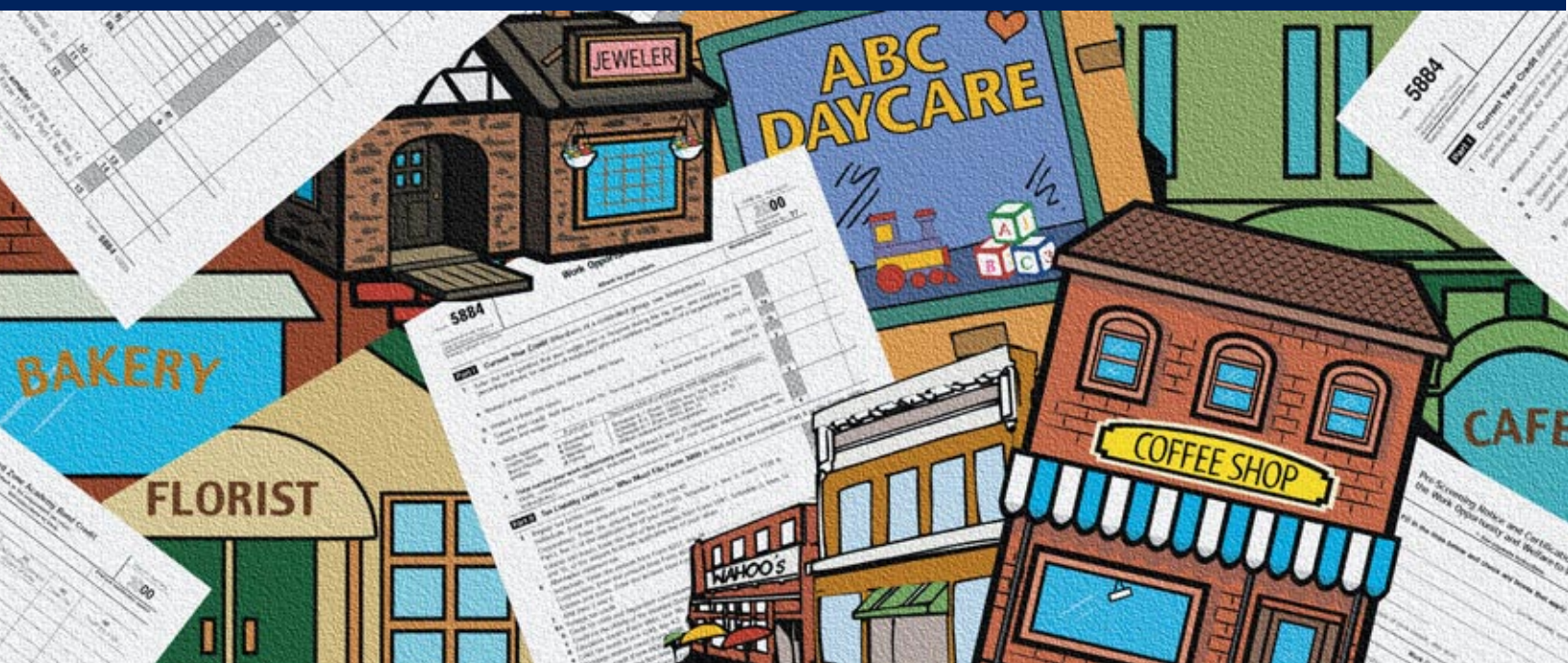


# Tax Incentive Guide for Businesses

*in the Renewal Communities,  
Empowerment Zones,  
and Enterprise Communities*

FY 2003



# Locations of the Renewal Communities, Empowerment Zones and Enterprise Communities

The U.S. Department of Housing and Urban Development (HUD) has designated Renewal Communities (RCs), Empowerment Zones (EZs) and Enterprise Communities (ECs) in distressed urban and rural areas throughout the United States. Go to [www.hud.gov/crlocator](http://www.hud.gov/crlocator) to determine if an address is located in one of these areas. To see maps, lists of census tracts, contacts, success stories, and more information on these designated areas, go to <http://www.hud.gov/offices/cpd/economicdevelopment/programs/rc/tour/index.cfm>.

The following is a list of current HUD-designated RCs, EZs and ECs:

<b>State:</b>	<b>Designee:</b>	<b>State:</b>	<b>Designee:</b>
Alabama	Birmingham EC Greene-Sumter RC Mobile County RC Southern Alabama RC	Nebraska	Omaha EC
Arizona	Phoenix EC Tucson EZ	Nevada	Las Vegas EC
Arkansas	Pulaski County EC Pulaski County EZ	New Hampshire	Manchester EC
California	Fresno EZ Los Angeles EZ Los Angeles RC Oakland EC Orange Cove RC Parlier RC San Diego RC San Francisco RC Santa Ana EZ	New Jersey	Camden RC Cumberland County EZ Newark RC
Colorado	Denver EC	New Mexico	Albuquerque EC
Connecticut	Bridgeport EC New Haven EC New Haven EZ	New York	Buffalo-Lackawanna RC Jamestown RC Newburgh-Kingston EC New York EZ Niagara Falls RC Rochester RC Schenectady RC Syracuse EZ Yonkers EZ
Delaware	Wilmington EC	North Carolina	Charlotte EC
District of Columbia	Washington EC Washington EZ	North Dakota	Turtle Mountain Band of Chippewa RC
		Ohio	Akron EC Cincinnati EZ Cleveland EC Cleveland EZ Columbus EC

<b>State:</b>	<b>Designee:</b>	<b>State:</b>	<b>Designee:</b>
Florida	Jacksonville EZ Miami EC Miami-Dade EZ Tampa EC	Ohio	Columbus EZ Hamilton RC Youngstown RC
Georgia	Albany EC Atlanta RC	Oklahoma	Oklahoma City EC Oklahoma City EZ
Illinois	Chicago EZ Chicago RC East St. Louis EC Springfield EC	Oregon	Portland EC
Indiana	Gary/Hammond/E. Chicago EZ Indianapolis EC	Pennsylvania	Harrisburg EC Philadelphia/Camden EZ (Pennsylvania & New Jersey) Philadelphia RC Pittsburgh EC
Iowa	Des Moines EC	Rhode Island	Providence
Kentucky	Eastern Kentucky RC Louisville EC	South Carolina	Charleston RC Columbia/Sumter EZ
Louisiana	Central Louisiana RC New Orleans RC Northern Louisiana RC Ouachita Parish RC	Tennessee	Chattanooga RC Knoxville EZ Memphis RC Nashville EC
Maryland	Baltimore EZ	Texas	Corpus Christi RC Dallas EC El Paso EC El Paso EZ El Paso County RC Houston EC San Antonio EC San Antonio EZ Waco EC
Massachusetts	Boston EC Boston EZ Lawrence RC Lowell RC Springfield EC	Utah	Ogden EC
Michigan	Detroit EZ Detroit RC Flint RC Muskegon EC	Vermont	Burlington RC
Minnesota	Minneapolis EC Minneapolis EZ St. Paul EC	Virginia	Norfolk EC Norfolk/Portsmouth EZ
Mississippi	Jackson EC West-Central Mississippi RC	Washington	Seattle EC Tacoma RC Yakima RC
Missouri	Kansas City EC (Kansas & Missouri) St. Louis EC St. Louis/E. St. Louis EZ (Illinois & Missouri)	West Virginia	Huntington EC  Huntington/Ironton EZ (West Virginia & Ohio)
		Wisconsin	Milwaukee RC

The U.S. Department of Agriculture (USDA) has designated EZs and ECs in distressed rural areas throughout the United States. Go to [www.hud.gov/crlocator](http://www.hud.gov/crlocator) to determine if an address is located in one of these areas. To see maps, lists of census tracts, and more information on these designated areas, go to <http://www.ezec.gov/ezec/mainmap.html>.

The following is a list of current USDA-designated EZs and ECs:

<b>State</b>	<b>Designee</b>	<b>State</b>	<b>Designee</b>
Alabama	Chambers County EC	Montana	Fort Peck Assiniboine & Sioux Tribe EC
Alaska	Metlakatla Indian Community EC	New Mexico	City of Deming EC La Jicarita EC
Arizona	Arizona Border Region EC Four Corners EC	North Carolina	Halifax/Edgecombe/Wilson EC Robeson County EC
Arkansas	East Arkansas EC Mississippi County EC	North Dakota	Griggs-Steele EZ
California	City of Watsonville EC Desert Communities EZ Huron-Tule EC Imperial County EC	Ohio	Greater Portsmouth EC
Florida	Empowerment Alliance of Southwest Florida EC Jackson County EC	Oklahoma	Southeast Oklahoma EC Tri-County Indian Nations EC
Georgia	Crisp/Dooly EC Central Savannah River Area EC Southwest Georgia United EZ	Oregon	Josephine County EC
Hawaii	Molokai EC	Pennsylvania	City of Lock Haven EC Fayette EC
Illinois	Southernmost Illinois Delta EZ	South Carolina	Allendale ALIVE EC Williamsburg-Lake City EC
Indiana	Town of Austin EC	South Dakota	Beadle/Spink EC Ogala Sioux Tribe EZ
Kansas	Wichita County EC	Tennessee	Clinch-Powell EC Fayette/Haywood County EC Scott/McCreary Area EC
Kentucky	Bowling Green EC Kentucky Highlands EZ	Texas	FUTURO Communities EC FUTURO Communities EZ Rio Grande Valley EZ
Louisiana	Northeast Louisiana Delta EC	Virginia	Accomack-Northampton EC
Maine	Aroostook County EZ Empower Lewiston EC	Washington	Five Star EC Lower Yakima County EC

<b>State</b>	<b>Designee</b>
Michigan	Clare County EC Lake County EC
Mississippi	Mid-Delta EZ North Delta Mississippi EC
Missouri	City of East Prairie EC

<b>State</b>	<b>Designee</b>
West Virginia	Central Appalachia EC McDowell County EC Upper Kanawha Valley EC
Wisconsin	Northwoods NiiJii EC

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# About the Empowerment Zone/ Enterprise Community and Renewal Community Initiatives

## Round I and Round II Empowerment Zones and Enterprise Communities

Launched in 1993, the Empowerment Zone and Enterprise Community (EZ/EC) Initiative is an interagency effort focused on the creation of self-sustaining, long-term development in distressed urban and rural areas throughout the Nation. The Initiative is based on a holistic, participatory approach that requires community stakeholders to work together to develop and implement comprehensive strategic plans for revitalization. Using a combination of Federal tax incentives and flexible grant funds, these partners are reinvigorating many communities that have been in decline for decades. Businesses are opening or expanding, residents have greater access to jobs, services, and new economic opportunities, and crime and violence are down.

Currently, 28 urban communities and 12 rural communities have Renewal Community (RC) designations from the U.S. Department of Housing and Urban Development (HUD). In addition, 30 urban communities have HUD Empowerment Zone (EZ) designations and 49 more urban communities have HUD Enterprise Community (EC) designations. Part of Washington, D.C., has HUD's only Enterprise Zone designation. The U.S. Department of Agriculture (USDA) has designated a total of 10 EZs and 48 ECs in rural areas throughout the country.

In 1994, HUD designated its first 6 urban EZs and 65 ECs during the Round I competition. HUD designated parts of Cleveland and Los Angeles as supplemental EZs and these designees received full EZ status in January 2000. USDA designated 3 rural EZs and 30 rural ECs in Round I. In 1999, HUD and USDA made additional designations in Round II. HUD designated 15 more urban EZs and USDA designated 5 more rural EZs and 20 rural ECs. The DC Enterprise Zone, together with additional DC areas suffering from 20+ percent poverty, received HUD's only Enterprise Zone designation, effective January 1998.

## Round III Empowerment Zones and Renewal Communities

In December 2000, Congress authorized a third round of EZs, seven in urban areas and two in rural areas. Congress also approved the designation of 40 new RCs. The goal of the new RC program, like that of the EZ/EC Initiative, is to promote economic development in distressed communities. Businesses located in the RCs and in the new



EZs are eligible for Federal tax incentives to hire local residents and to expand or improve their operations.

On December 31, 2001, HUD designated 28 RCs in urban areas and 12 more in rural areas. The law required an EZ or EC to forfeit its designation if any of its geographic areas were included in one of the RCs. Due to this law, the Atlanta EZ, 16 urban ECs, and 3 rural ECs lost their designations on December 31. The loss of the Atlanta EZ designation enabled HUD to designate 8 new EZs instead of just 7 in Round III. The 8-year designation period for the 40 RCs and 8 urban Round III EZs began January 1, 2002. USDA designated its two Round III EZs, located in Maine and Texas, on December 31 also.

## About This Publication

The Federal tax benefits available in EZs, ECs, and RCs are designed to encourage businesses to invest in these areas. Expanding business development and commerce leads to greater job opportunities for residents and to improved access to goods and services, both of which help energize long-term revitalization.

This guide summarizes the rules applicable to Federal tax incentives available to businesses operating in EZs, ECs, and RCs and to those hiring residents of these areas. As you use the guide, keep in mind that some tax incentives will work well for labor-intensive businesses, whereas others benefit those with capital needs. Some incentives make sense only for large companies while others work best for small ones. Several incentives discussed in this guide also apply to businesses and residents outside EZ/EC/RC communities. **Please contact your tax attorney or accountant for details regarding your eligibility to claim these incentives.** The following sections list the incentives discussed in this guide.

## Incentives

### Wage Credits

- Empowerment Zone Employment Credit (EZ Wage Credit). IRS Tax Form 8844.
- Renewal Community Employment Credit (RC Wage Credit). IRS Tax Form 8844.
- Work Opportunity Tax Credit (WOTC). IRS Tax Forms 5884 and 8850.
- Welfare to Work (WtW) Credit. IRS Tax Forms 5884, 8850, and 8861.
- Indian Employment Tax Credit. IRS Tax Form 8845.



## Deductions

- Increased Section 179 Expensing. IRS Tax Form 4562.
- Commercial Revitalization Deduction. IRS Tax Form 4562.
- Environmental Cleanup Cost Deduction (Brownfields). No applicable IRS tax forms.
- Depreciation of Property Used on Indian Reservations. See IRS Publication 946.

## Bond Financing

- Enterprise Zone Facility Bonds. No applicable IRS tax forms.
- Qualified Zone Academy Bonds (QZABs). IRS Tax Form 8860.



## Capital Gains

- Zero Percent Capital Gains Rate for RC Assets and DC Enterprise Zone Assets. No applicable IRS tax form identified at time of publication.
- Nonrecognition of Gain on Sale of Empowerment Zone Assets (EZAs). No applicable IRS tax form identified at time of publication.
- Partial Exclusion of Gain from Sale of Empowerment Zone Stock. No applicable IRS tax form identified at time of publication.

## Other Incentives

- New Markets Tax Credit. No applicable IRS tax form identified at time of publication.
- Low-Income Housing Tax Credit (LIHTC). IRS Tax Forms 8609 and 8586.

## For More Information

To find out more about the EZ/EC and RC Initiatives, to learn how to reach your local EZ/EC/RC contact person, or to obtain more copies of this guide, please call HUD's Community Connections Hotline at 1-800-998-9999 or visit [www.hud.gov/cr](http://www.hud.gov/cr) for urban EZ/ECs and urban and rural RCs or [www.ezec.gov](http://www.ezec.gov) for rural EZ/ECs. To obtain copies of IRS Publication 954, *Tax Incentives for Empowerment Zones and Other Distressed Communities*, and all other tax forms, call 1-800-829-3676 or visit [www.irs.ustreas.gov](http://www.irs.ustreas.gov).

**Table 1. Tax Incentive Matrix for Urban and Rural EZs/ECs/RCs**

Type of Benefit	Round I EZs	2 Round I Supplemental EZs (Los Angeles and Cleveland)	4 Round I Enhanced ECs	Round I ECs	Round II EZs	Round III EZs	40 Renewal Communities
<b>Grants/Loan Guarantees</b>							
\$100 million SSBG grant	X						
\$3 million SSBG grant		X <sup>1</sup>	X	X			
HUD EDI grant/Section 108 Loan Guarantee		X <sup>2</sup>	X				
HUD EZ grant					X <sup>3</sup>		
<b>Wage Credits</b>							
EZ Employment Wage Credit	X	X			X <sup>4</sup>	X	
Renewal Community Employment Credit							X <sup>4</sup>
Work Opportunity Tax Credit	X	X	X	X	X	X	X
Welfare to Work Wage Credit	X	X	X	X	X	X	X
Indian Employment Tax Credit	X	X	X	X	X	X	X
<b>Deductions</b>							
Increased Section 179 Deduction	X	X			X	X	X
Commercial Revitalization Deduction							X
Environmental Cleanup Cost Deduction	X	X	X	X	X	X	X
Depreciation of Property Used on Indian Reservations	X	X	X	X	X	X	X
<b>Bond Financing</b>							
Enterprise Zone Facility Bonds	X	X	X	X	X	X	
Qualified Zone Academy Bonds (QZABs)	X	X	X	X	X	X	X
<b>Capital Gains</b>							
Zero Percent Capital Gains Rate for RC Assets and DC Enterprise Zone Assets							X <sup>5</sup>
Nonrecognition of Gain on Sale of Empowerment Zone Assets	X	X			X	X	
Partial Exclusion of Gain on Sale of Empowerment Zone Stock	X	X			X	X	
<b>Other Incentives</b>							
New Markets Tax Credit	X	X	X	X	X	X	X
Low-Income Housing Tax Credits	X	X	X	X	X	X	X

1. Cleveland only  
 2. Los Angeles received \$450 million; Cleveland received \$177 million.  
 3. Subject to annual appropriation.  
 4. After December 31, 2001.  
 5. Also applicable to District of Columbia Enterprise Zone.

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**Table 2. Summary of Tax Incentives: Tax Credits, Deductions, Bonds, and Capital Gains**

Wage Credits	Description	Availability
Empowerment Zone Employment Credit (EZ Wage Credit)	Credit against Federal taxes up to \$3,000 for businesses for each year of EZ designation for every existing employee and new hire who lives and works in the EZ.	Available currently for Round I EZs; available for all EZs beginning January 1, 2002, through December 31, 2009. Cannot count wages for both the WOTC and WtW credits and the EZ Wage Credit.
Renewal Community Employment Credit (RC Wage Credit)	Credit against Federal taxes up to \$1,500 for businesses for each year of RC designation for every existing employee and new hire who lives and works in the RC.	Available beginning January 1, 2002, through December 31, 2009. Cannot count wages for both the WOTC and WtW credits and the RC Wage Credit.
Work Opportunity Tax Credit (WOTC)	Credit up to \$2,400 against Federal taxes for businesses for each new hire from groups that have high unemployment rates or other special employment needs, including youth ages 18 to 24 who live in an EZ, EC, or RC, and summer hires ages 16 to 17 who live in an EZ, EC or RC.	Expires for individuals who begin work after December 31, 2003. Business does not have to be in an EZ, EC, or RC to qualify. Cannot be combined with WtW Credit. State Employment Services Agency must certify employee is in targeted group.
Welfare to Work (WtW) Credit	Two-year credit against Federal taxes for businesses that hire long-term family assistance recipients. Credits up to \$3,500 for the first year, and \$5,000 for the second year for each new hire.	Expires for individuals who begin work after December 31, 2003. Business does not have to be in an EZ, EC, or RC to qualify. Cannot be combined with WOTC. State Employment Services Agency must certify employee is in targeted group.
Indian Employment Tax Credit	Credit against Federal taxes calculated on wages (including employee health insurance costs) up to \$20,000 for each qualified employee who is an enrolled member of an Indian tribe (or spouse) who lives on or near an Indian reservation. Available for existing employees and new hires.	A business does not have to be located in an EZ, EC, or RC to qualify for this credit. The majority of the services performed by the employee must be on an Indian reservation. The credit does not apply for taxable years beginning after December 31, 2003.

(continued)

**Table 2. Summary of Tax Incentives: Tax Credits, Deductions, Bonds, and Capital Gains (continued)**

Deductions	Description	Availability
Increased Section 179 Deduction	Allows businesses to claim increased Section 179 deduction (up to \$20,000 in additional expensing increasing to \$35,000 for property acquired after December 31, 2001) if the businesses qualifies as an Enterprise Zone Business or Renewal Community Business. Can be claimed on certain depreciable property such as equipment and machinery.	Can be used only in EZs and RCs. Cannot be used in developable sites until after December 31, 2001. Cannot be used in ECs.
Commercial Revitalization Deduction	Deduction of either one-half of qualified revitalization expenditures (QREs) in the first year a building is placed in service or all of QREs on ratable basis over 10 years if QREs have been allocated to revitalization of a commercial building located in an RC.	Available in RCs for buildings placed in service after December 31, 2001, and before January 1, 2010. State may allocate up to \$12 million in deductions (not more than \$10 million per project) for each year 2002–2009 for each RC in the State. Business does not have to be a Renewal Community Business.
Environmental Cleanup Cost Deduction (Brownfields)	Businesses can elect to deduct qualified cleanup costs of hazardous substances in certain areas (brownfields) in the tax year the business pays or incurs the costs.	Property is not required to be located in an EZ, EC, or RC. Need certification from State environmental agency. Includes costs paid or incurred prior to January 1, 2004.
Depreciation of Property Used on Indian Reservations	Special accelerated depreciation rules apply to qualified property placed in service on an Indian reservation after 1993 and before 2004. Certain public infrastructure used or located off the Indian reservation also qualifies.	A business does not have to use the property in an EZ, EC, or RC to use these special rules, but generally the property must be used on an Indian reservation. Property must be placed in service after 1993 and before 2004.

