone property. City N issues enterprise zone facility bonds, the proceeds of which are loaned to Corporation P to finance the acquisition of equipment. P uses the proceeds after the zone designation date to purchase used equipment located outside of the zone and places the equipment in service at its location in the zone. Substantially all of the use of the equipment is in the zone and is in the active conduct of a qualified business by P. The equipment is treated as qualified enterprise zone property under section 1397C because P makes the first use of the property within the zone after the zone designation date.

Example 8. Principal user. State R issues enterprise zone facility bonds and loans the proceeds to Partnership S to finance the construction of a small shopping center to be located in a zone. S is in the business of commercial real estate. S is not an enterprise zone business, but has secured one anchor lessee, Corporation T, for the shopping center. T would qualify as an enterprise zone business. S will derive 60% of its gross rental income of the shopping center from T. S does not anticipate that the remaining rental income will come from enterprise zone businesses. T will occupy 60% of the total rentable space in the shopping center. S can use enterprise zone facility bond proceeds to finance the portion of the costs of the shopping center allocable to T (60%) because T is treated as the principal user of the enterprise zone facility bond proceeds.

Example 9. Remedial actions. State W issues pooled financing enterprise zone facility bonds, the proceeds of which will be loaned to several enterprise zone businesses in the two enterprise communities and one empowerment zone in W. Proceeds of the pooled financing bonds are loaned to Corporation X, an enterprise zone business, for a term of 10 years. Six years after the date of the loan, X expands its operations beyond the empowerment zone and is no longer able to meet the requirements of section 1394. X does not reasonably expect to be able to cure the non-compliance. The loan documents provide

that X must prepay its loan in the event of noncompliance. W does not expect to be able to reloan the prepayment by X within six months of noncompliance. X's noncompliance will not affect the qualification of the pooled financing bonds as enterprise zone facility bonds if W uses the proceeds from the loan prepayment to redeem outstanding enterprise zone facility bonds within six months of noncompliance in an amount comparable to the outstanding amount of the loan immediately prior to prepayment. X will be denied an interest expense deduction for the interest accruing from the first day of the taxable year in which the noncompliance began.

(q) *Effective dates*—(1) *In general.* Except as otherwise provided in this section, the provisions of this section apply to all issues issued after July 30, 1996, and subject to section 1394.

(2) *Elective retroactive application in whole.* An issuer may apply the provisions of this section in whole, but not in part, to any issue that is outstanding on July 30, 1996, and is subject to section 1394.

[T.D. 8673, 61 FR 27259, May 31, 1996]

EMPOWERMENT ZONE EMPLOYMENT CREDIT

§ 1.1396-1 Qualified zone employees.

(a) *In general.* A qualified zone employee of an employer is an employee who satisfies the location-of-services requirement and the abode requirement with respect to the same empowerment zone and is not otherwise excluded by section 1396(d).

(1) *Location-of-services requirement.* The location-of-services requirement is satisfied if substantially all of the services performed by the employee for the employer are performed in the empowerment zone in a trade or business of the employer.

(2) *Abode requirement.* The abode requirement is satisfied if the employee's principal place of abode while performing those services is in the empowerment zone.

(b) *Period for applying location-of-services requirement.* In applying the location-of-services requirement, an employer may use either the pay period method described in paragraph (b)(1) of this section or the calendar year method described in paragraph (b)(2) of this section. For each taxable year of an

employer, the employer must either use the pay period method with respect to all of its employees or use the calendar year method with respect to all of its employees. The employer may change the method applied to all of its employees from one taxable year to the next.

(1) *Pay period method*—(i) *Relevant period*. Under the pay period method, the relevant period for applying the location-of-services requirement is each pay period in which an employee provides services to the employer during the calendar year with respect to which the credit is being claimed (*i.e.*, the calendar year that ends with or within the relevant taxable year). If an employer has one pay period for certain employees and a different pay period for other employees (e.g., a weekly pay period for hourly wage employees and a bi-weekly pay period for salaried employees), the pay period actually applicable to a particular employee is the relevant pay period for that employee under this method.

(ii) *Application of method*. Under this method, an employee does not satisfy the location-of-services requirement during a pay period unless substantially all of the services performed by the employee for the employer during that pay period are performed within the empowerment zone in a trade or business of the employer.

(2) *Calendar year method*—(i) *Relevant period*. Under the calendar year method, the relevant period for an employee is the entire calendar year with respect to which the credit is being claimed. However, for any employee who is employed by the employer for less than the entire calendar year, the relevant period is the portion of that calendar year during which the employee is employed by the employer.

(ii) *Application of method*. Under this method, an employee does not satisfy the location-of-services requirement during any part of a calendar year unless substantially all of the services performed by the employee for the employer during that calendar year (or, if the employee is employed by the employer for less than the entire calendar year, the portion of that calendar year during which the employee is employed by the employer) are performed within

the empowerment zone in a trade or business of the employer.