(continued)

**Table 2. Summary of Tax Incentives: Tax Credits, Deductions, Bonds, and Capital Gains (continued)**

Bond Financing	Description	Availability
Enterprise Zone Facility Bonds	State and local governments can issue Enterprise Zone Facility Bonds (a type of tax-exempt bond) to make loans at lower interest rates to Enterprise Zone Businesses to finance Qualified Zone Property.	\$3 million per borrower limit in any Round I EZ for bonds issued prior to January 1, 2002, or in any EC, with a \$20 million per borrower nationwide limit; must have State volume cap allocated. \$130 million or \$230 million available in urban Round II EZs (\$60 million in rural Round II EZs) over designation period and for all EZs after December 31, 2001, including developable sites (no per-borrower limit and bonds are not subject to State volume cap) for EZ- or EC-based commercial, retail, or industrial property; 35 percent of employees must be EZ or EC residents.
Qualified Zone Academy Bonds (QZABs)	State or local governments can issue bonds at 0-percent interest cost to them to finance public school programs with private business partnerships. Private businesses must contribute money, equipment, or services equal to 10 percent of bond proceeds (which may qualify as a charitable contribution). The Federal Government pays interest in the form of tax credit to banks, insurance companies, and certain lending corporations that hold QZABs.	Federal allocation to States annually from 1998–2003. State education agency allocates credit to a Qualified Zone Academy to finance materials, teacher training, building renovation, or equipment for programs that prepare students for jobs or college. Schools must be located in an EZ or EC or have 35 percent of students eligible for free or reduced-cost lunch program.

(continued)

**Table 2. Summary of Tax Incentives: Tax Credits, Deductions, Bonds, and Capital Gains (continued)**

Capital Gains	Description	Availability
Zero Percent Capital Gains Rate for RC and DC Enterprise Zone Assets	The holder, for a minimum of 5 years, of a District of Columbia Enterprise Zone (DC Enterprise Zone) asset acquired between January 1, 1998, and December 31, 2002, or an RC asset acquired between January 1, 2002, and December 31, 2009, will not have to include in its gross income any qualified capital gain from the sale or exchange of the asset.	Exclusion applies only to an interest in, or property of, certain businesses operating in the District of Columbia or an RC. The following qualify as DC Enterprise Zone or RC assets: DC Enterprise Zone or RC business stock, DC Enterprise Zone or RC partnership interests, and DC Enterprise Zone or RC business properties. Only gain attributable to the period from January 1, 1998, through December 31, 2008, for the DC incentive, and from January 1, 2002, through December 31, 2014, for RCs, may be excluded.
Nonrecognition of Gain on Sale of Empowerment Zone Assets (EZA)	Capital gain on EZAs (stock, partnership interests, and business property) of an Enterprise Zone Business held for more than 1 year is not recognized (and is rolled over) if replacement EZA is acquired within 60 days.	Election by taxpayer for EZA acquired after December 21, 2000, and before January 1, 2010, for all EZs (not available in the DC Enterprise Zone, ECs, or RCs).
Partial Exclusion of Gain on Sale of Empowerment Zone Stock	Exclusion of 60 percent of the gain on sale of small business stock of a C Corporation that is an Enterprise Zone Business located in an EZ if the stock is held for at least 5 years.	Stock must be acquired after December 21, 2000, and before January 1, 2010, at original issuance in exchange for cash. Sixty-percent exclusion does not apply to gain after December 31, 2014. Business must be an Enterprise Zone Business in an EZ (other than the DC Enterprise Zone).

(continued)

**Table 2. Summary of Tax Incentives: Tax Credits, Deductions, Bonds, and Capital Gains (continued)**

Other Incentives	Description	Availability
New Markets Tax Credit	Equity investors in qualified Community Development Entities (CDEs) can obtain a tax credit against Federal taxes of 5 to 6 percent of the amount invested for each of the years the investment is held, for up to 7 years of the credit period.	Allocations of the credit will be made annually from 2001 to 2007 to qualified CDEs. Investors must purchase stock or partnership interest in a CDE for cash at original issuance. Credit available at time of purchase (1 year) and on 6 anniversary dates of acquisition of investment.
Low-Income Housing Tax Credit (LIHTC)	Ten-year credit against Federal taxes for owners of newly constructed or renovated rental housing who set aside a specified percentage of units for low-income persons for a minimum of 15 years. The credit varies for new construction and renovation.	Project must receive allocation of State's annual credit ceiling or use multifamily housing tax-exempt bonds that receive allocation of State's bond volume cap. Allocations are made on basis of State plan. The project does not have to be located in an EZ, EC, or RC to qualify.



# Empowerment Zone Employment Credit/Renewal Community Employment Credit

## Applicable IRS Tax Form: Form 8844

Wage Credit	Description	Availability
Empowerment Zone Employment Credit (EZ Wage Credit)	Credit against Federal taxes of up to \$3,000 for businesses for each year of EZ designation for every existing employee and new hire who lives and works in the EZ.	Available currently for Round I EZs; available for all EZs beginning January 1, 2002, through December 31, 2009. Cannot count wages for the WOTC and WtW credits and the EZ Wage Credit.
Renewal Community Employment Credit (RC Wage Credit)	Credit against Federal taxes up to \$1,500 for each year of Renewal Community (RC) designation for every existing employee and new hire who lives and works in the RC.	RC Wage Credit available beginning January 1, 2002, through December 31, 2009. Cannot count wages for the WOTC and WtW credits and the RC Wage Credit.

The Empowerment Zone Employment Credit (EZ Wage Credit) and Renewal Community Employment Credit (RC Wage Credit) give businesses an incentive to retain or hire individuals who both live and work in an Empowerment Zone (EZ) or a Renewal Community (RC), respectively. (Individuals who work in the DC Enterprise Zone may live anywhere in the District of Columbia.) Businesses can claim the credit if they pay or incur “qualified zone wages” to a qualified employee. The credit can be as much as \$3,000 per qualified employee per year for the EZ Wage Credit and up to \$1,500 for the RC Wage Credit. The credit is available with respect to all EZs and RCs beginning January 1, 2002. Round I Zones are currently eligible for the EZ Wage Credit, continuing through December 31, 2009.



## Target Audience

- Businesses relocating to an EZ or RC that will have large hiring needs.
- Businesses expanding within an EZ or RC that will be hiring new employees.

## EZ Employment Credit/RC Employment Credit

- Businesses with relatively high turnover that often need new employees.
- Businesses with a stable workforce of employees living in an EZ or RC.
- Businesses looking to reduce tax liability.
- Businesses seeking to qualify as an Enterprise Zone Business or a Renewal Community Business that must meet the 35-percent EZ/RC resident employee requirement.

## Incentive Not Relevant to

- Startup businesses that may not have large tax liabilities.
- Nonprofit organizations.
- Businesses whose employees spend the majority of their time (by pay period or on average over the year) working outside an EZ or RC.

## Additional Resources

- Accountants and lawyers preparing business tax returns.
- Local bar associations or accountant groups to identify accountants or lawyers to field questions.
- Local schools, vocational schools, junior or community colleges, 4-year colleges, and job-training programs that may have EZ or RC residents participating in their programs. These training programs should be linked to employment agencies and job banks working with businesses that have operations in an EZ or RC.
- Job banks that have established relationships with businesses located in an EZ or RC.
- Instructions for IRS Form 8844. For copies call 1-800-829-3676 or visit [www.irs.ustreas.gov](http://www.irs.ustreas.gov).

## Questions & Answers on Empowerment Zone and Renewal Community Employment Credits



### **Are there any employer incentives for hiring employees who work in an EZ or RC?**

Yes. The tax code allows employers a credit against Federal taxes for hiring and retaining employees who live and work in an EZ or RC.

The EZ Wage Credit has been available since 1994 for Round I EZs and since 1998 for the District of Columbia. The EZ Wage Credit and RC Wage Credit will be available in all EZs and RCs beginning January 1, 2002, and will continue for all EZs and RCs through December 31, 2009.



### **Can a business use this credit for current employees?**

Yes. The EZ Wage Credit and RC Wage Credit are incentives to hire and retain individuals who live in an EZ or RC, so it is available each year throughout the EZ Wage Credit and RC Wage Credit periods.



### **How does a business document that an employee is an EZ or RC resident?**

The employer should obtain a statement from the employee, under penalty of perjury, that gives the address of the employee's principal residence and provides assurance that the employee will notify the employer of a change in the employee's principal residence. The local EZ or RC can confirm that the address is in the EZ or RC or a business can obtain the information over the Internet using the EZ/EC/RC address locator at <http://hud.esri.com/rcezec>. The statements are not filed with the business's tax return, but should be retained like any other documents supporting a tax return.



### **What if the employee works part-time?**

The credit is available for both part-time and full-time employees as long as they have been employed by the employer for at least 90 days. The amount of the credit is tied to the amount of wages paid rather than to the number of hours worked.



### **What is the definition of qualified wages?**

Qualified wages are generally wages subject to the Federal Unemployment Tax Act (FUTA). The credit is calculated against a maximum of \$15,000 in wages for the EZ Wage Credit and \$10,000 for the RC Wage Credit. A business may pay the employee more than \$15,000 for EZs or \$10,000 for RCs, but the maximum for purposes of calculating the credit is \$15,000 for an EZ or \$10,000 for an RC. The instructions for IRS Form 8844 provide additional information on qualified wages.



### **What is the credit amount?**

The EZ Wage Credit amount is 20 percent of wages up to the \$15,000 wage amount. The credit amount for the RC Wage Credit is 15 percent of wages up to the \$10,000 wage amount.



### **Is there a limit on the number of employees for which a business can take the credit?**

An employer can take the credit for as many employees as qualify.



### **What if the employee works in an EZ or RC for only part of the year?**

An employer can use either the pay-period or calendar-year method for determining the period of time the employee performs services in an EZ or RC. No other time periods can be used to prorate the credit. For example, if an employee works in several factory locations and is paid weekly, an employer can claim the wage credit for the weekly pay periods during which the employee works substantially all of his or her time in the factory located in an EZ or RC. “Substantially all” is defined as 85 percent for the purposes of some of the tax incentives discussed in this guide, but the regulations on the EZ and RC Wage Credits do not define substantially all. The employer must use the same method for all employees, but may change the method applied to all employees from one taxable year to another.



**What if the business is located in an EZ or RC, but the employees spend part of their time working outside the boundaries of the EZ or RC?**

The credit is available only if substantially all of the services performed during the period (see answer to question above on pay-period and calendar year calculations) are in an EZ or RC. “Substantially all” is defined as 85 percent for purposes of some of the tax incentives discussed in this guide, but the regulations on the EZ and RC Wage Credits do not define substantially all. If an employee does not perform substantially all services inside an EZ or RC within the calculation period selected, the credit cannot be prorated and no portion of the wages for that period would qualify for the credit.



**What if the Federal tax liability of the business is less than the total credit amount?**

The EZ Wage Credit and RC Wage Credit generally are subject to the same rules as other business tax credits. As with other business tax credits, unused credit amounts can be carried forward for up to 20 years and carried back a year. However, the credit cannot be carried back prior to the EZ or RC designation.



**Are there special procedures for taking the EZ or RC Wage Credit?**

The credit is accounted for on IRS Form 8844 and would be part of a business’s tax filing.



**Can nonprofit organizations benefit from the EZ or RC Wage Credits?**

Tax-exempt organizations, other than certain cooperatives, are ineligible for the credits.



**Can a pass-through entity, such as a partnership or S-corporation, use the credit?**

The EZ Wage Credit and RC Wage Credit are general business tax credits for Federal tax purposes and may be passed through under the rules similar to other business tax credits.



**Does the EZ Wage Credit or RC Wage Credit reduce Alternative Minimum Tax (AMT) liability?**

AMT may be reduced by 25 percent of the EZ Wage Credit or RC Wage Credit amount.



**Can the EZ Wage Credit or RC Wage Credit for an employee be taken concurrently with Work Opportunity Tax Credits (WOTC) or Welfare to Work (WtW) credits?**

Yes, but wages are not taken into account for the EZ Wage Credit or RC Wage Credit if they are being used in determining WOTC or WtW. In addition, the \$15,000 or \$10,000 cap on wages taken into account for the EZ Wage Credit or RC Wage Credit, respectively, would be reduced by any wages taken into account in computing WOTC or WtW.



**Which categories of employees would not qualify for the EZ and RC Wage Credits?**

The EZ and RC Wage Credits cannot be taken for any individual employed at any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other gambling facility, or store whose principal business is the sale of alcoholic beverages for consumption off premises.

The EZ and RC Wage Credits are not available for family members of the employer, including sons, daughters, parents, stepchildren, stepmothers, stepfathers, in-laws, and other persons treated as dependents under the tax code. Similar exclusions apply to 5-percent owners related to the employer and family members of majority shareholders or partners of the employer.



**Can entities that lease their employees use the credit?**

Employers should check with their tax advisors. The EZ and RC Wage Credits are based on FUTA wages, so the ability to take the credit will depend on who the employer is for purposes of the FUTA wages.



**Is there a definition of employee?**

The credit is tied to wages as defined for purposes of FUTA. Any individual treated as an employee under FUTA would generally be treated as an employee for purposes of the EZ Wage Credit.



**Can the EZ Wage Credit and RC Wage Credit be taken for farmworkers?**

If the employer's principal activity is farming, the credit is available for employees only if the sum of value of the assets owned or leased by the employer for use in the farming business does not exceed \$500,000. The definition of farming and the method for calculating the value of the assets are found in the tax laws, and the employer should consult its legal advisor on this matter before taking the credit.



**How does the credit affect the deduction for salaries and wages?**

A business must reduce the deduction for salaries and wages by the amount of the credit taken.



**Can a business benefiting from the EZ Wage Credit or RC Wage Credit transfer those credits to another business entity, such as a flowthrough entity?**

No. There is no provision in the Internal Revenue Code that allows one entity to transfer an unused EZ Wage Credit or RC Wage Credit to another entity.



There is, however, a provision that allows the unused credits—that is, credits exceeding tax liability—to be carried forward 20 years and back 1 year.



**With respect to the wage credit, can an employer count the time an employee is outside of the EZ or RC, for example on a tour boat in a lake, if the employee starts and stops its tours in the EZ or RC?**

To qualify for the credit, substantially all of the services performed by the employee for the employer during the period must be performed within the EZ or RC. Any services that are performed outside of the EZ or RC geographic boundaries would not count under this test. If an employer treated the pay period as the measurement period, the employer could take the wage credit for the pay period only if the employee performed substantially all services within the EZ or RC. For example, if an employee performed 50 percent of his or her services in the EZ or RC and 50 percent on the lake outside of the EZ or RC during a pay period, no credit would be allowed for that pay period.



**Can both the RC Wage Credit and the Indian Employment Credit be taken for an employee who qualifies for both credits?**

Neither the RC Wage Credit nor the Indian Employment Credit provisions prohibit taking both credits for the same employee.



**Can an employer receive the RC Wage Credit for an employee who lives in one RC and works in another, or lives in an RC and works in an EZ, or vice versa?**

No. Wages must be paid to a *qualified zone employee* to qualify for the credit. To be a qualified zone employee, the employee must live in the same EZ or RC in which substantially all of the services are performed for the employer.



**With respect to EZ Wage Credit and RC Wage Credit, is the 90-day period calculated based on the calendar or on days worked?**

The 90-day test is based on calendar days, not days worked.



**Are tips considered qualified wages in order to determine the EZ Wage Credit or RC Wage Credit?**

No. The definition of wages for this purpose does not include tips.



**How is the EZ Wage Credit or RC Wage Credit calculated if the fiscal year of the business is not the calendar year?**

The credit is based on the qualified wages paid or incurred during the calendar year that ends during the taxpayer's fiscal year. For example, a business with a fiscal year ending on September 30 would take the credit for wages paid or incurred from January 1 through December 31, 2001, on the tax return for the fiscal year that begins on October 1, 2001, and ends on September 30, 2002. For the wages paid or incurred from January 1 through December 31, 2002, the credit would be claimed on the return for the fiscal year that begins on October 1, 2002, and ends on September 30, 2003. Therefore, even though the taxpayer's deduction is for fiscal year wages, the credit is for calendar year wages.

Note: This rule applies only to the EZ Wage Credit and the RC Wage Credit. The WOTC, WtW credit, and Indian Employment Tax Credit all use fiscal year wages.



**Can a company with employees working at a building construction site in an RC qualify for the RC Wage Credit?**

The RC Wage Credit is available for any employee who performs substantially all of his/her services in the RC during the period and who also lives in the RC. The Internal Revenue Service (IRS) has interpreted the language

“the period” to include pay periods. Thus, if an employee is working at a construction site for substantially all specified pay periods, the wages paid during those pay periods would be qualified wages eligible for the 15-percent credit against up to \$10,000 per year in wages. The employee must live in the RC during that same time period.



**With regard to the EZ Wage Credit and RC Wage Credit, what does *substantially all* mean with regard to services performed?**

Although there is no published guidance on this question that specifically relates to the EZ Wage Credit or RC Wage Credit, the IRS recently ruled that “substantially all” means “80 percent or more” as it relates to identical statutory language regarding services performed by New York Liberty Zone business employees for purposes of a different wage incentive.



**Could a tax-exempt organization take advantage of the EZ Wage Credit or RC Wage Credit?**

Tax-exempt organizations (other than farmers’ cooperatives) are not eligible to claim the EZ Wage Credit or RC Wage Credit.



**What if the sister of an employer works at a company that wishes to use the EZ Wage Credit or RC Wage Credit? If she is married and files her taxes separately from the employer, will she qualify?**

No. Wages paid to certain family members, including sisters, brothers, mothers, fathers, and spouses of the taxpayer, are not qualifying wages for purposes of the EZ Wage Credit or RC Wage Credit, regardless of the filing status of the relative. In addition, the tax rules prohibit taking a wage credit for a broader list of relatives (including sons, daughters, stepsons, stepdaughters, a father or mother [or an ancestor of either], a stepfather or stepmother, aunts, uncles, nieces, nephews, and various in-laws) if that individual is claimed as a dependent.



**The EZ Wage Credit and RC Wage Credit indicate the employee must live in the EZ or RC. How, then, would an EZ or RC use these credits when providing employment for a homeless individual?**

There seems to be no definition in the IRS Code, committee reports, or other published IRS guidance defining the “principal place of abode” of the employee, which must be located in the EZ or RC. The employer is responsible for proving that the employee’s principal place of abode was within the EZ or RC during the period the services were performed for the employer. Presumably, this is the address that the employee entered on Form W-4 on starting work. There seems to be no reason why a homeless shelter could not be considered a “principal place of abode.” This is a compliance matter and would be raised only (if at all) during an audit of the employer’s tax return.



**Which are the “certain cooperatives” that may qualify to use EZ Wage Credit or RC Wage Credit? Are telephone and electrical cooperatives included?**

The cooperative must be a farmers’ cooperative as described in section 521 of the tax code.



**In defining nonqualifying zone employees in its discussion on the employment credits, IRS Publication 954 refers to employees of a farming trade or business. What is the definition here of farming? Does this include those employed in horse farming, cattle farming, tobacco farming, goat producer cooperatives, etc.? Does the definition include tree farmers?**

Yes. Farming is defined as cultivating the soil or raising or harvesting any agricultural or horticultural commodity (including animals) on a farm, or handling, drying, packing, grading, or storing on a farm any agricultural or horticultural commodity in its unmanufactured state if the farmer regularly produces more than one half of the commodity so treated.

Not all farming operations are excluded from the definition. Small farms are eligible. Small farms are those whose business assets (greater of unadjusted basis or fair market value) plus the value of leased business assets does not exceed \$500,000.



**What documentation is required if an employer wants to claim the EZ Wage Credit or RC Wage Credit? If the business has employee records showing residence during employment is this sufficient?**

There is no prescreening for the EZ Wage Credit or RC Wage Credit. The taxpayer files would need a signed statement by the employee attesting to residence, which is usually found in the employment application. At some point, the taxpayer would have to determine if the residence is in the EZ or RC, but the employer is not required to submit any particular IRS form to substantiate this. Many employers use the HUD address locator available from HUD's Web site at [www.hud.gov/cr](http://www.hud.gov/cr). There are also consulting firms that verify addresses.



**Where can a business obtain more information on this incentive?**

A business should consult with its tax advisor. IRS Publication 954 and IRS Form 8844 describe this incentive. For copies call 1-800-829-3676 or visit [www.irs.ustreas.gov](http://www.irs.ustreas.gov).

# Work Opportunity Tax Credit

## Applicable IRS Tax Forms: Forms 5884 and 8850

Wage Credit	Description	Availability
Work Opportunity Tax Credit (WOTC)	Credit up to \$2,400 against Federal taxes for businesses for each new hire from groups that have high unemployment rates or other special employment needs, including: youth ages 18 to 24 who live in an EZ, EC, or RC, and summer hires ages 16 to 17 who live in an EZ, EC, or RC.	Expires for individuals who begin work after December 31, 2003. Business does not have to be in an EZ, EC, or RC to qualify. Cannot be combined with WtW credit. State Employment Services Agency must certify employee is in targeted group.

The Work Opportunity Tax Credit (WOTC) provides businesses with an incentive to hire individuals from groups that have particularly high unemployment rates or other special employment needs. Businesses do not have to be located in an Empowerment Zone (EZ), Enterprise Community (EC), or Renewal Community (RC) to qualify for this credit. They can claim the credit if they pay or incur qualified first-year wages to a targeted-group employee who began work after September 1996. Groups that qualify include:

- High-risk youth (ages 18 to 24 who live in an EZ, EC, or RC).
- Veterans.
- Ex-felons.
- Vocational rehabilitation referrals.
- Summer youth employees (ages 16 and 17) who live in an EZ, EC, or RC.
- Food stamp recipients.
- Recipients of assistance under Aid to Families with Dependent Children (AFDC) or its successor program, Temporary Assistance for Needy Families (TANF).
- Supplemental security income (SSI) recipients.



Each qualifying category has specific requirements. Employers should consult their tax advisors and the State Employment Services Agency (SESA).

## Target Audience

- Businesses outside an EZ, EC, or RC that will have large hiring needs.
- Businesses expanding within an EZ, EC, or RC that will be hiring new employees.
- Businesses with relatively high turnover that often need new employees.
- Businesses looking to reduce tax liability.
- Businesses participating in summer youth employment programs.
- Businesses seeking to qualify as an Enterprise Zone Business or a Renewal Community Business that must meet the 35-percent EZ, EC, or RC resident employee requirement.

## Incentive Not Relevant to

- Startup businesses that may not have large tax liabilities.
- Nonprofit organizations.
- Businesses with highly specialized employees, unless a local training program can supply appropriately trained employees.

## Additional Resources

- Accountants and lawyers preparing business tax returns.
- Local bar associations or accountant groups to identify accountants or lawyers to field questions.
- The SESA assigned to handle WOTC certifications (may be at State or local level). The SESA staff should be included in informational meetings held for employees and EZ, EC, and RC residents as well as in job-training programs. The SESA is also likely to have materials prepared on the incentives.
- Local schools, vocational schools, junior or community colleges, 4-year colleges, and job-training programs that may have EZ, EC, or RC residents of the appropriate age participating in their programs. The training programs should be linked to the SESA or other employment agencies and job banks.



- Job banks with established relationships with the SESA so that EZ, EC, and RC residents can have conditional certification as qualifying for WOTC.
- Instructions for IRS Forms 8850 and 5884. For copies call 1-800-829-3676 or visit [www.irs.ustreas.gov](http://www.irs.ustreas.gov).

## Questions & Answers on the Work Opportunity Tax Credit



### Are there any incentives for hiring residents of an EZ, EC, or RC?

Yes. The tax code gives employers a credit (WOTC) against Federal taxes for hiring residents of an EZ, EC, or RC ages 18 to 24. WOTC also applies to EZ, EC, and RC residents ages 16 and 17 who are hired for summer work and is available for the hiring of certain other groups identified as having difficulty entering the job market.



### Can a business use this credit for current employees?

No. WOTC is an incentive to hire individuals, and the credit is calculated against wages paid only during the first year an employee works for an employer. To take advantage of the credit, the business must obtain information from the employee prior to offering him or her a job.



### What paperwork is involved?

A business must have a prospective employee fill out IRS Form 8850 prior to making a job offer. The employer also signs the form. In some cases, the prospective employee may bring a precertification form to the interview. Form 8850 must be forwarded to the SESA within 21 days of the date the employee starts work. WOTC may be taken only for employees who have been certified by the SESA as qualifying for the incentive.



### **How does a business document that an EZ, EC, or RC resident is qualified?**

In most cases, a driver's license will serve to establish the age and address of a prospective employee. The EZ, EC, or RC can confirm that the address is within designated boundaries, or a business can obtain the information using the EZ/EC/RC address locator at <http://hud.esri.com/rcezec>. The SESA can provide a business with other ways to establish the age and address when a prospective employee does not have a driver's license.



### **What if the employee leaves during the first year of employment?**

The credit is available for any person who works at least 120 hours for a business. The credit rate is 25 percent of wages paid to an individual who works at least 120 hours. If the employee works at least 400 hours, the credit rate is increased to 40 percent of first-year wages.



### **What if the employee works part-time?**

The credit is available for both part-time and full-time employees. The credit percentage is tied to the total number of hours worked.



### **What is the definition of qualified wages?**

Qualified wages are generally wages subject to the Federal Unemployment Tax Act. The credit is calculated against a maximum of \$6,000 in first-year wages or \$3,000 in the case of summer youth. A business may pay the employee more than \$6,000 in the first year, but the maximum for purposes of calculating the credit is \$6,000. The instructions for IRS Form 5884 provide additional specific information on qualified wages.



**Is there a limit on the number of employees for which a business can take the credit?**

An employer can take the maximum \$2,400 credit (40 percent of \$6,000) for as many new hires as are qualified.



**What if the Federal tax liability of the business is less than the total credit amount?**

WOTC is one of several business credits and generally is subject to the same rules as other business tax credits. As with other business tax credits, unused WOTC amounts can be carried forward for up to 20 years and carried back 1 year.



**Can nonprofit organizations benefit from WOTC?**

Tax-exempt organizations, other than certain cooperatives, are ineligible for the credits.



**Can a pass-through entity, such as a partnership or S-corporation, use the credit?**

WOTC is a general business credit for Federal tax purposes and may be passed through under the rules similar to other business credits.



**Is there a time limit for taking WOTC?**

WOTC is not a permanent provision of the tax code; rather, it is available for individuals who start work by a specified date. A business should check with its tax preparer or visit [www.doleta.gov](http://www.doleta.gov) to determine that date. Currently, individuals must start work before January 1, 2004, but the date is likely to be extended.



### **Can both WOTC and Welfare to Work (WtW) credits be claimed for the same employee?**

If an employer takes the WtW credit, that individual does not qualify as a member of a WOTC-targeted group. An employer cannot claim both credits with respect to the same individual in any 1 taxable year.

The WtW credit may be claimed for the second-year wages of a qualifying individual regardless of whether the employer took WOTC or WtW for the first-year wages.



### **How does the credit affect the deduction for salaries and wages?**

A business must reduce the deduction for salaries and wages by the amount of the credit taken.



### **Are there special procedures for taking the tax credit?**

The credit is accounted for on IRS Form 5884 and would be part of a business's tax filing. Form 8850 and certification by the SESA are not filed with the tax return but should be retained by the business to substantiate the credit.



### **Where can a business obtain more information on this incentive?**

A business should consult its tax advisor. IRS Publication 954 and IRS Forms 5884 and 8850 describe this incentive. For copies call 1-800-829-3676 or visit [www.irs.ustreas.gov](http://www.irs.ustreas.gov). Questions about the certification process should be directed to the SESA.

# Welfare to Work Tax Credit

## Applicable IRS Tax Forms: Forms 5884, 8850, and 8861

Wage Credit	Description	Availability
Welfare to Work (WtW) Credit	Two-year credit against Federal taxes for businesses that hire long-term family assistance recipients. Credits up to \$3,500 for the first year, and \$5,000 for the second year for each new hire.	Expires for individuals who begin work after December 31, 2003. Business does not have to be in an EZ, EC, or RC to qualify. Cannot be combined with WOTC. State Employment Services Agency must certify employee is a long-term family assistance recipient.

The Welfare to Work (WtW) credit provides businesses with an incentive to hire long-term family assistance recipients. Businesses do not have to be located in an Empowerment Zone (EZ), Enterprise Community (EC), or Renewal Community (RC) to qualify for this credit. They can claim the credit if they pay or incur qualified wages (during the first 2 years of employment) to a long-term family assistance recipient who began work after December 1997 but before January 1, 2004. This incentive applies only to new hires.



## Target Audience

- Businesses with large hiring needs.
- Businesses expanding that will be hiring new employees.
- Businesses with relatively high turnover that often need new employees.
- Businesses looking to reduce tax liability.

## Incentive Not Relevant to

- Startup businesses that may not have large tax liabilities.
- Nonprofit organizations.

## Additional Resources

- Accountants and lawyers preparing business tax returns.
- Local bar associations or accountant groups to identify accountants or lawyers to field questions.
- The State Employment Services Agency (SESA) assigned to handle Welfare to Work certifications (may be at State or local level). SESA staff should be included in informational meetings held for employees and EZ, EC, and RC residents as well as in job-training programs. The SESA is also likely to have materials prepared on the incentives.
- Local schools, vocational schools, junior or community colleges, 4-year colleges, and job-training programs for members of families who have been long-term recipients of family assistance (Aid to Families with Dependent Children (AFDC) or Temporary Aid for Needy Families (TANF) payments) participating in their programs. The training programs should be linked to the SESA or other employment agencies and job banks.
- Job banks with established relationships with the SESA so that long-term welfare recipients can have conditional certification as qualifying for Welfare to Work.
- Instructions for IRS Forms 5884, 8850, and 8861. For copies call 1-800-829-3676 or visit [www.irs.ustreas.gov](http://www.irs.ustreas.gov).

## Questions & Answers on Welfare to Work Tax Credit



### **Are there any incentives for hiring individuals who have received family assistance payments?**

Yes. The tax code gives employers a Welfare to Work (WtW) Credit against Federal taxes for hiring members of families who have been long-term recipients of family assistance (AFDC or TANF payments), or who have ceased to qualify for such assistance because of time limitations imposed by Federal or State laws.



### **Can a business use this credit for current employees?**

No. WtW is an incentive to hire individuals, and the credit is calculated against wages paid only during the first and second years an employee works for an employer. To take advantage of the credit, a business must obtain information from a prospective employee prior to offering him or her a job.



### **What paperwork is involved?**

A business must have the prospective employee fill out IRS Form 8850 prior to making a job offer. The employer also signs that form. In some cases, the prospective employee may bring a precertification form to the interview. Form 8850 must be forwarded to the SESA within 21 days of the date the employee starts work. WtW may be taken only for employees who have been certified by the SESA as qualifying for the incentive.



### **How does a business document that a prospective employee is qualified?**

The SESA will verify that an employee is eligible based on information from Form 8850.



### **What if an employee leaves during the first year of employment?**

The credit is available for any person who works at least 400 hours or 180 days for a business. If the minimum is not met, the credit may not be taken with respect to that employee.



**What if the employee works part-time?**

The credit is available for part-time and full-time employees. The credit is available once the minimum 400-hour/180-day test is met.



**What is the definition of qualified wages?**

Qualified wages are generally wages subject to the Federal Unemployment Tax Act. The credit is calculated against a maximum of \$10,000 per year in first- and second-year wages. A business may pay the employee more than \$10,000 in either year, but the maximum for purposes of calculating the credit is \$10,000. The instructions for IRS Form 5884 provide additional specific information on qualified wages. Wages for this purpose include employer-provided health and accident insurance, educational assistance, and dependent care assistance.



**Is there a limit on the number of employees for which a business can take the credit?**

An employer can take the maximum \$8,500 credit over 2 years (35 percent times \$10,000 for the first year plus 50 percent times \$10,000 for the second year) for as many new hires as qualify.

**Table 3. Welfare to Work Tax Credits for Long-Term Family Assistance Recipients**

Years Employed	Maximum Rate	Qualified Wages	Maximum Credit
1	35%	\$10,000	\$3,500
2	50%	\$10,000	\$5,000



**Are there special procedures for taking the tax credit?**

The credit is accounted for on IRS Form 8861 and would be part of a business's tax filing. Form 8850 and certification by the SESA are not filed with the tax return but should be retained by the business to substantiate the credit.





### **Is there a time limit for taking WtW?**

WtW is not a permanent provision of the tax code; rather, it is available for individuals who start work by a specified date. A business should check with its tax preparer or visit [www.doleta.gov](http://www.doleta.gov) to determine that date. Currently, individuals must start work before January 1, 2004, but the date is likely to be extended.



### **Can both Work Opportunity Tax Credit (WOTC) and WtW credits be claimed for the same employee?**

If an employer takes the WtW credit, that individual does not qualify as a member of a WOTC-targeted group. An employer cannot claim both credits with respect to the same individual in any 1 taxable year. The WtW credit may be claimed for the second-year wages of a qualifying individual regardless of whether the employer took WOTC or WtW for the first-year wages.



### **How does the credit affect the deduction for salaries and wages?**

A business must reduce the deduction for salaries and wages by the amount of the credit taken.



### **Where can a business obtain more information on this incentive?**

A business should consult its tax advisor. IRS Publication 954 and IRS Forms 8861 and 8850 describe this incentive. For copies call 1-800-829-3676 or visit [www.irs.ustreas.gov](http://www.irs.ustreas.gov). Questions about the certification process should be directed to the SESA.

# Indian Employment Tax Credit

## Applicable IRS Tax Form: Form 8845

Wage Credit	Description	Availability
Indian Employment Tax Credit	Credit against Federal taxes calculated on wages (including employee health insurance costs) up to \$20,000 for each qualified employee who is an enrolled member of an Indian tribe (or spouse) who lives on or near an Indian reservation. Available for existing employees and new hires.	A business does not have to be located in an EZ, EC, or RC to qualify for this credit. The majority of the services performed by the employee must be on an Indian reservation. The credit does not apply for taxable years beginning after December 31, 2003.

The Indian Employment Tax Credit provides businesses with an incentive to hire and retain individuals who are enrolled members of an Indian tribe (or the spouse of an enrolled member) who live on or near **an Indian reservation**. **The majority of the services performed by the employee must take place on the Indian reservation. The business does not have to be located in an Empowerment Zone (EZ), Enterprise Community (EC), or Renewal Community (RC) to qualify for this credit. The credit is calculated on wages (including employee health insurance costs) of up to \$20,000 per employee.**



## Target Audience

- Businesses new to an Indian reservation that will have substantial hiring needs.
- Businesses expanding within an Indian reservation that will be hiring new employees.
- Businesses with operations on an Indian reservation that have relatively high turnover and often need new employees.
- Businesses looking to reduce tax liability.

## Incentive Not Relevant to

- Businesses that do not have employees who perform services on an Indian reservation.
- Startup businesses that may not have large tax liabilities.
- Nonprofit organizations.

- Businesses that pay a qualified employee more than the maximum wage (\$30,000 in 1993, to be adjusted by cost of living).

## Additional Resources

- Accountants and lawyers preparing business tax returns.
- Local bar associations or accountant groups to identify accountants or lawyers to field questions.
- Local schools, vocational schools, junior or community colleges, 4-year colleges, and job-training programs that may have Indian reservation residents participating in their programs.
- Job banks with established relationships with Indian tribal members.
- Instructions for IRS Form 8845. For copies call 1-800-829-3676 or visit [www.irs.ustreas.gov](http://www.irs.ustreas.gov).

## Questions & Answers on the Indian Employment Tax Credit



### Are there any incentives to increase employment of members of Indian tribes?

Yes. The tax code gives employers a credit against Federal taxes for employees that are enrolled members of an Indian tribe, or the spouse of an enrolled member. The employee must perform substantially all of its services for the employer on an Indian reservation and must live on or near that reservation.



### Can a business use this credit for current employees?

Yes. The credit is an incentive for both hiring and retaining employees and may be taken so long as the enrolled member works on the Indian reservation and lives on or near the reservation.



### **What is the amount of credit?**

The credit is calculated as a percentage of increases in wages. The credit is 20 percent of the excess of the current year wages (including certain employee health insurance costs) for all qualifying employees over the sum of the corresponding amounts paid or incurred by an employer during calendar year 1993 for qualifying employees. If no qualified employees worked for a business in 1993, the 20-percent credit would be applied to the current year wages.



### **Is there any cap on the credit?**

The aggregate amount of wages (including health insurance) taken into account for any employee cannot exceed \$20,000.



### **What if an employee is paid more than \$20,000 in a year?**

An employee's wages can exceed \$20,000, but the credit cannot be taken with respect to an employee that a business pays more than \$30,000 (a 1993 figure adjusted for cost of living) during a taxable year, or at a rate that, if applied for the entire year, would cause an employer to pay an employee more than \$30,000.



### **What is the definition of qualified wages?**

Qualified wages are generally wages subject to the Federal Unemployment Tax Act. Wages for the purpose of this credit also include any qualified health insurance costs a business pays or incurs on behalf of an employee. Costs for health insurance under a salary reduction plan do not count.



**Is there a minimum time the employee must work for a business before the credit can be taken?**

Generally, if you terminate a qualified employee less than 1 year after the date of initial employment, you cannot claim a credit for that employee for the tax year the employment is terminated. Also, you may have to recapture credits allowed in earlier years. These rules do not apply in the following situations:

- The employee voluntarily quits.
- The employee is terminated because of misconduct.
- The employee becomes disabled. However, if the disability ends before the end of the first year of employment, a business must offer reemployment to its former employee.



**How does an employer determine if an employee is an enrolled member of an Indian tribe?**

Indian tribe means any Indian tribe, band, nation, pueblo, or other organized group or community, including any Alaska Native village or regional or village corporation, as defined in, or established under, the Alaska Native Claims Settlement Act, that is recognized as eligible for the special programs and services provided by the United States to Indians because of their status as Indians. The list of federally recognized Indian tribes is published annually in the *Federal Register*. (See, for example, the *Federal Register* dated March 13, 2000 (65 FR 13298)).



**What if the Federal tax liability of the business is less than the total credit amount?**

The Indian Employment Tax Credit is one of several business credits and generally is subject to the same rules as other business tax credits. As with other business tax credits, unused Indian Employment Tax Credits can be carried forward for up to 20 years and carried back 1 year.



**Can a nonprofit organization benefit from the credit?**

Tax-exempt organizations, other than certain cooperatives, are ineligible for the credit.



**Can a pass-through entity, such as a partnership or S-corporation, use the credit?**

The Indian Employment Tax Credit is a general business tax credit and may be passed through under the rules similar to other business credits.



**Can gambling establishments located within an Indian reservation use the credit?**

The credit is not available for any individual who performs services involving the conduct of Class I, II, or III gaming as defined in section 4 of the Indian Gaming Regulatory Act and any individual performing any services in a building housing such gaming activity.



**Are there other categories of employees who would not qualify for the credit?**

The credit is not available for family members of the employer, including sons, daughters, parents, stepchildren, stepmothers, stepfathers, in-laws, and other persons treated as dependents under the tax code. Similar exclusions apply to 5-percent owners of the business and majority shareholders or partners of the employer and any family members of majority shareholders or partners.



**Can the credit be used against Federal Alternative Minimum Tax (AMT) liability?**

The credit may not be used to reduce AMT tax liability.



**Can both the Work Opportunity Tax Credit (WOTC) and the Indian Employment Tax Credit be taken for an employee who qualifies for both credits?**

Any portion of wages used to determine the WOTC does not qualify for the Indian Employment Tax Credit. An employer must choose between the two credits.



**How does the credit affect the deduction for salaries and wages?**

A business must reduce the deduction for salaries and wages and health insurance costs by the amount of the credit taken.



**Is there a time limit on the credit?**

The Indian Employment Tax Credit will expire for taxable years beginning after December 31, 2002. A business should check with its tax advisor to see if the expiration date is extended.



**How can a business get more information on this credit?**

The credit is taken on IRS Form 8845 and the instructions to this form provide additional information. For copies call 1-800-829-3676 or visit [www.irs.ustreas.gov](http://www.irs.ustreas.gov). A business should also check with its tax advisor with respect to the specific details.

# Increased Section 179 Deduction

## Applicable IRS Tax Form: Form 4562

Deduction	Description	Availability
Increased Section 179 Deduction	Allows businesses to claim increased Section 179 deduction (up to \$20,000 in additional expensing increasing to \$35,000 for property acquired after December 31, 2001) if the business qualifies as an Enterprise Zone Business or Renewal Community Business. Can be claimed on certain depreciable property such as equipment and machinery.	Can be used only in EZs and RCs. Cannot be used in developable sites until after December 31, 2001. Cannot be used in ECs.