(3) *Examples*. This paragraph (b) may be illustrated by the following examples. In each example, the following assumptions apply. The employees satisfy the abode requirement at all relevant times and all services performed by the employees for their employer are performed in a trade or business of the employer. The employees are not precluded from being qualified zone employees by section 1396(d)(2) (certain employees ineligible). No portion of the employees' wages is precluded from being qualified zone wages by section 1396(c)(2) (only first \$15,000 of wages taken into account) or section 1396(c)(3) (coordination with targeted jobs credit and work opportunity credit). The examples are as follows:

Example 1. (i) Employer X has a weekly pay period for all its employees. Employee A works for X throughout 1997. During each of the first 20 weekly pay periods in 1997, substantially all of A's work for X is performed within the empowerment zone in which A resides. A also works in the zone at various times during the rest of the year, but there is no other pay period in which substantially all of A's work for X is performed within the empowerment zone. Employer X uses the pay period method.

(ii) For each of the first 20 pay periods of 1997, A is a qualified zone employee, all of A's wages from X are qualified zone wages, and X may claim the empowerment zone employment credit with respect to those wages. X cannot claim the credit with respect to any of A's wages for the rest of 1997.

Example 2. (i) Employer Y has a weekly pay period for its factory workers and a bi-weekly pay period for its office workers. Employee B works for Y in various factories and Employee C works for Y in various offices. Employer Y uses the pay period method.

(ii) Y must use B's weekly pay periods to determine the periods (if any) in which B is a qualified zone employee. Y may claim the empowerment zone employment credit with respect to B's wages only for the weekly pay periods for which B is a qualified zone employee, because those are B's only wages that are qualified zone wages. Y must use C's bi-weekly pay periods to determine the periods (if any) in which C is a qualified zone employee. Y may claim the credit with respect to C's wages only for the bi-weekly pay periods for which C is a qualified zone employee, because those are C's only wages that are qualified zone wages.

Example 3. (i) Employees D and E work for Employer Z throughout 1997. Although some

of D's work for Z in 1997 is performed outside the empowerment zone in which D resides, substantially all of it is performed within that empowerment zone. E's work for Z is performed within the empowerment zone in which E resides for several weeks of 1997 but outside the zone for the rest of the year so that, viewed on an annual basis, E's work is not substantially all performed within the empowerment zone. Employer Z uses the calendar year method.

(ii) D is a qualified zone employee for the entire year, all of D's 1997 wages from Z are qualified zone wages, and Z may claim the empowerment zone employment credit with respect to all of those wages, including the portion attributable to work outside the zone. Under the calendar year method, E is not a qualified zone employee for any part of 1997, none of E's 1997 wages are qualified zone wages, and Z cannot claim any empowerment zone employment credit with respect to E's wages for 1997. Z cannot use the calendar year method for D and the pay period method for E because Z must use the same method for all employees. For 1998, however, Z can switch to the pay period method for E if Z also switches to the pay period method for D and all of Z's other employees.

(c) *Effective date.* This section applies with respect to wages paid or incurred on or after December 21, 1994.

[T.D. 8747, 62 FR 67727, Dec. 30, 1997]

§ 1.1397E-1 Qualified zone academy bonds.

(a) *Overview.* In general, a qualified zone academy bond is a taxable bond issued by a state or local government the proceeds of which are used to improve certain eligible public schools. An eligible taxpayer that holds a qualified zone academy bond generally is allowed annual Federal income tax credits in lieu of periodic interest payments. These credits compensate the eligible taxpayer for lending money to the issuer and function as payments of interest on the bond. Accordingly, this section generally treats the allowance of a credit as if it were a payment of interest on the bond. In addition, this section provides rules to determine the credit rate, the present value of qualified contributions from private entities, and the maximum term of a qualified zone academy bond.

(b) *Credit rate.* The Secretary shall determine monthly (or more often as deemed necessary by the Secretary) the credit rate the Secretary estimates will generally permit the issuance of a

qualified zone academy bond without discount and without interest cost to the issuer. The manner for ascertaining the credit rate for a qualified zone academy bond as determined by the Secretary shall be set forth in procedures, notices, forms, or instructions prescribed by the Commissioner.

(c) *Private business contribution requirement—(1) Reasonable discount rate.* To determine the present value (as of the issue date) of qualified contributions from private entities under section 1397E(d)(2), the issuer must use a reasonable discount rate. The credit rate determined under paragraph (b) of this section is a reasonable discount rate.

(2) *Definition of private entities.* For purposes of section 1397E(d)(2)(A), the term *private entities* includes any person (as defined in section 7701(a)) other than the United States, a State or local government, or any agency or instrumentality thereof or related party with respect thereto. To determine whether a person is related to the United States or a State or local government under this paragraph (c)(2), rules similar to those for determining whether a person is a related party under § 1.150-1(b) shall apply (treating the United States as a governmental unit for purposes of § 1.150-1(b)).

(3) *Qualified contribution.* For purposes of section 1397E(d)(2)(A), the term *qualified contribution* means any contribution (of a type and quality acceptable to the eligible local education agency) of any property or service described in section 1397E(d)(2)(B)(i), (ii), (iii), (iv) or (v). In addition, cash received with respect to a qualified zone academy from a private entity (other than cash received indirectly from a person that is not a private entity as part of a plan to avoid the requirements of section 1397E) constitutes a qualified contribution if it is to be used to purchase any property or service described in section 1397E(d)(2)(B)(i), (ii), (iii), (iv) or (v). Services of employees of the eligible local education agency do not constitute qualified contributions.

(d) *Maximum term.* The maximum term for a qualified zone academy bond is determined under section 1397E(d)(3) by using a discount rate equal to 110