Section 179 of the Internal Revenue Code allows businesses to choose to deduct all or part of the cost of certain qualifying property in the year they place it in service. Businesses can do this instead of recovering the cost by taking depreciation deductions over a specified recovery period. There are limits, however, on the amount businesses can deduct in a tax year. Businesses may be able to claim an increased Section 179 deduction of as much as \$20,000 (increasing to \$35,000 after December 31, 2001) if they qualify as Enterprise Zone Businesses or Renewal Community Businesses. A business cannot claim this increased deduction, however, if it operates in an Enterprise Community (EC).



## Target Audience

- Businesses with relatively small (less than \$200,000) equipment needs in any taxable year, such as labor-intensive businesses with computer costs.
- Existing businesses that need to update equipment but are not otherwise purchasing equipment.
- Businesses moving into an Empowerment Zone (EZ) or Renewal Community (RC) from another location that own the majority of their equipment but have additional new equipment needs. (Note: see appendix A, Questions & Answers on Enterprise Zone Businesses and Renewal Community Businesses.)



## Incentive Not Relevant to

- Businesses in ECs, or in developable site portions of Round II EZs, until after January 1, 2002.
- Businesses that cannot meet the definition of an Enterprise Zone Business or Renewal Community Business (see appendix A).
- Consolidated companies with large equipment needs within the entire consolidated group.
- Equipment that will be used outside of an EZ or RC (such as delivery equipment).
- Companies with large or expensive equipment needs on yearly basis.
- Startup businesses that expect tax losses or other normal business expenses to equal income.
- Businesses with equipment that has a short economic life.

## Additional Resources

- Accountants and lawyers preparing business tax returns.
- Local bar associations or accountant groups to identify accountants or lawyers to field questions.
- Instructions for IRS Form 4562. For copies call 1-800-829-3676 or visit [www.irs.ustreas.gov](http://www.irs.ustreas.gov).

## Questions & Answers on Increased Section 179 Deduction



### What assistance is available to businesses located in an EZ or RC for equipment purchases?

The tax code allows an Enterprise Zone Business or Renewal Community Business to take an additional expense deduction of up to \$20,000 per year (increasing to \$35,000 after December 31, 2001) on purchases of tangible personal property (equipment) for use in an EZ or RC, respectively.



**The President signed the Jobs and Growth Tax Relief Reconciliation Act on May 28, 2003. The law increases the expense deduction on purchases of tangible personal property (equipment) for small businesses to \$100,000 and expands the deduction to include off-the-shelf computer software. Are Renewal Community and Enterprise Zone Businesses still able to increase their Section 179 expense deduction by an additional \$35,000?**

Yes. A business that meets the definition of a Renewal Community Business or Enterprise Zone Business can take a Section 179 expense deduction of up to \$135,000. The \$100,000 limit is increased by the smaller of \$35,000 or the cost of Section 179 property placed in service during the year that it is Qualified Renewal Property or Qualified Zone Property. The increase in the deduction to \$100,000 is effective for tax years beginning after 2002 and before 2006.



**What is the benefit of additional expensing?**

Expensing permits a business to take a deduction for the full cost of equipment in the year it is purchased. In addition, this writeoff of costs means that a business does not have to set up a tax depreciation schedule and deduct the expense over time. Expensing is particularly helpful for equipment with a long recovery period.



**Are some businesses ineligible for this incentive?**

Certain business activities do not qualify, such as residential rental activity; commercial real estate, unless at least 50 percent of the gross rental income is from Enterprise Zone Businesses or Renewal Community Businesses; rental of personal property, such as car rental agencies, unless at least 50 percent of the rentals are to Enterprise Zone Businesses or Renewal Community Businesses, or to EZ or RC residents; businesses that predominantly hold or develop intangibles for sale or license; country clubs; liquor stores; golf courses; racetracks; or gambling facilities.



### **Is expensing available in the Round II developable sites?**

Expensing is not available for property located in a Round II developable site until after December 31, 2001.



### **What type of property qualifies?**

The additional expensing allowance is available only for a Qualified Zone Property (QZP) or Qualified Renewal Property (QRP), defined as the following:

- Eighty-five percent of the use of the property must be in the active conduct of an Enterprise Zone Business or Renewal Community Business by a taxpayer in an EZ or RC.
- The taxpayer acquired the property by purchase after the date of EZ or RC designation.
- Original use of the property in an EZ or RC commences with the taxpayer (that is, the taxpayer is the first person to use the property inside an EZ or RC), or the taxpayer meets the substantial renovation rule. Property is substantially renovated if, during any 24-month period beginning after EZ or RC designation, there are additions to the basis of the property equal to either 100 percent of the adjusted basis of the property or \$5,000, whichever is greater.



### **How do the expensing phase-out limits work?**

For tax years beginning before 2003, the general tax rule was that the maximum Section 179 expense deduction was reduced by the excess of the cost of Section 179 property placed in service during the year over \$200,000. For Enterprise Zone and Renewal Community Businesses, only 50 percent of the cost of QZP or QRP counts when figuring the cost of Section 179 property in excess of \$200,000. For tax years beginning after 2002 and before 2006, the Jobs and Growth Tax Relief Reconciliation Act of 2003 increases the \$200,000 threshold to \$400,000. The reduction for 50 percent of the cost of QZP or QRP (and 100 percent of the cost of other Section 179 property) remains unchanged.



### **How does a business file for this incentive?**

The additional expensing amount is recorded on IRS Form 4562. This form has a special line, along with instructions, for QZP and QRP. A business should consult with its tax advisor.

# Commercial Revitalization Deduction

**Applicable IRS Tax Form: No applicable IRS tax form identified at time of publication; see IRS Publication 946**

Deduction	Description	Availability
Commercial Revitalization Deduction	Deduction of either one-half of qualified revitalization expenditures (QREs) in the first year a building is placed in service or all of QREs on ratable basis over 10 years if QREs have been allocated to revitalization of a commercial building located in an RC.	Available in Renewal Communities (RCs) for buildings placed in service after December 31, 2001, and before January 1, 2010. State may allocate up to \$12 million in deductions (not more than \$10 million per project) for each year 2002–2009 for each RC in the State. Business does not have to be a Renewal Community Business.

Businesses that construct or rehabilitate commercial property in Renewal Communities (RCs) can deduct a portion of the costs of acquisition and rehabilitation over a shorter period of time than permitted under standard depreciation rules. A business can elect a deduction of one-half of “qualifying revitalization expenditures” (QRE) up to \$10 million for any one project in the year the building is placed in service or can deduct all QRE pro rata over 10 years. The project must receive an allocation from the State (up to \$12 million allocated for each RC in the State from 2002 through 2009).

## Target Audience

- Developers and businesses specializing in redeveloping abandoned and underutilized buildings in RCs.
- Developers and businesses undertaking new building construction projects in RCs.
- Businesses located in RCs that cannot meet the Renewal Community Business definition (that is, their employees perform services outside the RC, they do not meet the 35-percent RC resident employee requirement, or too much of their gross income is earned outside the RC).



## Incentive Not Relevant to

- Developers of residential rental projects.
- Building acquisitions that do not involve substantial renovation expenditures.
- Land speculation purchases.
- Startup or similar businesses with insufficient income to take advantage of accelerated depreciation.

## Additional Resources

- Accountants and lawyers preparing business tax returns.
- Local bar associations or accountant groups to identify accountants or lawyers to field questions.
- Real estate developers familiar with local property markets.
- Local chambers of commerce or business associations involved in economic development.
- Tax lawyers and accountants associated with developers and current or prospective business owners in RCs.
- IRS Publication 946. For copies call 1-800-829-3676 or visit [www.irs.ustreas.gov](http://www.irs.ustreas.gov).

## Questions & Answers on Commercial Revitalization Deduction



### Are there any incentives for commercial building investment in an RC?

In 2000, Congress created a new “commercial revitalization deduction” (CRD) that is intended to increase economic development in RCs. The incentive is a deduction from income before calculating Federal income tax liability, and provides a way to deduct costs on an accelerated basis.



### **Are there limits on the deduction?**

The amount of the deduction is subject to a State limitation of up to \$12 million of “commercial revitalization expenditures” (CREs) for each RC located within a State for each calendar year after 2001 and before 2010. In addition, the CREs for a particular building cannot exceed the actual qualifying costs and there is an overall limit per building of \$10 million.



### **Is the CRD available only for new construction?**

The deduction is calculated on the basis of qualifying CREs. CREs include the depreciable costs of a new building or the costs associated with an existing building that is substantially rehabilitated. Substantial rehabilitation means that, within a 24-month period, rehabilitation expenditures exceed the greater of the adjusted basis of the building (and its structural components) or \$5,000. For purposes of determining whether a building has been substantially rehabilitated, rehabilitation expenditures do not include enlarging a building. If the substantial rehabilitation test is met (without taking into account the costs of expansion), the cost of expanding the building could qualify as a CRE.



### **To what extent do building acquisition costs qualify for the CRD?**

A taxpayer can include the cost of the building acquisition in taking a CRD, but only to the extent that the acquisition cost does not exceed 30 percent of the aggregate qualifying CREs (determined without regard to the acquisition cost). For example, if the building cost \$500,000 to acquire and renovations eligible for CREs were \$1 million, up to \$300,000 of the acquisition cost could qualify as a CRE.



### **Could an investor obtain special tax advantages for land speculation in an RC?**

The CRD is permitted only for the cost of acquiring a building and rehabilitating it, not for land costs. Acquisition of land for speculation would not qualify.



### **Is the CRD available for residential rental property?**

The building must be used for commercial purposes, so a residential rental property would not qualify. However, if a developer were to provide commercial facilities at or near the residential rental property, these expenditures might be eligible, assuming the commercial development is located in an RC.



### **Who will make the allocation of the CRD?**

This incentive requires that each State identify an entity to act as the commercial revitalization agency. The commercial revitalization agency will develop the procedures for allocating the \$12 million in CRDs permitted for each RC.



### **How can a developer determine if a particular project might be competitive for obtaining the CRD?**

The commercial revitalization agency must develop a plan for allocating the CRD and must submit the plan to a public hearing. The plan must then be approved by the governmental unit of which the RC is a part. The Federal statute provides guidelines for the qualified allocation plan, requiring the commercial revitalization agency to take into account full-time jobs created by the project, active community involvement and contribution to the implementation of the Strategic Plan of the RC. The developer of a potential project should obtain a copy of the plan to determine the priorities of the commercial revitalization agency where the project might be located.



### **What is the accelerated period for the CRD?**

The taxpayer may elect one of two permitted accelerated deduction methods. A taxpayer can elect either to (a) deduct one-half of the CREs for the taxable year the building is placed in service or (b) amortize all the CREs ratably over a 120-month period beginning the month the building is placed in service. The method selected will depend on a taxpayer's particular tax situation. This special deduction provision would be in lieu of depreciating the property over a period up to 39 years.





### **What if the building was purchased and renovated prior to RC designation?**

The CRD is available only to buildings placed in service after the RC designation and before January 1, 2010. If the building was purchased before RC designation, but the renovation was not completed until after RC designation, the renovation expenditures would be treated as a separate building for purposes of determining when it was placed in service and could qualify for the CRD on that basis.



### **What other tax consequences arise from using the CRD?**

No depreciation is allowed for amounts deducted as a CRD. The adjusted basis of the building is reduced by the amount of the CRD, and the deduction is treated as a depreciation deduction in applying the depreciation recapture rules.



### **Does a CRD affect Alternative Minimum Tax (AMT) liability?**

The CRD is allowed as a deduction in computing a taxpayer's AMT income.



### **Do the passive loss limitation rules apply to the CRD?**

The CRD is treated in the same manner as the Low-Income Housing Tax Credit in applying the passive loss rules. That means that an individual taxpayer can have up to \$25,000 of passive activity deductions (the CRD together with the other deductions and credits not subject to the passive loss limitation), regardless of the taxpayer's adjusted gross income. Corporations are not subject to the \$25,000 passive loss limitation.



### **Are there any special rules for 2002 or 2003 commercial revitalization expenditure ceilings?**

Yes. The \$12 million commercial revitalization expenditure ceiling for 2003 for an RC is increased by any portion of the 2002 commercial revitalization expenditure ceiling for that RC not allocated in 2002.

For example, if State A has only one RC and only \$7 million of the \$12 million commercial revitalization expenditure ceiling for 2002 for the RC was allocated, the commercial revitalization expenditure ceiling for 2003 for the RC in State A is \$17 million.

In addition, the 2002 commercial revitalization expenditure ceiling for each RC within a State may be aggregated and apportioned to any RC within the State. However, after 2002, no aggregation of the ceiling is permitted, including any portion of the 2003 ceiling attributable to the unallocated portion of the 2002 ceiling. For more information, please refer to the June 16, 2003, *Internal Revenue Bulletin*.



### **If an RC cannot award the \$12 million total in any given year, is there a carry forward provision to the next year?**

No. If an RC cannot award all of the \$12 million for an RC for any given year, the unused amount of the \$12 million may not be carried forward to a later year. However, if the RC did not award all of the \$12 million for 2002, see the special rule in the answer to the previous question.

If an RC cannot award all of the \$12 million in any given year to qualified revitalization buildings placed in service in that year, the RC may consider making a carryover allocation. A carryover allocation is made with respect to a qualified revitalization building placed in service by a taxpayer not later than the close of the second calendar year following the calendar year in which the allocation is made. The carryover allocation is contingent on the provision that the taxpayer's basis in the project of which the building is a part (as of the 6 months after the date that the allocation is made or the close of the calendar year in which the allocation is made, whichever is later) is more than 10 percent of the taxpayer's reasonably expected basis in the project as of the close of the second calendar year following the calendar year in which the allocation is made.

A carryover allocation may be for either a single-building project (a building-based allocation) or a multibuilding project (a project-based allocation). A carryover allocation

reduces the commercial revitalization expenditure ceiling for the calendar year in which the allocation is made.

If a carryover allocation is made after June 30, 2002, and before January 1, 2003, the taxpayer must meet the 10-percent basis requirement set forth above by December 31, 2003.



**If a State finishes appointing a commercial revitalization agency and receiving public approval of the CRD allocation plan during the second half of a calendar year, can it still make CRD allocations available retroactively to a business that purchased or rehabilitated qualified RC property earlier in the year?**

Yes.



**Are CRD allocations made only after projects are placed into service so that actual costs are used, or are allocations based on estimated costs? If proposed projects are used, how will any discrepancies between actual qualifying expenses versus estimated qualifying expenses be reconciled?**

The statute does not require allocations to be based on either actual or estimated costs. Each State will handle the procedures differently, as all allocations must be made pursuant to a qualified allocation plan approved by the governmental unit of which the agency is a part. The procedures may include a preliminary allocation based on projected expenditures, with a final allocation made based on the actual qualifying expenditures. Actual expenditures eligible for the CRD could never exceed the amount that is allocated, but in some instances, the allocation process may result in more being allocated than can ultimately be used.



**If the commercial revitalization agency for the State allocates, for example, \$8 million of an available \$12 million to one project, does the entire \$8 million count against the total available allocation of \$12 million for that year, regardless of the deduction method used by the business (50 percent in the first year or 10 percent over 10 years)? Also, would the amount of allocation for the RC the next year be impacted by the amount and the deduction method (that is, 50 percent or 10 percent) used?**

The entire \$8 million counts against the \$12 million available allocation. The amount or method chosen by the business to claim the CRD has no effect on the amount of the allocation for any given year.



**The CRD states that a company can exercise one of two options for taking accelerated deductions, either a 50-percent writeoff or a 100-percent writeoff of all of its investment over a 10-year period. Is the stipulation under the latter limited to the \$10 million per project cap, or if a company had an expense of, for example, \$38 million, could it write off (depreciate) this entire amount over a 10-year period?**

No. Under either method, the company cannot take accelerated deductions in excess of the expenditure amount allocated to the building by the commercial revitalization agency or \$10 million, if less. The remaining expenditures must be capitalized and depreciated under the applicable Modified Accelerated Cost Recovery Systems recovery period (generally 39 years).



**Is the depreciation in the CRD based on straight-line accounting?**

Yes. If the taxpayer elects to depreciate over the 120-month period, the deduction is allowed ratably over that period.



**Can a business in the RC take both the CRD and the Federal tax credits available for the rehabilitation of historic buildings?**

Yes. However, the expenditures used to calculate the rehabilitation credit may not also be included in the amount that is used for the CRD. For example, if the total rehabilitation costs were \$20 million and the taxpayer took rehabilitation credits on \$12 million of those expenditures, the maximum amount of expenditures eligible for the CRD would be \$8 million.



**How does the CRD apply to mixed-use buildings? What is the amount of residential space that is allowed? Are there any other limits on the mix of uses?**

The CRD applies to any nonresidential real property. Nonresidential real property is any real property other than residential rental property or property with a class life of less than 27.5 years. Residential rental property is a building or structure for which at least 80 percent of the gross rental income is rental income from dwelling units. Therefore, if less than 80 percent of a building's gross rental income is rental income from dwelling units, the building would qualify for the CRD. Thus, the determination is made on the source of gross rentals rather than on square footage of the building. If the building is considered a nonresidential building, qualifying expenditures are eligible for the CRD regardless of whether they are made to the residential or the commercial portion of the building.



**Part of the qualified allocation plan requires the RC to have a monitoring piece in place. What level of monitoring will be required by the State commercial revitalization agency?**

The qualified allocation plan is required to provide the procedures that the agency will use in monitoring compliance. There is no federally mandated "level" of monitoring.



### **What forms are required to claim the CRD?**

There is no specific form for the CRD. IRS Publication 954 provides information on claiming the CRD.



### **If a business has a net operating loss as a result of using this deduction, is it treated in the same manner as a net operating loss under the current tax code?**

Yes.



### **Does the tax code require RC States to adopt the CRD (and other RC incentives) for State tax purposes, so that when a business determines its Federal taxable basis with use of RC deductions, the taxable basis is carried over to the State tax return? (This does not pertain to the State process for allocating credits, but rather, to a State's recognition of Federal tax incentives for the State's taxable basis.)**

No. The Internal Revenue Code does not require any State to follow Federal income tax law on RC or EZ tax provisions for State tax purposes.



### **What factors should a State consider in determining the recipients of the CRD and the amount per recipient?**

The Federal statute requires the State to develop a qualified allocation plan with criteria appropriate to local conditions. Specifically, the plan must consider:

- The degree to which a project contributes to the implementation of a Course of Action that is devised for an RC through a citizen participation process.

- The amount of any increase in permanent, full-time employment by reason of any project.
- The active involvement of residents and nonprofit groups within the RC.



**For an RC located on an Indian Reservation, does the tribe act as the State in allocating the CRD?**

The reservation governing body (as determined by the Secretary of the Interior) is treated as being both the State and local governments with respect to the RC.



**What is the earliest date on which a CRD allocation can be made?**

The CRD allocation can be made at any time, starting in 2002, provided it is made under a qualified allocation plan that has been approved by the governmental unit of which the commercial revitalization agency is a part. The commercial revitalization agency must also notify the chief executive officer of the local jurisdiction in which the building is located of the allocation and give that individual a reasonable opportunity to comment on the allocation.

If the allocation is made in calendar year 2002, Internal Revenue Code requires that either the building is placed in service by December 31, 2002, *or* the building is placed in service no later than December 31, 2004, *and* the taxpayer's basis in the project in which the building is a part (as of 6 months after the date the allocation was made or, if later, December 31, 2002) is at least 10 percent of the taxpayer's reasonably expected basis in the project (as of the end of 2004).

However, if it is determined that the building may not meet either deadline, the Internal Revenue Code allows the commercial revitalization agency to make a "binding commitment" to allocate a specified dollar amount to the building in a specified later tax year. The binding commitment must constitute a binding contract under local law and be signed by both parties. If the binding commitment is made, the building does not have to be placed in service until the end of the specified later tax year (which cannot be later than 2009). Please note that a binding commitment is *not* considered an allocation for the current year and does not reduce the State commercial revitalization expenditure ceiling until the specified later tax year in which it is actually allocated. A building commitment made in 2002 cannot be used to reduce the 2002 State ceiling.





**If an allocation is made for a project that is never put into service, can the RC reallocate unused incentives?**

No provision in the Internal Revenue Code allows a reallocation of unused CRDs once there is a final allocation by the end of the calendar year.



**What should the commercial revitalization agency give to businesses that receive a CRD allocation? Is there a required form or letter from the commercial revitalization agency to substantiate the allocation?**

No specific Internal Revenue Service (IRS) form is available or under development to inform the taxpayer of an allocation. A letter or other notice signed by an authorized commercial revitalization agency official reporting the date and dollar amount of the allocation, the address of the building, and the name and address of the owner of the building would be a valid allocation as of the date it is mailed to the building owner. The taxpayer should retain this letter for the full depreciation period.



**In a mixed-use project (less than 80 percent of gross rental income from dwelling units) that is CRD eligible, are all capital expenses eligible or only the expenses from construction or rehabilitation of the commercial component of the property?**

The same rules that apply to exclusively commercial buildings also apply to mixed-use buildings (assuming less than 80 percent of the gross rent comes from dwelling units). Both types of buildings are considered nonresidential real property and therefore, no allocation is made between the residential portion and the commercial portion.

Please note that not all capital expenditures are eligible for the deduction. The expenditures described in section 1400I(b)(2)(B) (relating to part of the acquisition cost of a rehabilitated building and expenditures used to compute any tax credit) cannot be included as qualified revitalization expenditures.





**A developer is looking to build a new \$7 million hotel in the RC. One half of the building will be located in the RC with the remainder outside the RC. Would this business qualify for the entire CRD, for a pro rata portion, or not at all?**

The statute does not address how to treat a building that is included in more than one census tract for purposes of claiming the CRD. The taxpayer should request a private letter ruling rather than relying on informal advice. The first Internal Revenue Bulletin that the IRS issues each year provides procedures on requesting private letter rulings.

# Environmental Cleanup Cost Deduction (Brownfields)

**Applicable IRS Tax Form: No applicable IRS Tax Forms. For more information about the Environmental Cleanup Cost Deduction, see IRS Publication 954.**

Deduction	Description	Availability
Environmental Cleanup Cost Deduction (Brownfields)	Businesses can elect to deduct qualified cleanup costs of hazardous substances in certain areas (brownfields) in the tax year the business pays or incurs the costs.	Property is not required to be located in EZ, EC, or RC. Need certification of State environmental agency. Includes costs paid or incurred prior to January 1, 2004.

This deduction provides businesses with an incentive to clean up certain sites that are contaminated with hazardous substances. Businesses can choose to deduct qualified environmental cleanup costs in the tax year they pay or incur the cost. A business can do this instead of adding the cost to the basis of its property (and, if the property is depreciable, recovering the cost by taking depreciation deductions over a specified recovery period). Businesses do not have to be located in an Empowerment Zone (EZ), Enterprise Community (EC), or Renewal Community (RC) to qualify for this deduction. This special tax treatment is generally available for qualified environmental cleanup costs that businesses pay or incur after August 5, 1997, and before January 1, 2004.

## Target Audience

- Prospective purchasers of contaminated property willing to pay the cost of cleanup rather than having the seller pay.
- Businesses with sufficient income to be able to use the full deduction of cleanup costs in the year expenditures are paid or incurred.
- Current owners of contaminated property who wish to expand or improve property.
- Businesses interested in developable sites.



## Incentive Not Relevant to

- Startup businesses that may not generate enough income initially to deduct remediation expenses.
- Sites listed on the National Priorities List under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) of 1980 (Superfund sites).
- Sites with cleanup that does not involve hazardous substances.
- Businesses with cleanup costs that are not capitalized costs.

## Additional Resources

- Accountants and lawyers preparing business tax returns.
- Local bar associations or accountant groups to identify accountants or lawyers to field questions.
- State environmental agency staff who will be involved in certification procedures.
- Local environmental agency staff who maintain a list of brownfield sites in the jurisdiction.
- Real estate developers familiar with local property markets.
- Local tax lawyers and accountants who can serve as speakers on the topic at informational meetings or whose clients can take advantage of the incentive. For copies call 1-800-829-3676 or visit [www.irs.ustreas.gov](http://www.irs.ustreas.gov).

## Questions & Answers on Environmental Cleanup Cost Deduction



### Is there any tax incentive for cleaning up contaminated industrial sites in an EZ, EC, or RC?

The tax code allows a business to elect to deduct qualified environmental cleanup costs in the tax year the business pays or incurs the cost. The deduction enhances the bottom line if a business can take a deduction for the full amount when paid, rather than recovering the amount over time in the form of depreciation deductions.



### **Does the business have to meet any special requirements, such as being an Enterprise Zone Business or Renewal Community Business, to take advantage of this incentive?**

The ability to expense cleanup expenditures depends on the hazardous substance status of the land and the nature of the expenditures. The business does not have to be an Enterprise Zone Business or Renewal Community Business to qualify for this deduction or even be located in an EZ, EC, or RC.



### **What sites qualify for this incentive?**

A site qualifies if it meets all of the following requirements:

- It is held for use in a trade or business, for the production of income, or as inventory.
- There has been a release (or threat of release) of a hazardous substance at or on the site.



### **Does a business need to obtain a designation from any government official?**

The State environmental agency must certify that there has been a release, or a threat of release, of a hazardous substance or substances.



### **What is meant by hazardous substances?**

The tax code generally uses the same definition of hazardous substances as that used in CERCLA. Some additional limitations apply to asbestos and similar substances within buildings, certain naturally occurring substances such as radon, and certain other substances released into drinking water supplies due to deterioration through ordinary use.



### **What costs qualify for this incentive?**

Qualified environmental cleanup costs are generally costs paid or incurred to abate or control a hazardous substance at the site. The costs must be expenditures that would otherwise be chargeable to capital accounts. The incentive is governed by the normal tax rules relating to the deduction or capitalization of expenditures. A business should consult with its tax advisor.



### **Is there a time limit for deducting these expenditures?**

This special tax treatment is generally available for qualified environmental cleanup costs paid or incurred after August 5, 1997, and before January 1, 2004. This period may be extended by Federal tax legislation, so a business should consult with its tax advisor or an accountant to be assured that expenditures will qualify.



### **Are the costs expensed even for purposes of Alternative Minimum Tax (AMT)?**

Expensing of these remediation costs applies for both regular taxes and AMT tax liability.



### **What happens if a business later sells the property?**

The deduction may have to be recaptured as ordinary income when property is sold or the owner otherwise disposes of it.



### **What forms must a business file for this incentive?**

There are no separate tax forms for this incentive. The qualified environmental remediation expenditures are included as Other Deductions on a business tax return (or Other Expenses if on an individual tax return) with a notation that these represent a Section 198 Election.

# Depreciation of Property Used on Indian Reservations

**Applicable IRS Tax Form: For more information, see IRS Publication 946, *How to Depreciate Property*.**

Deduction	Description	Availability
Depreciation of Property Used on Indian Reservations	Special accelerated depreciation rules apply to qualified property used on an Indian reservation. Certain public infrastructure used or located off the Indian reservation also qualifies.	A business does not have to use the property in an EZ, EC, or RC to use these special rules, but generally the property must be used on an Indian reservation. Property must be placed in service after 1993 and before 2004.

Special accelerated depreciation rules apply to qualified property placed in service on an Indian reservation after 1993 and before 2004. A business does not have to use the property in an Empowerment Zone (EZ), Enterprise Community (EC), or Renewal Community (RC) to use these special rules. The property generally must be used on an Indian reservation, but certain public infrastructure used on and off an Indian reservation may qualify. (See description under Target Audience.) These rules allow a business to use shorter recovery periods to calculate a depreciation deduction for the qualified property. As a result, the annual deduction is larger.

## Target Audience

- Businesses with real property and equipment used in the active conduct of business, including rental of real property, on an Indian reservation.
- Businesses that own infrastructure (for example, power lines, water systems, or communication facilities) used in conjunction with business on an Indian reservation (even if a portion is not located on the reservation) if the property is available to the general public.

## Incentive Not Relevant to

- Property placed in service before 1993 and after December 31, 2003.
- Equipment that will be used outside of an Indian reservation (such as delivery equipment).
- Business property used in certain gaming activities.



## Additional Resources

- Accountants and lawyers preparing tax returns for businesses.
- Bar associations or accountant groups in areas that include an Indian reservation, which can identify accountants or lawyers who can answer questions.
- Instructions for IRS Form 4562 and IRS Publication 946. For copies call 1-800-829-3676 or visit [www.irs.ustreas.gov](http://www.irs.ustreas.gov).

## Questions & Answers on Depreciation of Property Used on Indian Reservations



### Are there any special depreciation provisions for property used by a business within an Indian reservation?

The tax code provides for an accelerated depreciation schedule for property used predominantly in the active conduct of business on an Indian reservation. Real property rented to others on an Indian reservation is also eligible for an accelerated depreciation schedule.



### Are there any categories of property that would not qualify?

The following property is **not** qualified property:

- Property used or located outside an Indian reservation on a regular basis.
- Property acquired directly or indirectly from certain related persons.
- Property placed in service for purposes of conducting or housing certain gaming activities.



### **What about infrastructure property used both on and off an Indian reservation?**

Infrastructure property includes, but is not limited to, roads, power lines, water systems, railroad spurs, and communications facilities.

A business can take accelerated depreciation on property used off the Indian reservation if it is used to connect “qualified infrastructure” within the reservation and it meets all of the following requirements:

- It meets the requirements listed in the previous answer under qualified property (except that it can be outside the reservation).
- It benefits the tribal infrastructure.
- It is available to the general public.
- It was placed in service in connection with the active conduct of a trade or business within a reservation.



### **What is the definition of Indian reservation?**

An Indian reservation is defined in section 3(d) of the Indian Financing Act of 1974 or section 4(10) of the Indian Child Welfare Act of 1978.



### **How does the accelerated depreciation affect Federal Alternative Minimum Tax (AMT)?**

The shortened period also applies for purposes of determining AMT so that this depreciation is not a tax preference.



### **Is there a time limit for qualifying for accelerated depreciation?**

This depreciation incentive is available only for property placed in service after calendar year 1993 and before January 1, 2004.





**How does a business obtain more information on this tax incentive?**

IRS Publication 946 and the instructions to IRS Form 4562 contain additional information. For copies, call 1-800-829-3676 or visit [www.irs.ustreas.gov](http://www.irs.ustreas.gov).

# Enterprise Zone Facility Bonds

**Applicable IRS Tax Form: No applicable IRS Tax Forms. For more information about the Enterprise Zone Facility Bonds, see IRS Publication 954.**

Financing	Description	Availability
Enterprise Zone Facility Bonds	State and local governments can issue Enterprise Zone Facility Bonds (a type of tax-exempt bond) to make loans at lower interest rates to Enterprise Zone Businesses to finance Qualified Zone Property.	\$3 million per borrower limit in any Round I EZ for bonds issued prior to January 1, 2002, or in any EC, with \$20 million per borrower nationwide limit; must have State volume cap allocated. \$130 million or \$230 million available in urban Round II EZs (\$60 million in rural Round II EZs) over the EZ designation period and for all EZs including developable sites for bonds issued after December 31, 2001 (no per-borrower limit and bonds are not subject to State volume cap), for EZ- or EC-based commercial, retail, or industrial property; 35 percent of employees must be EZ or EC residents.

State or local governments can issue Enterprise Zone Facility Bonds (a type of exempt facility tax-exempt bond) to make loans to an Enterprise Zone Business to finance Qualified Zone Property. At least 95 percent of the net proceeds from the bond issue must be used to finance Qualified Zone Property principally used by an Enterprise Zone Business, and certain land used for a related purpose (for example, land where the business and its customer and employee parking lot is located). Tax-exempt bonds generally have lower interest rates than conventional financing because the purchaser of the bonds does not have to pay Federal income tax on the interest income received from the bonds.



## Target Audience

- Zone businesses with a capital project of sufficient cost for going to the public bond market (generally \$2 million or more) with a good credit rating or a letter-of-credit bank. (Note: For Round I Empowerment Zones (EZs) prior to January 1, 2002, and all Enterprise Communities (ECs), the maximum amount in a Zone is \$3 million

## Enterprise Zone Facility Bonds

per borrower. It is \$15 million per borrower in the District of Columbia's Enterprise Zone.)

- Large national businesses setting up branch stores or operations in a Zone.
- Local banks that may be interested in lower cost capital to lend to qualifying businesses (and may need to meet their Community Reinvestment Act requirements).

## Incentive Not Relevant to

- Businesses that cannot meet the definition of an Enterprise Zone Business (see appendix A) and are not leasing to tenant businesses that meet the definition.
- Startup businesses with minimal equity.
- Businesses with employees likely to perform most of their work outside the Zone (such as delivery services or offsite services).
- 501(c)(3) tax-exempt organizations (unless the financing would be for an activity that generates unrelated business income).
- Businesses with small capital needs.
- Businesses seeking operating or working capital funds.
- Closely held businesses unwilling to make public disclosures about finances in securities marketing documents.
- Businesses seeking grant monies rather than loans.

## Additional Resources

- Local issuers of tax-exempt bonds. These may be State or local governments, State or local industrial or economic development boards or authorities, or State bond banks. Issuers will have established procedures for applications, evaluation of projects, and fee arrangements.
- Bond counsel to issuers. Many issuers have attorneys under contract who specialize in tax-exempt bonds or who may also be able to refer businesses to firms with experience in this type of legal work.
- Investment banking firms and local bankers. These firms make their money by marketing tax-exempt bonds. Many regional investment banking firms specialize

in placing or marketing smaller principal amounts of tax-exempt bonds or have pooled borrowings together for larger issuance amounts.

- Local developers and real estate agents. Both developers and real estate agents are aware of capital projects and building or site acquisitions. The availability of tax-exempt financing in the EZ or EC may help them sell or develop property.
- IRS Publication 954. For copies call 1-800-829-3676 or visit [www.irs.ustreas.gov](http://www.irs.ustreas.gov).

## A Tax-Exempt Bond Transaction

- All Enterprise Zone Businesses using tax-exempt bonds may be required to pay an administrative fee to the respective State and local governments or industrial development authorities authorized by the Federal tax code to confer tax-exempt status on the bond issuance.
- A State or local bond issuer sells bonds (debt) through an underwriter to investors in the market.
- The issuer lends the bond proceeds to an Enterprise Zone Business.
- The Enterprise Zone Business makes loan payments to the issuer.
- The issuer passes the payments through to the investor.

## Technical Steps, Documents, and Players

- A private business that meets the definition of an Enterprise Zone Business makes an application to its State or local government issuer.
- The business obtains an Inducement Resolution or Intent Declaration from the bond issuer.
- The issuer reviews and approves the financing after a published notice and a public hearing.
- The issuer enters into a bond purchase agreement with an underwriter or placement agent (investment banking firm).
- The investment banker, Enterprise Zone Business, and issuer prepare securities offering documentation for the bonds, describing the terms of the bonds, the project to be financed, and the security for repayment.
- Legal counsel specializing in Federal tax laws related to municipal bonds reviews the transaction and delivers an opinion that interest income bond purchasers receive will

## Enterprise Zone Facility Bonds

be exempt from Federal income tax (and also usually exempt from State and local income taxes in the issuer's State).

- The investor is willing to charge a lower interest rate for the issuer's debt because the interest income is exempt. (The investor gets a higher return with exempt income.)
- The underwriter sells the issuer's bonds in the public debt market based on the credit of the Enterprise Zone Business (or a letter-of-credit bank).
- The issuer enters into a loan agreement with the Enterprise Zone Business to lend the money from the sale of the bonds to the Enterprise Zone Business.
- The issuer passes on a lower rate on the issuer's bonds to the Enterprise Zone Business, but the issuer may charge the Enterprise Zone Business an upfront or continuing fee for its debt program.
- The loan agreement will have financial and tax covenants that the Enterprise Zone Business must comply with throughout the term of the bonds. Financial covenants will be based on what the underwriter believes is needed to sell the bonds to the public.
- The issuer enters into a trust indenture with a trustee bank to carry out the issuer's obligations to the investors.
- The Enterprise Zone Business requisitions money from the trustee bank to pay the costs of the project.
- The Enterprise Zone Business makes loan payments to the trustee, who passes the payments on to investors.

## Some Suggestions for Making a Bond Program Work

- Determine who will be the issuer of the bonds (a State or local government unit or agency) and involve the issuer's staff and bond counsel in marketing this program. They will review the transaction and determine whether the project qualifies for financing under the tax laws.
- Do not assume that all Enterprise Zone Businesses will be small startup businesses. Look to market the bond program to national chain stores or businesses with strong credit ratings that are interested in low-cost financing.
- Involve the financial institutions that participated in the Strategic Plan in the bond program. They can participate by:

- Buying the bonds for their own portfolios.
  - Placing the bonds with trust customers (particularly in States where the trust customer may benefit from having interest on the bonds exempt from State and local taxes).
  - Providing a letter of credit to secure payment of the bonds. The bank analyzes the credit risk and charges a fee for the letter of credit. The bonds are more marketable because they are based on the bank's credit.
  - Participating in a “loans to lenders” program. The issuer loans the money to the bank, giving the bank a source of lower cost funds. The bank then loans this money to Enterprise Zone Businesses. The bank must repay the bonds, but it expects to use payments from its EZ loans to make those bond payments.
- Identify an investment banking firm that has experience with tax-exempt bonds. Prior to 1986 tax law changes, investment banks successfully marketed similar types of bonds called industrial development bonds, or IDBs. They can now apply this experience to these bond offerings.
  - Place the bonds with local businesses that want to invest in their community. They will receive tax-exempt income and be closer to evaluating the potential for the success of the Enterprise Zone Business. Many cities have successfully sold so-called mini bonds to their residents for various municipal projects.
  - Pool or do a composite issue of bonds for several EZs or ECs (or for several businesses within EZs or ECs) in one offering. This permits the smaller borrowers to share costs associated with offering the bonds. Timing the projects so that they are all offered at once can be difficult, but a bank may be able to provide taxable bridge financing until a sufficient number of projects are ready to proceed.

## Questions & Answers on Enterprise Zone Facility Bonds



### What is tax-exempt financing?

A tax-exempt bond is a debt instrument issued by a State or local government that is sold in the public market or placed with investors by an investment banking firm. Bond purchasers do not have to pay Federal income tax on the interest income received from a tax-exempt bond if certain tax rules are met. Interest on the bond may also be exempt from State and local income taxes.



### **Who can issue a tax-exempt Enterprise Zone Facility Bond?**

Only a State or local government unit, or an economic or industrial development authority authorized by a State or local government unit to issue bonds, can issue a tax-exempt Enterprise Zone Facility Bond.

A borrower cannot issue debt on its own and qualify it as tax-exempt debt.



### **Who purchases tax-exempt bonds?**

At present, the majority of tax-exempt bonds are purchased by individuals, but corporations, mutual funds, and insurance companies also purchase a large portion of tax-exempt bonds. Technically, the investment banking firm serving as the underwriter of the bonds will purchase the bonds from the State or local government issuer, then re-offer the bonds for sale to the public. A bank or investment banking firm may also place the bonds with a small group of purchasers.



### **How will businesses in the Zone benefit from tax-exempt financing?**

The primary benefit of tax-exempt financing is a lower interest rate than the rate on a conventional loan. Bond purchasers are willing to take a lower interest rate because they will not have to pay tax on the interest income that they receive from the bond. The government issuer loans the proceeds of the bonds to a business, passing on the lower interest rate. Lower interest rates mean a better cash flow for Enterprise Zone Businesses. Another benefit is the time period of the debt. Tax-exempt bonds may be issued for 120 percent of the average useful life of the capital investment. It is also possible—depending on many financial circumstances—to issue tax-exempt bonds to finance 100 percent, or nearly 100 percent, of the transaction. In addition, up to 2 percent of the issuance can be used to pay for the costs of issuance, thus allowing the borrower to finance those expenses instead of paying them out of pocket.



### **Can real estate developers use this bond financing?**

Real estate developers would have to meet the qualified business definition. At least 50 percent of the developer's gross rental income must be derived from Enterprise Zone Businesses. If the developer then meets all of the income and property locational tests of the Enterprise Zone Business definition, tax-exempt financing could be used to finance the whole project. If the developer, as owner of the project, does not meet the Enterprise Zone Business test but does have 50 percent of the gross rentals from Enterprise Zone Businesses, regulations permit the developer to finance the portion of the project allocable to Enterprise Zone Business tenants.



### **At what point in the process should a business contact the government issuer?**

Tax-exempt financing typically takes longer to complete than a standard conventional loan. To expedite the process, a business should contact the government issuer in the very early planning stages. The issuer will select attorneys (bond counsel) who specialize in tax-exempt bonds to work with the borrower on understanding the tax, securities, and other rules associated with the financing. Once the borrowing and repayment details are determined, the bond counsel will give an opinion stating that interest on the bonds is excludable from Federal income taxes. In addition, a business will need an intent declaration or inducement resolution from the issuer indicating its intent to finance costs with tax-exempt bonds if the business expects to use tax-exempt bond proceeds to reimburse itself for any costs paid before tax-exempt bonds are issued.



### **What types of businesses can take advantage of bond financing?**

Only an Enterprise Zone Business can use this type of tax-exempt bond financing. In general, a business has to meet several criteria to demonstrate it is an Enterprise Zone Business. This definition is discussed in appendix A.

These requirements may be met by treating operations of a business within the Zone as if it were separately incorporated. Certain business activities are not qualified Zone Business activities, including residential rental activities; commercial real estate rentals,



unless at least 50 percent of the gross rental income is from Enterprise Zone Businesses meeting the qualifications described above; rental of personal property, such as car rentals, unless 50 percent of the rental income is from Enterprise Zone Businesses or Zone residents; businesses that hold or develop intangibles for sale or license; country clubs; liquor stores; golf courses; racetracks; or gambling facilities. Nonprofit organizations are not automatically precluded merely because the activities carried on by them are on a not-for-profit basis.



### **Must a business meet the Enterprise Zone Business test when the bonds are issued?**

A business is allowed a startup period for coming into compliance with the Enterprise Zone Business test. Generally, a business would have 2 years from the date the bonds were issued or the date the financed property is placed in service, whichever is later. A business must make bona fide efforts to meet the definition by the end of the startup period.



### **How long must a business meet the Enterprise Zone Business definition?**

A business must meet all the requirements for at least 3 taxable years (beginning after any startup period) and must meet the requirement that 35 percent of its employees be Zone residents throughout the term of the bonds. This 3-year period is called the testing period.



### **Do the 3 years of the testing period have to be consecutive?**

The testing period is the 3 consecutive taxable years of the business following the startup period (if any).



### **What happens if a business ceases to be an Enterprise Zone Business within the 3-year testing period or it fails the Zone resident employee requirement at a later date?**

If the failure to meet the tests is corrected within a year of when the failure is discovered, a business is deemed to have met the rules. If the EZ or EC designation is terminated early or the business goes into bankruptcy, the business is not treated as failing the tests. The tax laws allow a borrower a reasonable time to cure any noncompliance. If the noncompliance is not cured, the borrower will lose the deduction for its interest expense on the loan of the bond proceeds from the issuer, and interest on the bonds received by the purchasers of the bonds may become taxable. If interest becomes taxable, the borrower may be required to redeem the bonds as soon as possible, pay a penalty to the Internal Revenue Service, or pay a higher taxable interest rate to the purchasers.



### **What is considered a reasonable time to cure any noncompliance?**

Reasonable time to cure is defined in the tax regulations as up to a year from the date the failure to comply is discovered. To take advantage of this period, the borrower must annually demonstrate to the issuer of the bonds that the borrower is monitoring compliance. Presumably, each issuer will establish its own procedures.



### **What types of projects can be financed with Enterprise Zone Facility Bonds?**

Bond proceeds can be used only to construct a building; renovate an existing building or equipment; or acquire land, new equipment, or a new building. However, bond proceeds can be used to acquire used equipment or an existing building if an amount equal to 15 percent of the adjusted basis of the equipment or building or \$5,000, whichever is greater, is spent to recondition or rehabilitate the equipment or building within a 2-year period.



### **Can a business use bond proceeds for working capital purposes?**

At least 95 percent of the bond proceeds (including any investment earnings) must be used to pay costs that are capitalized for Federal tax purposes. Any amounts available for working capital would be minimal.



### **Are there any limits on the amount that can be borrowed on a tax-exempt basis?**

For Enterprise Zone Facility Bonds issued by Round I EZs (prior to January 1, 2002) and ECs, a business entity (including any related persons) can have no more than \$3 million (\$15 million in the District of Columbia Enterprise Zone) in Enterprise Zone Facility Bonds outstanding in the Zone. An entity could have bonds issued in other EZs or ECs around the Nation, but the total amount outstanding in those EZs and ECs per borrower can be no more than \$20 million. In addition, before any bonds can be issued, the State in which the EZ or EC is located must allocate a portion of the State's annual private activity bond volume cap in an amount equal to the amount of the bonds.

Every Round II EZ (and after December 31, 2001, every EZ except the District of Columbia) has a limit on the total principal amount of tax-exempt Enterprise Zone Facility bonds that can be issued over the period of designation. For example, rural EZs may issue \$60 million, urban EZs with a population less than 100,000 may issue \$130 million, and urban EZs with a population of 100,000 or more may issue \$230 million. Beyond this overall limit, there is no tax law limit on the size of borrowing for any one borrower. The size of any borrowing will also, of course, be limited by the business's ability to repay the loan.



### **What costs are involved in tax-exempt financing?**

Certain costs involved in tax-exempt financing may be higher than those involved in a conventional loan. A business may need to consider the costs of tax-exempt borrowing compared with interest savings over the term of the bond. These costs include fees to a bond counsel who reviews the transaction and delivers an opinion that interest on the bonds is exempt from Federal income taxes; fees to an underwriter who markets the bond; and fees to a trustee who disburses bond proceeds and collects loan payments from the business. The tax laws allow up to 2 percent of the bond proceeds to be used to pay costs of issuance of the bond. Additional amounts must come from the equity of the business or from taxable

financing. An Enterprise Zone Business using tax-exempt bonds may be required to pay an administrative fee to the State or local government industrial development authorities authorized by Federal tax code to confer tax-exempt status on the bond issuance.



### **What information must a business make available to the public?**

The tax laws require a public notice and hearing regarding the bond issuance, including the amount to be borrowed, the name of the borrower, and the nature and location of the financed property. Following the hearing, the bond issue must be approved by an elected executive or the legislative body of the issuer. Other proceedings of the issuer and documents submitted to the issuer may be subject to public disclosure requirements. The financial condition of the borrower will also be included in offering materials made available to prospective purchasers of a bond.



### **Will tax-exempt financing affect any other tax rules of a business?**

A business will not be able to take advantage of accelerated depreciation for any depreciable property purchased with proceeds of the bonds. Bond-financed property must be depreciated over the class life of the property using the straight line method.



### **What forms would a business have to file with the Internal Revenue Service (IRS) for tax-exempt financing?**

The business would not file any specific forms with the IRS beyond forms usually filed with a tax return. When bonds are issued, the issuer files an information return on the bonds with the IRS, and there may be certain other informational filings. However, all filings will be made by the issuer based on information supplied by the borrower. For example, any investment income earned on bond proceeds above the yield on the bonds must be paid to the IRS every 5 years, but the filing itself would be signed by the issuer. If the IRS audits the bond transaction, the business would likely be called on to submit documentation.



**Can nonprofit organizations take advantage of Enterprise Zone Facility Bonds when they develop facilities such as shopping centers or mixed-use residential/commercial centers?**

**Would the rent generated from these centers be considered unrelated business income?**

Nothing in the Enterprise Zone Facility Bond provisions directly precludes nonprofit organizations from taking advantage of Enterprise Zone Facility Bonds. However, a nonprofit organization must obtain a determination from the IRS that its activities are within the exemption categories of the tax laws. A nonprofit organization considering this type of activity would need to consult its own legal advisor to determine whether conducting such an activity would be within its exempt purpose, whether the activity would generate unrelated business income in light of that exempt purpose, and whether involvement in the activity might jeopardize its nonprofit status.



**In an EZ with a population of less than 100,000, is the total allocation of Enterprise Zone Facility Bonds \$130 million?**

For urban EZs, the allocation for the EZ over the period of designation is \$130 million if the population of the EZ (not the population of the city or county) is less than 100,000 people. If the EZ population is 100,000 or more, the allocation is \$230 million. There are no per-borrower limits. For rural EZs, regardless of population, the allocation is \$60 million.

# Qualified Zone Academy Bonds

## Applicable IRS Tax Form: Form 8860

Bond Financing	Description	Availability
Qualified Zone Academy Bonds	State or local governments can issue bonds at 0-percent interest cost to them to finance certain public school programs with private business partnerships. Private businesses must contribute money, equipment, or services equal to 10 percent of bond proceeds (which may qualify as a charitable contribution). The Federal government pays interest in the form of tax credit to banks, insurance companies, and certain lending corporations that hold QZABs.	Federal allocation to States annually from 1998 to 2003. State education agency allocates credit to Qualified Zone Academy to finance materials, teacher training, building renovation, or equipment for programs that prepare students for jobs or college. Schools must be located in an EZ or EC, or have 35 percent of students eligible for free or reduced-cost lunch program.

Beginning in 1998, State or local governments can issue Qualified Zone Academy Bonds (QZABs) to raise funds for a Qualified Zone Academy. However, these bonds require that the Qualified Zone Academy receive a private business contribution (which may be tax deductible as a charitable contribution). Certain banks, insurance companies, and corporations actively engaged in the business of lending money can receive a tax credit as an incentive to hold these bonds.

## Target Audience

- Banks, insurance companies, or corporations in the business of lending money that are eligible to receive tax credits (in lieu of receiving interest payments) as holders of the bonds.
- Local businesses with specific employee skill sets that could be taught at the secondary school level.
- Businesses interested in providing mentorship or internship opportunities to secondary school students.
- School districts seeking to upgrade schools located in Empowerment Zones (EZs), Enterprise Communities (ECs), or Renewal Communities (RCs).



## Incentive Not Relevant to

- Potential holders (banks or insurance companies) that have insufficient Federal tax liability to use the tax credit or are interested only in receiving tax-exempt income.
- Businesses unable to benefit from charitable deductions if contributions are made to schools.

## Additional Resources

- Local school districts (the real beneficiaries of this incentive) that are willing to take on the primary marketing role.
- Chambers of commerce or business associations that can help identify the educational programs needed by the local labor force.
- State or local job-placement agencies that may help identify job-skill gaps and the employers that would be most interested in seeing appropriate programs established in schools.
- State education agencies (SEAs) that are responsible for allocating the State's volume cap for QZABs. These agencies should be contacted to determine the application process and selection criteria.
- Instructions for IRS Form 8860. For copies call 1-800-829-3676 or visit [www.irs.ustreas.gov](http://www.irs.ustreas.gov).

## Questions & Answers on Qualified Zone Academy Bonds



### How can a business improve the training and skill levels of potential employees coming from the public schools in an EZ or EC?

Public schools located in an EZ or EC can obtain interest-free loans if they partner with private businesses to establish programs within public schools. A business can partner through contributions or, in certain cases, by lending money to schools to improve the academic curricula, enhance graduation and employment rates, and better prepare students for college and the workforce.



### **What schools can qualify?**

A Qualified Zone Academy must be a public elementary or secondary school located in either an EZ or an EC, or the school must have a reasonable expectation when the bonds are issued that at least 35 percent of the school's students (or Qualified Zone Academy participants) will be eligible for free or reduced-cost lunches. The Qualified Zone Academy must receive an allocation of the State's QZAB limit from the SEA. The academy must have a comprehensive education plan approved by its local education agency (LEA).



### **How does a business benefit from lending money to public schools?**

If the loan is structured as a QZAB, the interest on the bond is paid by the Federal Government in the form of an annual tax credit to the lender. This tax credit is available only to banks, insurance companies, and companies in the business of lending money. The credit rate is generally equivalent to the market taxable interest rate. The bond is not a tax-exempt bond. The interest QZAB credit is treated as taxable income but is also a credit against Federal tax liability.



### **What contributions can a business make to a school to qualify the school for QZAB financing?**

Before a QZAB can be issued, the school must obtain written commitments from private entities for qualified contributions with a present value (as of the bond issue date) of not less than 10 percent of the proceeds of the bond issue. Qualifying contributions include:

- Equipment for use in a Qualified Zone Academy.
- Technical assistance in developing curricula or in training teachers to promote appropriate market-driven technology in the classroom at a Qualified Zone Academy.
- Employee services as volunteer mentors in a Qualified Zone Academy.
- Internships, field trips, or other educational opportunities for students outside a Qualified Zone Academy.





### **What can the school finance with the proceeds of the QZAB?**

The proceeds from the bond issue are to be used to rehabilitate or repair facilities at Qualified Zone Academies, obtain equipment, develop course materials, or train teachers and other school personnel.

Proceeds cannot be used for new construction.



### **Are there any other tax benefits to participating private entities?**

The contributions to the school from the business would be treated (for Federal tax purposes) like any other charitable deductions to a State or local government.



### **Who issues the bond?**

The bond must be issued by a State or local government, including the District of Columbia and any possessions of the United States.



### **How does the school repay a QZAB?**

A school would likely repay the QZAB from the school system's general revenues. The entire principal amount could be repaid in a lump sum at maturity to maximize the credit to the holder, or the bondholder can negotiate intermediate principal repayments. If the entire amount is due at maturity, the bondholder may require that the borrower deposit payments of principal in a sinking fund pledged to repayment of principal at maturity.



### **Is the creditworthiness of the borrower an issue?**

The tax laws provide for single interest regardless of the creditworthiness of the school. A purchaser may feel the interest rate is too low for borrowers with a lower credit rating. To reflect this increased risk of not being repaid, the purchaser may reduce the amount borrowed by purchasing the bonds at a discount. This has the effect of increasing the yield on the bond to the purchaser but reduces the amount of proceeds for the project that the borrower receives. For borrowers with better credit ratings, QZAB may be sold at a premium.



### **Are “charter” schools eligible for these tax credits?**

Whether charter schools qualify varies from jurisdiction to jurisdiction. The tax laws require that a Qualified Zone Academy be established by and operated under the supervision of an eligible LEA, that the comprehensive educational plan of the academy be approved by the LEA, and that the students in the academy be subject to the same academic standards and assessments as other students educated by the LEA. Charter schools seeking to use QZAB financing must consult with and obtain the approval of the LEA.



### **Certain banks, insurance companies, and investment corporations receive tax credits to offset the interest payment of the bond, thus lowering the cost to the borrower. What types of organizations can use these credits, and what criteria are used to determine which companies can participate?**

A holder of a QZAB must anticipate that it will have a Federal tax liability that could be offset by the tax credit it receives from the QZAB. Some banks may also be able to obtain Community Reinvestment Act credit for a QZAB. Such a credit would make the QZAB an attractive investment.



### **Some of the employment tax credit provisions expire on December 31, 2003. Do QZABs have a similar expiration date?**

The QZAB provision has a termination date based on when the bonds are issued. QZAB allocations to the States have been extended through 2003. The allocation of a State’s QZAB volume cap can be carried forward for up to 2 or 3 years after its termination. For updates on any extensions or increases in QZAB allocations, visit [www.ed.gov/offices/OESE/SST/qzab.html](http://www.ed.gov/offices/OESE/SST/qzab.html).



## How can QZABs be used to create apprenticeship programs in schools to develop skills needed by area employers?

Both the contribution requirements and the permitted uses of QZAB proceeds can be used to develop an apprenticeship program at a Qualified Zone Academy. QZAB proceeds can be used to develop curricula and train teachers, and a business can contribute mentorship opportunities and employee time. The employee time could be used to assist the academy in developing curricula related to the background skills (such as math, computers, or drafting) necessary for a particular apprenticeship opportunity. The business can contribute equipment and training materials to be used in the academy to support initial or continuing training. The business can also provide personnel, workspace, and equipment at a worksite to train academy students.

### Qualified Zone Academy Bond Example

A for-profit hospital is a major employer in the EZ. During the development of the Strategic Plan for Federal designation as an EZ, the hospital indicated a willingness to cooperate with an EZ school to establish a special academic program that would prepare students for jobs at the hospital. The hospital indicated that it is willing to donate state-of-the-art medical equipment and computer software to the school and to provide internship and mentoring experiences for students. The school determined that it needs to renovate a classroom to accommodate the donated equipment, purchase appropriate instructional materials, and train teachers to instruct students on the use of the equipment and oversee the internship and mentoring components of the program. The school estimates its costs at \$500,000.

To obtain the benefits of the low-cost capital afforded through the QZAB tax credit, the school needs to take the following steps.

- The school obtains from the hospital an estimate of the value of the equipment, personnel time, and facility cost associated with the internship and mentorship opportunities. As a for-profit organization, the hospital will be able to take a charitable deduction for the equipment and should readily be able to value this part of the donation. The determination of the value of the time of personnel and any facility cost involved in an internship and mentoring program may require more of an effort.

- If the value of the hospital's donation is equal to at least 10 percent of the cost the school expects to incur for the training program (simplified in this example to 10 percent of \$500,000, or \$50,000), the hospital would provide the school with a written commitment for this donation.
- The school contacts the financial officer and other school system personnel responsible for debt issuance. The QZAB must be issued by a State or local governmental unit. In most cases, the likely issuer would be the school system but the local or State government may be the issuer in other cases.
- The parties must determine the source of repayment of the \$500,000. The QZAB tax credit mechanism basically eliminates any interest cost, but QZABs are still loans that must be repaid; they are not grants.
- The school system seeks an allocation from the State department of education (DOE) of the State's QZAB allocation equal to \$500,000 (the amount the school expects to borrow). The State DOE must provide written verification of an allocation of the QZAB volume limitation.
- The school identifies a financial institution, insurance company, or corporation in the business of lending money to purchase the QZAB. In this case, assume the school sells the QZAB to a financial institution in the area that commits to providing assistance in the strategic planning process associated with acquiring EZ designation. The financial institution and the school system enter into a loan agreement for the \$500,000.
- The credit rate on the loan and the maximum term for the loan are set under the QZAB provisions. Assume the rate posted for the date the QZAB is issued is 7 percent. The school system agrees to pay the \$500,000 back in 10 years. The loan documents, the hospital's written commitment, and the school's cost estimate are reviewed by a tax lawyer to obtain an opinion for the financial institution that the transaction is a QZAB and enables the holder to take the tax credit.

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- The financial institution requires the school system to set aside \$50,000 each year into a segregated fund to ensure that the debt will be repaid when the loan matures. Any interest on this fund belongs to the school system. In each of the 10 years the QZAB is outstanding, the financial institution receives a tax credit equal to \$35,000 (7 percent times \$500,000) and can reduce its Federal tax liability by that amount each year. The school does not pay interest.

# Zero Percent Capital Gains Rate for Renewal Community and District of Columbia Enterprise Zone Assets

**Applicable IRS Tax Form: For more information, see IRS Publication 954, *Tax Incentives for Empowerment Zones and Other Distressed Communities*.**

Capital Gains	Description	Availability
Zero Percent Capital Gains Rate for Renewal Community Assets and District of Columbia Enterprise Zone Assets	The holder, for a minimum of 5 years, of a District of Columbia Enterprise Zone (DC Enterprise Zone) asset, acquired between January 1, 1998, and December 31, 2003 or an RC asset, acquired between January 1, 2002, and December 31, 2009, will not have to include in its gross income any “qualified capital gain” from the sale or exchange of the asset.	Exclusion applies only to an interest in, or property of, certain businesses operating in the DC Enterprise Zone or an RC. The following qualify as DC Zone or RC assets: DC Enterprise Zone or RC business stock, DC Enterprise Zone or RC partnership interests, and DC Enterprise Zone or RC business properties. Only gain attributable to the period from January 1, 1998, through December 31, 2008, for the DC incentive, and from January 1, 2002, through December 31, 2014, for RCs, may be excluded.

If a business holds a District of Columbia Enterprise Zone (DC Enterprise Zone) Business asset acquired between January 1, 1998, and December 31, 2003, or a Renewal Community Business asset acquired after December 31, 2001, and before January 1, 2010, for a minimum of 5 years, the business does not have to include any “qualified capital gain” from the asset’s sale or exchange in its gross income. This exclusion applies only to an interest in, or property of, certain businesses operating in the District of Columbia or a Renewal Community (RC). The following qualify as DC Enterprise Zone or RC assets: DC Enterprise Zone or RC business stock, DC Enterprise Zone or RC partnership interests, or DC Enterprise Zone or RC business properties. Only gain attributable to the period from January 1, 1998, through December 31, 2008, may be excluded for the DC Enterprise Zone and to the period from January 1, 2002, through December 31, 2014, for RCs.



## Target Audience

- New business partnerships or corporations that issue new stock or ownership interests for entities with operations in the expanded DC Enterprise Zone or in an RC.
- Existing businesses with operations in the expanded DC Enterprise Zone or in an RC that issue new stock or acquire new ownership interests.
- Qualified business entities that purchase real estate in the expanded DC Enterprise Zone or in an RC.

## Incentive Not Relevant to

- Businesses that cannot meet the definition of an Enterprise Zone Business or the definition of a Renewal Community Business. With the expanded DC Enterprise Zone, the 35-percent resident employee requirement does not apply, and 80 percent rather than 50 percent of gross income must come from the active conduct of business in the expanded DC Enterprise Zone.
- Businesses that acquire stock or partnership interests issued before or after the DC Enterprise Zone or RC designation period.
- Businesses that purchase existing assets (such as buildings) that will not be rehabilitated substantially within a 2-year period.
- Taxpayers who do not expect to hold stock, partnership interests, or assets for the minimum 5-year holding period.
- Taxpayers with capital gains on intangible assets or who own land that is not an integral part of a DC Enterprise Zone Business or an RC Business.

## Additional Resources

- Accountants and lawyers preparing business tax returns.
- Local bar associations or accountant groups to identify accountants or lawyers to field questions.
- Developers and real estate brokers who have knowledge of DC Enterprise Zone or RC boundaries.
- Tax attorneys and accountants in the District of Columbia or an RC area.
- IRS Publication 954. For copies call 1-800-829-3676 or visit [www.irs.ustreas.gov](http://www.irs.ustreas.gov).

## Questions & Answers on Zero Percent Capital Gains Rate for Renewal Community and District of Columbia Enterprise Zone Assets



### **Is there any special capital gain treatment for property in an Empowerment Zone (EZ), Enterprise Community (EC), or RC?**

The capital gain on certain assets is eligible for 0-percent capital gains rate in all RCs and the DC Enterprise Zone. Assets in other EZs or ECs are not eligible.



### **What assets are eligible for 0-percent capital gains in RCs and the DC Enterprise Zone?**

The 0-percent capital gains rate applies to gain from the sale of a DC Enterprise Zone asset acquired after December 31, 1997, and before January 1, 2004, or for an RC asset acquired after December 31, 2001, and before January 1, 2010. Qualifying assets include (1) stock in a domestic company acquired by the taxpayer at its original issue from the corporation solely in exchange for cash, (2) any capital or profits interest in a domestic partnership if the interest was acquired by the taxpayer from the partnership solely in exchange for cash, and (3) tangible business property acquired by the taxpayer by purchase, in which either the original use of the property in an RC or the DC Enterprise Zone commences with the taxpayer or the taxpayer substantially improves the property. In the case of stock or partnership interests and ownership of the tangible business property, the business must be a Renewal Community Business or DC Enterprise Zone Business when the stock, interest, or property is acquired (or be formed with the purpose of being a Renewal Community Business or DC Enterprise Zone Business) and must remain a Renewal Community Business or DC Enterprise Zone Business for substantially all of the holding period. (See appendix A.)



### **If the asset was purchased before an area receives an RC or DC Enterprise Zone designation does the 0-percent capital gains rate apply?**

No. The asset must be purchased after designation. If additional stock or partnership interests of an entity are purchased at original issuance after the RC or the DC Enterprise Zone designation, these additional interests might qualify.





**What if a taxpayer purchased a DC Enterprise Zone asset or RC asset, such as an existing building, from the taxpayer’s parents?**

The 0-percent capital gains rate is not available for transactions between related parties. “Related persons” include sons, daughters, parents, stepchildren, stepmothers, stepfathers, in-laws, and other persons treated as dependents under the tax code. Similar restrictions apply to sales to majority shareholders or partners of the business.



**What if a business ceases to meet the definition of a DC Enterprise Zone Business or Renewal Community Business?**

The business must meet the requirements for substantially all of the 5-year holding period. “Substantially all” generally means 85 percent of the period. If the business ceases to meet the test after the 5-year holding period, the 0-percent rate applies, but only to the extent of the gain to the date the business failed to meet the requirements.



**How long must the asset be held?**

The minimum holding period is 5 years.



**If the asset is sold before the end of the 5-year period, can the 0-percent gain feature be preserved for the subsequent holder?**

A subsequent purchaser of an asset that otherwise qualifies for 0-percent capital gain treatment is eligible for the incentive. The original purchaser would not be able to exclude any gain attributable to the period the asset was held, however, because the asset was not held by that original purchaser for the minimum period.



**What if the asset is held beyond the DC Enterprise Zone or RC designation period?**

The 0-percent rate applies only to gain attributable to the period after December 31, 1997, and before January 1, 2009, in the case of a DC Enterprise Zone asset and after December 31, 2001, and before January 1, 2015, in the case of an RC asset. The taxpayer is not required to sell the asset in 2008 (in the case of a DC Enterprise Zone asset) or in 2015 (for an RC asset), but must determine and substantiate the gain attributable to that period and may apply the 0-percent rate to that amount.



**What if the stock or partnership interest is redeemed before the end of the minimum holding period?**

The asset would not be eligible for the 0-percent capital gains rate.



**The 0-percent capital gains rate is available to Renewal Community businesses. What happens if, during the 5-year period that the asset must be held, the status of the business changes? For example, a business buys a building January 1, 2002, and meets the RC Business definition at that time and in 2007 after holding it for more than 5 years. Does the business still get the 0-percent tax rate on the capital gains?**

No. To qualify for the capital gain exclusion, substantially all of the use of the property during substantially all of the taxpayer's holding period must have been by an RC business. Although *substantially all* is not defined in the Internal Revenue Code for this purpose, it seems clear that qualifying as an RC business for only 3 of 5 years would not be considered substantially all of the taxpayer's holding period.



**To qualify for the 0-percent capital gains rate, what percentage of a business' gross income must come from the active conduct of business within the RC? Is it 50 percent or 80 percent?**

The 80-percent rule is an Enterprise Zone benefit that applies only to businesses operating in the District of Columbia. For RC businesses, at least 50 percent of gross income must come from the active conduct of business within the RC. That does not mean that the customers or products of the business must come from the RC; it means that the business must actively conduct its business in the RC. For the purposes of determining gross income, this income would be the same figure that a business would use for other Federal tax purposes.

# Nonrecognition of Gain on Sale of Empowerment Zone Assets

**Applicable IRS Tax Form: No applicable IRS tax form identified at time of publication.**

Capital Gains	Description	Availability
Nonrecognition of Gain on Sale of Empowerment Zone Assets (EZAs)	Capital gain on EZAs (stock, partnership interests, and business property) of an Enterprise Zone Business held for more than 1 year is not recognized (and is rolled over) if a replacement EZA is acquired within 60 days.	Election by taxpayer for EZAs acquired after December 21, 2000, and before January 1, 2010, for all EZs (not available in the DC Enterprise Zone, ECs, or RCs).

A taxpayer can elect to postpone gain on the sale of certain stock, partnership interests, or business property of an Enterprise Zone Business if replacement property is purchased within 60 days. The amount of gain rolled over cannot exceed the cost of the replacement asset. The incentive does not eliminate the payment of tax but postpones payment, which can be advantageous for tax planning purposes.

## Target Audience

- Businesses in Empowerment Zones (EZs) that frequently replace property used by the business with similar property.
- Investors interested in holding stock or partnership interests in an Enterprise Zone Business for a short term.
- Businesses interested in locating in an EZ and postponing gain on investments for tax planning purposes.



## Incentive Not Relevant to

- Businesses that cannot meet the definition of an Enterprise Zone Business.
- Investors seeking long-term stock or partnership investments.

## Additional Resources

- Accountants and lawyers preparing business tax returns.
- Local bar associations or accountant groups to identify accountants or lawyers to field questions.
- Tax attorneys and accountants with clients in EZs.
- Investment advisors familiar with EZs and EZ businesses.

## Questions & Answers on Nonrecognition of Gain on Sale of Empowerment Zone Assets



### Are there any special provisions for nonrecognition of gain for property in an EZ, Enterprise Community (EC), or Renewal Community (RC)?

In 2000, Congress created a new incentive for EZs that permits a taxpayer to roll over gain from the sale of certain assets held for more than 1 year. The incentive is not available for ECs, the District of Columbia Enterprise Zone, or RCs. The tax law permits the “nonrecognition” or so-called “rollover” of gain, at the taxpayer’s election, for a qualifying Empowerment Zone Asset (EZA) if the proceeds from the sale are used to purchase other qualifying EZA in the same Zone (“replacement zone asset”) within 60 days of the sale of the original EZA.



### What is the advantage of rollover of gain?

A business may be able to delay payment of capital gains to a taxable year where the gain is netted against a capital loss or to a year when the gain is otherwise beneficial to the taxpayer’s calculation of taxes.



### **Can gain on any asset used in the EZ qualify for the rollover treatment?**

Only certain assets of a business that meet the definition of Enterprise Zone Business will qualify. (See appendix A.) EZA includes (1) stock in a domestic company acquired by the taxpayer after December 21, 2000, and before January 1, 2010, at its original issue from the corporation solely in exchange for cash, (2) any capital or profit interest in a domestic partnership if the interest was acquired by the taxpayer after December 21, 2000, and before January 1, 2010, from the partnership solely in exchange for cash, and (3) tangible business property acquired by the taxpayer by purchase after December 21, 2000, and before January 1, 2010, where either the original use of the property in the EZ commences with the taxpayer or the taxpayer substantially improves the property.



### **Does the incentive apply to gain on sale of real property or intangible property?**

Any gain attributable to real property or an intangible asset can be rolled over only if it is an integral part of an Enterprise Zone Business.



### **Are there any limits on the dollar amount of gain that can be rolled over?**

The amount of gain rolled over cannot exceed the cost of the replacement EZA, and that cost is reduced by any gain that previously has not been recognized under this special rollover provision.



### **Are there any other tax consequences?**

Any gain that is not recognized reduces the basis of the replacement EZA.



**Is replacement EZA eligible for the same rollover treatment?**

The gain on the replacement EZA may also be rolled over, but only if the actual holding period of the replacement EZA is more than 1 year.



**How is the incentive reflected on a tax return?**

There is no special form for this provision, and the gain that is not being recognized would be accounted for in the same manner that capital gains generally are taken into account.

# Partial Exclusion of Gain on Sale of Empowerment Zone Stock

**Applicable IRS Tax Form: No applicable IRS tax form identified at time of publication; see IRS Publication 550.**

Capital Gains	Description	Availability
Partial Exclusion of Gain on Sale of Empowerment Zone Stock	Exclusion of 60 percent of gain on sale of small business stock of a C Corporation that is an Enterprise Zone Business located in an EZ if the stock is held for at least 5 years.	Stock must be acquired after December 21, 2000, and before January 1, 2010, at original issuance in exchange for cash. Sixty-percent exclusion does not apply to gain after December 31, 2014. Business must be an Enterprise Zone Business in an EZ (other than the DC Enterprise Zone).

A taxpayer can exclude 60 percent of gain realized on the sale of stock in a small business that meets the definition of an Enterprise Zone Business and is located in an Empowerment Zone (EZ). The exclusion of gain encourages investment in small EZ businesses whose stock is expected to appreciate prior to 2014.

## Target Audience

- Small corporations starting up or seeking additional cash infusion that locate in EZs.
- Startup corporations that expect rapid appreciation in the value of their stock.
- Investment banking firms that specialize in selling stock of emerging, small corporations.
- Local investment clubs seeking to invest in small businesses in an EZ.
- Taxpayers with stock portfolios looking to reduce capital gain.





## Incentive Not Relevant to

- Businesses formed as partnerships.
- Investors interested in investments in partnerships.
- Investors with large capital losses.
- Investors in businesses that are not likely to meet the definition of an Enterprise Zone Business for the 5-year holding period.

## Additional Resources

- Accountants and lawyers preparing business tax returns.
- Local bar associations or accountant groups to identify accountants or lawyers to field questions.
- Investment advisors familiar with small corporations and businesses within an EZ.
- IRS Publication 550. For copies call 1-800-829-3676 or visit [www.irs.ustreas.gov](http://www.irs.ustreas.gov)

## Questions & Answers on Partial Exclusion of Gain on Sale of Empowerment Zone Stock



### Are there any incentives for investing in small startup companies located in economically depressed areas?

In 2000, Congress extended an existing tax incentive encouraging investment in small companies to target small corporations located in EZs.



### What is meant by “small companies”?

This is generally a C corporation with gross assets of \$50 million or less. A business should consult its tax advisor for more specific requirements.



### **What if the taxpayer already owns stock in the company?**

The stock qualifies only if the taxpayer acquires the stock upon original issuance. Gain would not qualify for the 60-percent exclusion if the stock was purchased before December 21, 2000.



### **Must the business be an Enterprise Zone Business when the stock is purchased?**

The corporation must either be an Enterprise Zone Business when the stock is purchased or be formed for purposes of meeting the definition and must meet the definition for substantially all of the taxpayer's 5-year holding period. (See appendix A.)



### **What amount of gain is excluded?**

The tax code will permit 60 percent of the gain realized to be excluded. This exclusion would not apply to gains after December 31, 2013.



### **What if the stock is held for less than 5 years?**

The favorable exclusion treatment applies only if the stock is held for more than 5 years.



### **What if the business ceases to be an Enterprise Zone Business?**

The exclusion is available only if the business meets the Enterprise Zone Business definition for substantially all of the 5-year holding period. Substantially all generally means 85 percent of the period. An investor would not be eligible for the benefit if the business was not able to meet the requirements.



### **How is the incentive shown on a tax return?**

The exclusion is included in the general portion of taxpayer's return related to capital gain and loss (such as Schedule D of IRS Form 1040) when the stock is sold or otherwise disposed of. There are no regulations on how an investor should document that a business met the small stock and Enterprise Zone Business requirements. An investor may want to consult his or her tax advisor for advice on documenting compliance.



### **Which tax form should EZ businesses use to itemize rolled-over gains on the sale of EZ assets that are purchased after December 21, 2000, held for more than 1 year, and then replaced within 60 days?**

An EZ should use IRS Schedule D or Form 4797 (the same form that would normally be used in the absence of a rollover). Instructions for reporting the rollover of gain on the sale of EZ assets for Schedule D filers are included in IRS Publication 550.

# New Markets Tax Credit

**Applicable IRS Tax Form: No applicable IRS tax form identified at time of publication.**

Tax Credit	Description	Availability
New Markets Tax Credit	Equity investors in qualified Community Development Entities (CDEs) can obtain a tax credit against Federal taxes of 5 to 6 percent of the amount invested for each of the years the investment is held, for up to 7 years of the credit period.	Allocations of the credit will be made annually from 2001 to 2007 to qualified CDEs. Investors must purchase stock or partnership interest in a CDE for cash at original issuance. Credit available at time of purchase (1 year) and on 6 anniversary dates of acquisition of investment.

The New Markets Tax Credit provides individuals and corporations with an incentive to invest in a community development entity (CDE) that provides capital and financial advisory services to low-income communities. The investor receives a credit against Federal tax liability equal to a percentage of the amount invested in the CDE. The credit can be taken for up to 7 years. The credit will be available for up to \$15 billion in investments in CDEs designated by the U.S. Treasury Department over the 2001–2007 period.

## Target Audience

- Corporations and individuals looking to reduce Federal tax liability up to a 7-year period.
- Investors wanting to invest in low-income community businesses.
- Financial institutions seeking to reduce Federal tax liability and obtain Community Reinvestment Act credit through the same investment.
- Investors in Low-Income Housing Tax Credit (LIHTC) projects that may want a similar tax credit investment for commercial development.
- Community development corporations seeking to broaden their source of capital through investments in for-profit subsidiaries.



## Incentive Not Relevant To

- Startup or similar businesses that may not have large tax liabilities.
- Individuals who are unable to benefit from the investment because of passive loss limitations.
- Individuals or corporations paying the Federal Alternative Minimum Tax.

## Additional Resources

- Accountants and lawyers preparing business tax returns.
- Local bar associations or accountant groups to identify accountants or lawyers to field questions.
- Community development corporations, community bankers, and business associations that are familiar with business opportunities in low-income communities.
- Syndicators of low-income housing tax credits familiar with credit syndication.

## Questions & Answers on New Markets Tax Credits



### Are there any incentives for persons wishing to invest in commercial enterprises located in economically distressed communities?

In 2000, Congress added a New Markets Tax Credit against Federal tax liability for taxpayers who hold an equity investment in certain CDEs. The CDE, in turn, makes loans to, or investments in, qualifying businesses in low-income communities. The investor in the CDE obtains the tax benefit based on the amount invested in the CDE.



### What type of entity qualifies as a CDE?

A CDE is any domestic corporation or partnership for Federal tax purposes that

- Has a primary mission serving or providing investment capital for low-income communities or low-income persons.

- Maintains accountability to residents of low-income communities through their representation on any governing board or on any advisory board of the CDE.
- Is certified by the Treasury Department as an eligible CDE.

In allocating the credits, the Treasury Department will give priority to entities with records of having successfully provided capital or technical assistance to disadvantaged businesses or communities, as well as to entities that intend to invest substantially all of the proceeds from their investors in businesses in which persons unrelated to the CDE hold the majority of the equity interest. A “small business investment company” (as defined in the tax laws) and a “community development financial institution” (as defined in Federal banking laws) are treated as meeting these requirements.



### **How does an investor get an allocation of the credit?**

The investor does not receive the credit directly from the Federal Government. Instead, CDEs that are eligible for the credit will be selected by the U.S. Treasury Department. The Treasury Department can allocate credits to qualified CDEs of \$1 billion for 2001, \$1.5 billion each year for 2002–2003, \$2 billion each year for 2004–2005, and \$3.5 billion each year for 2006–2007. The CDE will have up to 5 years to allocate the credit to specific investments. The credit is available when the investor makes an equity contribution to the qualified CDE.



### **How does an investor determine which CDEs have received an allocation of the credit?**

The Treasury Department will publish a list of CDEs designated each year.



### **How will the CDE use the equity that qualifies for the New Markets Tax Credit?**

The CDE must use at least 85 percent of the cash infusion to make a “qualified low-income community investment” (a Qualified Investment). A Qualified Investment includes 1) a capital or equity investment in, or loan to, a “qualified active low-income community business” or a qualified CDE, 2) the purchase of a loan made by another qualified CDE to a qualified active

low-income community business, or 3) the provision of financial counseling and other similar services to businesses and residents located in low-income communities. There are no limits on the use of the remaining 15 percent of the equity raised by the CDE.



### **What is a “qualified active low-income community business” (Qualified Active Business)?**

A “qualified active low-income community business” is defined as a corporation, partnership, or sole proprietorship that meets the following tests:

- At least 50 percent of its gross income comes from the active conduct of a qualified business within any low-income community.
- A “substantial portion” of the use of tangible property of the business (whether owned or leased) must be located within a low-income community.
- A substantial portion of employee services must be performed in a low-income community.
- No more than 5 percent of the property of the business can be “nonqualified financial property,” generally defined as debt, stock, partnership interests, and various financial instruments (other than reasonable amounts of working capital held in cash or short-term debt instruments or accounts receivable arising from sales of inventory).
- No more than 5 percent of the property of the business can be works of art or other “collectibles,” unless held for sale to customers.

This definition is a modification of the definition of an Enterprise Zone Business (see appendix A). There is no requirement that a specified percentage of employees live in the low-income community, however.



### **Are there any types of business operations that do not qualify as a Qualified Active Business?**

Certain businesses cannot qualify, including residential rental property; a business, whose predominant activity of which is the development or holding of intangibles for sale or license; a golf course, country club, massage parlor, hot tub facility, suntan facility, race track, or a facility used for gambling; or a store, whose principal business is selling alcoholic beverages for consumption off-premises. In addition, as distinguished from the Enterprise Zone Business definition, rental of improved commercial real estate located in a low-income community is a Qualified Active Business regardless of the characteristics of the commercial tenants

of the property. The purchase and holding of unimproved real estate is not a Qualified Active Business. A Qualified Active Business can include a nonprofit organization.



### **Where must a Qualified Active Business be located?**

The tax credit is based on assistance to certain businesses in a low-income community. A low-income community is defined as census tracts with either (1) poverty rates of at least 20 percent (based on the most recent census data), or (2) a median family income that does not exceed 80 percent of the greater of metropolitan area income or statewide median family income (for a nonmetropolitan census tract, 80 percent of nonmetropolitan statewide median family income). In addition, the Treasury Department may designate any area within any census tract as a low-income community provided that (1) the boundary of the area is continuous, (2) the area (if it were a census tract) would satisfy the poverty rate or median income requirements within the targeted area, and (3) an inadequate access to investment capital exists in the area.



### **How long must an investor hold the investment?**

There is no minimum holding period. The investment is eligible for the credit on the date the investment is made and on six subsequent anniversary dates. The credit is equal to 5 percent of the amount invested for the first three allowance dates, with an increase to 6 percent for the remaining four allowance dates. The investor must hold the investment on the “credit allowance date,” which is the date on which the investment is initially made and on each of the six subsequent anniversaries of the date on which the investment is initially made. If the investment is not held on the credit allowance date, the investor is not eligible to take the New Markets Tax Credit.



### **What if an investor is unable to use the credit in a specific tax year?**

The New Markets Tax Credit is a general business tax credit, and can be carried forward 20 years and carried back 1 year (except for tax years ending prior to January 1, 2001).





### **Will an investor be able to sell the investment in the CDE with the credit attached?**

The credit is available to subsequent purchasers of the investment. If an initial investor is unable to use the tax credit, the investment can be transferred with the credit available to the subsequent purchaser.



### **Are there any tax benefits for an owner of a potential Qualified Active Business?**

The tax benefit itself does not go to the business. There is no requirement that the CDE pass through the value of the benefit of the tax credit, for example, in the form of a lower interest rate on a loan. The credit merely provides an incentive for creating a source of capital for organizations that have a mission and a proven track record for stimulating economic development in economically depressed areas. The ultimate benefit to the business owner will be access to the new capital infusion in low-income communities.



### **Is the New Markets Tax Credit subject to recapture like other credits?**

The credit is subject to recapture during the 7-year credit period if the entity invested in ceases to be a CDE, the proceeds of the investment are not used to make Qualified Investments, or the investment in the CDE is redeemed by the CDE. The recapture amount is generally based on tax benefit derived from the credit.



### **Are there any other tax consequences to holding this tax credit investment?**

The taxpayer's basis in the investment is generally reduced by the amount of the credit. The credit is subject to the general business credit and passive loss limitation rules.



### **Can this credit be used to reduce Federal Alternative Minimum Tax (AMT) liability?**

No. The credit cannot be used to reduce the AMT liability of an individual or corporation.



### **Can an investor contribute property to a CDE to obtain an equity investment that qualifies for the credit?**

The credit is available only in cases in which the stock of a corporation, a membership interest of a limited liability company, or capital interest in a partnership is acquired at original issuance for cash. An investment acquired through an underwriter at original issuance would meet this requirement.



### **How is this credit different from LIHTC?**

LIHTC is based on the eligible costs of a residential rental project that sets aside units for low- and moderate-income persons. It cannot be used for commercial projects. An investor receiving the New Markets Tax Credit receives the credit based on its investment in the CDE. Investment by the CDE in residential rental real estate is not a Qualified Investment for purposes of meeting the requirement that 85 percent of the cash be used to acquire Qualified Investments.

# Low-Income Housing Tax Credit

## Applicable IRS Tax Form: Forms 8609 and 8586

Housing Tax Credit	Description	Availability
Low-Income Housing Tax Credit (LIHTC)	Ten-year credit against Federal taxes for owners of newly constructed or renovated rental housing who set aside a specified percentage of units for low-income persons for a minimum of 15 years. The credit varies for new construction and renovation.	Project must receive allocation of State's annual credit ceiling or use multifamily housing tax-exempt bonds that receive allocation of State's bond volume cap. Allocations are made on basis of State plan. The project does not have to be located in an EZ, EC, or RC to qualify.

The Low-Income Housing Tax Credit (LIHTC) is available over a 10-year period to the tax owners of rental projects who set aside a specified percentage of units for low-income persons for a minimum of 15 years. The project owner must receive an allocation of tax credits to qualify for this incentive. Information on the LIHTC can be obtained from IRS Publication Form 8586 and from the National Council of State Housing Agencies on their Internet site at [www.ncsha.org](http://www.ncsha.org). (Little information on this credit is provided here because LIHTC is not included in the Internal Revenue Service (IRS) publication 954. Because this is a very complicated tax credit, please contact the IRS for more information.)



# Appendix A

## Questions & Answers on Enterprise Zone Businesses and Renewal Community Businesses

Tax incentives are generally designed to encourage businesses to locate or expand operations in an Empowerment Zone (EZ), Enterprise Community (EC), or Renewal Community (RC) and to hire residents of an EZ, EC, or RC. Five of the Federal tax incentives—Increased Section 179 Deduction, Enterprise Zone Facility Bonds, Zero Percent Capital Gains Rate for DC Enterprise Zone Assets, Nonrecognition of Gain on Sale of Empowerment Zone Assets, and Partial Exclusion of Gain on Sale of Empowerment Zone Stock—require that the business meet the definition of “Enterprise Zone Business.” Two of the RC incentives—Increased Section 179 Expensing Deduction and Zero Percent Capital Gains for RC Assets—require that the business meet the definition of “Renewal Community Business” in order to qualify for the incentive.

A business qualifies as an Enterprise Zone Business or Renewal Community Business if it actively conducts business in an EZ, EC, or RC, has its tangible and intangible property located and used in the active conduct of business in an EZ, EC, or RC, employs residents of an EZ, EC, or RC (a required 35 percent of its employees), and has its employees perform services in an EZ, EC, or RC. The business can be a sole proprietorship, partnership, or corporation for Federal tax purposes. Some businesses are excluded from qualifying. The business must meet the requirements of being an Enterprise Zone Business or Renewal Community Business continuously for several years, depending on the incentive.



### What is an Enterprise Zone Business or Renewal Community Business?

In general, an Enterprise Zone Business or Renewal Community Business is a corporation, partnership, or sole proprietorship that, for each taxable year, meets the following tests:

- Except with respect to a sole proprietorship, every trade or business of the entity is actively conducted in an EZ, EC, or RC (legally separate entities are not aggregated with related entities for these tests).
- At least 50 percent of the total gross income of the entity is derived from the active conduct of business within an EZ, EC, or RC.

- A substantial portion of the use of the tangible property of the entity (whether owned or leased) is within an EZ, EC, or RC.
- A substantial portion of the intangible property of the business is used in the active conduct of the business.
- A substantial portion of the services performed for the employer by its employees occur within an EZ, EC, or RC.
- At least 35 percent of the employees reside in an EZ, EC, or RC. (This does not apply in the DC Enterprise Zone.)
- No more than 5 percent of the property is nonqualified financial property (such as debt, stock, and various financial instruments) except for reasonable amounts of working capital held in cash, cash equivalents, or debt instruments with a term of 18 months or less and certain accounts receivable arising from sales of inventory.
- No more than 5 percent of the property is works of art or other collectibles unless held for sale to customers.



### **How does a business know whether its building is in the Zone or an RC?**

The local EZ, EC, or RC entity can provide businesses with information on its boundaries, or businesses may obtain the information over the Internet at [www.hud.gov/cr](http://www.hud.gov/cr) for urban EZ/ECs and for urban and rural RCs or [www.ezec.gov](http://www.ezec.gov) for rural EZ/ECs.



### **Are there any types of businesses that cannot be Enterprise Zone Businesses or Renewal Community Businesses?**

Yes. The tax laws exclude certain businesses from the definition, including liquor stores, golf courses, racetracks, gambling facilities, country clubs, residential rental properties, businesses that predominantly hold or develop intangibles for sale or license, or businesses that rent personal property, such as car rental agencies (unless at least 50 percent of the rentals are to Enterprise Zone Businesses or Renewal Community Businesses or to EZ, EC, or RC residents). Non-profit organizations are not automatically precluded merely because the activities carried on by the organization are conducted on a nonprofit basis.



### **Can a high-technology company qualify as an Enterprise Zone Business or Renewal Community Business?**

The answer depends on its operations. The tax law states that no business consisting predominantly of the development or holding of intangibles for sale or license can qualify as an Enterprise Zone Business or Renewal Community Business.



### **Can a real estate developer qualify as an Enterprise Zone Business or Renewal Community Business?**

A business that develops and owns commercial real estate can qualify only if at least 50 percent of its gross rental income from real property is from Enterprise Zone Businesses or Renewal Community Businesses. The owner is permitted to accept certifications of lessees in determining whether the lessee is an Enterprise Zone Business or Renewal Community Business. If the project is residential rental property, the business is automatically excluded by statute from the definition of an Enterprise Zone Business or Renewal Community Business.



### **Is farming a qualified business for purposes of the Enterprise Zone Business or Renewal Community Business definition?**

Farming is a qualified business only if the sum of the value of the assets owned or leased by the employer for use in the farming business does not exceed \$500,000. The definition of farming and the method for calculating the value of the assets are found in the tax laws. An employer should consult its legal advisor on this matter.



### **How does a business apply the tests if it has several locations?**

The tests generally apply to legally separate entities. If a single business entity has locations both within and outside an EZ, EC, or RC, all of the tests apply to the overall operations. If the various locations are operated by legally separate entities, the tests apply only to that location's operations even if the various legal entities are related for Federal tax purposes. For example, if a national chain store or restaurant set up operations in an EZ, EC, or RC, the tests would be measured with respect to the EZ, EC, or RC location store only if that store or restaurant was separately incorporated from other stores or restaurants in the chain.



### **What does it mean that “legally separate entities are not aggregated with related entities for the Enterprise Zone Business tests?”**

This rule permits businesses to set up separate corporations or partnerships to conduct business in an EZ, EC, or RC. All Enterprise Zone Business or Renewal Community Business tests would be measured based on the EZ, EC, or RC business, and a business would not have to include any activities of other related entities outside of the EZ, EC, or RC. Many other tax law provisions treat related entities as one business and require adding together the activities of all entities. This rule for Enterprise Zone Businesses and Renewal Community Businesses is more lenient than other tax rules.



### **How does a business apply the active conduct of business within an EZ, EC, or RC test if raw materials and customers come from outside the EZ, EC, or RC?**

The tax regulations relating to Enterprise Zone Facility Bonds describe a mail-order clothing business that is located in an EZ. The business purchases the supplies for its clothing business from suppliers located both within and outside the EZ and expects that orders will be received both from customers who will reside or work within the EZ and from others outside the EZ. All orders are received, filled at, and shipped from the clothing business located in the EZ. The income generated from the sales would be treated as gross income derived from the active conduct of business within an EZ.





### **How do the tests apply if a business makes deliveries inside and outside an EZ, EC, or RC?**

The tax regulations for Enterprise Zone Facility Bonds give an example of a printing operation located in an EZ. All orders are taken and completed, and all billing and accounting activities are performed, at the print shop located in the EZ. The business, on occasion, uses its equipment (including its trucks) and employees to deliver large print jobs to customers who reside outside the EZ. As long as the business is able to establish that its trucks are used in the EZ a substantial portion of the time and that its employees perform a substantial portion of their services for the business in the EZ, the business meets the requirements with respect to the use of tangible property and location of services performed by employees.



### **How does a business calculate the requirement that 35 percent of its employees be EZ, EC, or RC residents?**

The tax regulations relating to tax-exempt bonds permit calculation either on a per-employee fraction or an employee actual work-hour fraction. In the per-employee fraction method, the business would compare the number of EZ, EC, or RC resident employees in a taxable year to the total number of employees during the same taxable year. Employees include persons employed for at least 90 days and who work at least 15 hours per week. The employee actual work-hour fraction seeks to accommodate businesses with full- and part-time workers and compares actual hours worked by EZ, EC, or RC residents to total employee hours worked in a taxable year. A business must apply the same method consistently over the period of the tax incentive once a method is selected. The same methods of determining whether the 35-percent test is met may apply for purposes of the other EZ incentives and the incentives that require a Renewal Community Business, but the Internal Revenue Service (IRS) has not formally extended the rules.



### **Are there any waivers for businesses that meet requirements in all other areas but the “35-percent rule” for EZ, EC, or RC employees?**

The 35-percent EZ, EC, or RC employee requirement is statutory and cannot be waived. For purposes of tax-exempt financing, the Enterprise Zone Business is permitted to average yearly percentages over a rolling, consecutive 5-year period. There are no tax regulations on whether the averaging provision applies to any of the other EZ incentives or the RC incentives.





**Do employees contracted through a temporary agency meet the definition of employee for purposes of the Enterprise Zone Business or Renewal Community Business tests? Do employees who are also relatives meet the definition of employee for this purpose?**

The tax laws do not directly address these issues with respect to the Enterprise Zone Business or Renewal Community Business definition. If the business treats the individuals as employees for other Federal tax purposes, the business presumably could treat them as employees for this purpose.



**How does a business know it qualifies as an Enterprise Zone Business or Renewal Community Business?**

There is no formal application or certification process for being an Enterprise Zone Business or Renewal Community Business. A business must analyze the requirements in light of its own operations and use the same standards it applies for taking any position on its Federal tax return. This requires a legal determination, so a business should consult a tax attorney or its tax preparer. The business should retain documents that establish that it is an Enterprise Zone Business or Renewal Community Business, such as statements that an employee is an EZ, EC, or RC resident, in case of an audit by the IRS.



**Can real estate developers qualify as RC or EZ businesses?**

Yes, provided the property owned by the real estate developer is not in the business of holding residential rental property and at least 50 percent of the gross rental income from the lessees is from EZ or RC businesses. Note that property is residential rental property only if at least 80 percent of the gross rental income from the property is from dwelling units.



**Can a bank located in an EZ or RC, which has more than 35 percent of its employees residing in the EZ or RC and does more than 50 percent of its business in the EZ or RC meet the definition of an EZ or RC business? This question arises because the provision stating that less than 5 percent of the aggregate adjusted bases of the property of the business be attributable to “nonqualified financial property” is unclear. What type of business is this provision referring to?**

There is no explanation in the Congressional Committee Reports as to the types of businesses targeted by this provision. A bank could not qualify if more than 5 percent of the bank’s average aggregate unadjusted bases is attributable to nonqualified financial property. Nonqualified financial property includes debt and other similar property (other than accounts or notes receivable from sales or services).



**In what manner can a business with national or international locations qualify as an EZ or RC business if they have a plant or plants located in an EZ or RC?**

The qualifications for an EZ or RC business are measured with respect to a legal entity. Activities of legally separate (even if related) parties are not aggregated for purposes of determining whether an entity qualifies as an EZ or RC business. That means that a plant of a national company located in an EZ or RC can qualify as an EZ or RC business if it is set up as a separate legal entity (such as a subsidiary or partnership).



**May a business count family members as employees in determining if the business is considered an RC business? For example, if a business located in an RC has 10 employees, 4 of whom are family members who live in the RC, how many total employees need to live in the RC for the business to be considered an RC business? Would it be 35 percent of 10 employees or 35 percent of 6 employees?**

Yes, employees who are also family members count for purposes of the 35-percent test. So, in the example, you would base the test on 10 employees.



**If the answer is a fraction, do you round up or down to determine the correct number of employees?**

You would not round at all. At least 35 percent of the employees must be residents of an RC. For any percentage less than 35 percent, the employer would fall below the 35-percent threshold and would fail to meet the test.



**An employer's business address is located in an RC, but the business has multiple adjacent buildings connected by pedestrian walkways that are physically located outside the RC according to the demarcation lines of the census tract. If all the connected buildings have one central business address located in the RC, can all the buildings be considered to be inside the RC?**

Under the Internal Revenue Code provisions defining an RC business, if a business uses real property located both within and outside an RC, the amount of the real property located within the RC is *substantial* when compared to the amount of the real property located outside the RC, and the property located outside the RC is contiguous to the real property within the RC, the contiguous property is treated as being within the RC. However, this rule applies **only** for purposes of defining a RC business. For any other purpose, the taxpayer can get an answer by submitting a private letter ruling request to the IRS.

# Appendix B

## Current Renewal Communities, Empowerment Zones, and Enterprise Communities as Designated by HUD and USDA

### HUD Designees

#### Renewal Communities (RCs)—40

Urban (U)—28

Rural (R)—12

#### Alabama

Greene-Sumter (R)  
Mobile County (U)  
Southern Alabama (R)

#### California

Los Angeles (U)  
Orange Cove (R)  
Parlier (R)  
San Diego (U)  
San Francisco (U)

#### Georgia

Atlanta (U)

#### Illinois

Chicago (U)

#### Kentucky

Eastern Kentucky (R)

#### Louisiana

Central Louisiana (R)  
New Orleans (U)  
Northern Louisiana (R)  
Ouachita Parish (U)

#### Massachusetts

Lawrence (U)  
Lowell (U)

#### Michigan

Detroit (U)  
Flint (U)

#### Mississippi

West Central Mississippi (R)

#### New Jersey

Camden (U)  
Newark (U)

#### New York

Buffalo-Lackawanna (U)  
Jamestown (R)  
Niagara Falls (U)  
Rochester (U)  
Schenectady (U)

#### North Dakota

Turtle Mountain Band of  
Chippewa (R)

#### Ohio

Hamilton (U)  
Youngstown (U)

#### Pennsylvania

Philadelphia (U)

#### South Carolina

Charleston (U)

#### Tennessee

Chattanooga (U)  
Memphis (U)

#### Texas

Corpus Christi (U)  
El Paso County (R)

#### Vermont

Burlington (R)

#### Washington

Tacoma (U)  
Yakima (U)

#### Wisconsin

Milwaukee (U)

## Urban Empowerment Zones (EZs)—30

### Round I Urban EZs—5

#### Illinois

Chicago

#### Maryland

Baltimore

#### Michigan

Detroit

#### New York

New York

#### Pennsylvania/New Jersey

Philadelphia/Camden

### Supplemental Round I EZs—2

#### California

Los Angeles

#### Ohio

Cleveland

### Round II Urban EZs—15

#### California

Santa Ana

#### Connecticut

New Haven

#### Florida

Miami-Dade County

#### Indiana

Gary-Hammond-East Chicago

#### Massachusetts

Boston

#### Minnesota

Minneapolis

#### Missouri/Illinois

St. Louis/East St. Louis

**New Jersey**  
Cumberland County

**Ohio**  
Cincinnati  
Columbus

**South Carolina**  
Columbia-Sumter

**Tennessee**  
Knoxville

**Texas**  
El Paso

**Virginia**  
Norfolk-Portsmouth

**West Virginia/Ohio**  
Huntington/Ironton

**Round III Urban EZs—8**

**Arizona**  
Tucson

**Arkansas**  
Pulaski County

**California**  
Fresno

**Florida**  
Jacksonville

**New York**  
Syracuse  
Yonkers

**Oklahoma**  
Oklahoma City

**Texas**  
San Antonio

**Enterprise Zones—1**

**District of Columbia**  
Washington

**Urban Enterprise Communities (ECs)—49**

**Round I Urban ECs—45**

**Alabama**  
Birmingham

**Arizona**  
Phoenix

**Arkansas**  
Pulaski County

**Colorado**  
Denver

**Connecticut**  
Bridgeport  
New Haven

**Delaware**  
Wilmington

**District of Columbia**  
Washington

**Florida**  
Miami  
Tampa

**Georgia**  
Albany

**Illinois**  
East St. Louis  
Springfield

**Indiana**  
Indianapolis

**Iowa**  
Des Moines

**Kentucky**  
Louisville

**Massachusetts**  
Springfield

**Michigan**  
Muskegon

**Minnesota**  
Minneapolis  
St. Paul

**Mississippi**  
Jackson

**Missouri**  
St. Louis

**Nebraska**  
Omaha

**Nevada**  
Las Vegas

**New Hampshire**  
Manchester

**New Mexico**  
Albuquerque

**New York**  
Newburgh-Kingston

**North Carolina**  
Charlotte

**Ohio**  
Akron  
Cleveland  
Columbus

**Oklahoma**  
Oklahoma City

**Oregon**  
Portland

**Pennsylvania**  
Harrisburg  
Pittsburgh

**Rhode Island**  
Providence

**Tennessee**  
Nashville

**Texas**  
Dallas  
El Paso  
San Antonio  
Waco

**Utah**  
Ogden

**Virginia**  
Norfolk

**Washington**  
Seattle

**West Virginia**  
Huntington

**Round I Urban Enhanced ECs—4**

**California**  
Oakland

**Massachusetts**  
Boston

**Missouri/Kansas**  
Kansas City

**Texas**  
Houston

## **USDA Designees**

### **Round I Rural EZs—3**

#### **Kentucky**

Kentucky Highlands

#### **Mississippi**

Mid-Delta

#### **Texas**

Rio Grande Valley

### **Round II Rural EZs—5**

#### **California**

Desert Communities

#### **Georgia**

Southwest Georgia United

#### **Illinois**

Southernmost Illinois Delta

#### **North Dakota**

Griggs-Steele

#### **South Dakota**

Oglala Sioux Tribe

### **Round III Rural EZs—2**

#### **Maine**

Aroostook County

#### **Texas**

FUTURO

### **Round I Rural ECs—28**

#### **Alabama**

Chambers County

#### **Arizona**

Arizona Border Region

#### **Arkansas**

East Arkansas

Mississippi County

#### **California**

Imperial County

Watsonville

#### **Florida**

Jackson County

#### **Georgia**

Central Savannah River Area

Crisp-Dooly

#### **Louisiana**

Northeast Louisiana Delta

#### **Michigan**

Lake County

#### **Mississippi**

North Delta Mississippi

#### **Missouri**

East Prairie

#### **New Mexico**

La Jicarita

#### **North Carolina**

Halifax-Edgecombe-Wilson

Empowerment Alliance

Robeson County

#### **Ohio**

Greater Portsmouth

#### **Oklahoma**

Southeast Oklahoma

#### **Oregon**

Josephine County

#### **Pennsylvania**

Lock Haven

#### **South Carolina**

Williamsburg-Lake City

#### **South Dakota**

Beadle and Spink

#### **Tennessee**

Fayette-Haywood Counties

Scott-McCreary Area

#### **Virginia**

Accomack-Northampton

#### **Washington**

Lower Yakima County

#### **West Virginia**

Central Appalachia

McDowell County

### **Round II Rural ECs—20**

#### **Alaska**

Metlakatla Indian

Community

#### **Arizona**

Four Corners

#### **California**

Huron-Tule

#### **Florida**

Empowerment Alliance of

Southwest Florida

#### **Hawaii**

Molokai

#### **Indiana**

Austin

#### **Kansas**

Wichita County

#### **Kentucky**

Bowling Green

#### **Maine**

Empower Lewiston

#### **Michigan**

Clare County

#### **Montana**

Fort Peck Assiniboine and

Sioux Tribe

#### **New Mexico**

Deming

#### **Oklahoma**

Tri-County Indian Nations

#### **Pennsylvania**

Fayette

#### **South Carolina**

Allendale County ALIVE

#### **Tennessee**

Clinch-Powell

#### **Texas**

FUTURO

#### **Washington**

Five Star

#### **West Virginia**

Upper Kanawha Valley

#### **Wisconsin**

Northwoods Nijjii

