

**TECHNICAL EXPLANATION OF THE
TAX PROVISIONS IN H.R. 4923
THE "COMMUNITY RENEWAL AND
NEW MARKETS ACT OF 2000"**

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of the

JOINT COMMITTEE ON TAXATION



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I. INTRODUCTION

This document,¹ prepared by the staff of the Joint Committee on Taxation, provides a technical explanation of the tax provisions contained in H.R. 4923, the “Community Renewal and New Markets Act of 2000.”

¹ This document may be cited as follows: Joint Committee on Taxation, *Technical Explanation of the Tax Provisions in H.R. 4923, the “Community Renewal and New Markets Act of 2000”* (JCX-85-00), July 25, 2000.

II. SUMMARY

H.R. 4923, the "Community Renewal and New Markets Act of 2000," provides additional tax incentives for targeted areas that are identified as areas of pervasive poverty, high unemployment, and general economic distress. The bill also increases the limits with respect to the low-income housing tax credit and the private activity bond volume caps.

Tax incentives for renewal communities

The bill authorizes the Secretary of HUD to designate up to 40 "renewal communities" from areas nominated by States and local governments. At least eight of the designated renewal communities must be in rural areas. In general, nominated areas are ranked based on a formula that takes into account the area's poverty rate, median income, and unemployment rate. A nominated area within the District of Columbia will be designated as a renewal community (without regard to its ranking) beginning in 2003.

A nominated area that is designated as a renewal community is eligible for the following tax incentives during the period beginning July 1, 2001, and ending December 31, 2009: (1) a 100-percent capital gains exclusion for capital gain from the sale of qualifying assets acquired after June 30, 2001, and before January 1, 2010, and held for more than five years; (2) a 15 percent wage credit to employers for the first \$10,000 of qualified wages paid to each employee who (i) is a resident of the renewal community, and (ii) performs substantially all employment services within the renewal community in a trade or business of the employer; (3) a "commercial revitalization expenditure" that allows taxpayers (to the extent allocated by the appropriate State agency for the period after June 30, 2001) to deduct either (i) 50 percent of qualifying expenditures for the taxable year in which a qualified building is placed in service, or (ii) all of the qualifying expenditures ratably over a 10-year period beginning with the month in which such building is placed in service; (4) an additional \$35,000 of section 179 expensing for qualified renewal property placed in service after June 30, 2001 and before January 1, 2010 by a renewal community business; (5) the expensing of certain environmental remediation expenditures incurred after June 30, 2001, and before January 1, 2010 within a renewal community; and (6) an expansion of the Work Opportunity Tax Credit with respect to qualified individuals who live in a renewal community.

Extension and expansion of empowerment zone incentives

The bill extends the designation of empowerment zone status for existing zones (other than the D.C. Enterprise Zone) through December 31, 2009. In addition, the 20-percent wage credit is made available to all existing empowerment zones beginning in 2002 (and remains at the 20-percent rate). Furthermore, \$35,000 (rather than \$20,000) of additional section 179 expensing is available for qualified zone property placed in service in taxable years beginning after December 31, 2001, by a qualified zone business. The bill also extends an empowerment zone's status as a "target area" under section 198 (thus permitting expensing of certain environmental remediation costs) for costs incurred after December 31, 2001, and before January

1, 2010. Also beginning in 2002, certain businesses in existing empowerment zones (other than the D.C. Enterprise Zone) become eligible for more generous tax-exempt bond rules.

The bill also authorizes Secretaries of HUD and Agriculture to designate nine additional empowerment zones (seven to be located in urban areas and two in rural areas). The new empowerment zones must be designated by January 1, 2002, and the tax incentives with respect to the new empowerment zones generally are available during the period beginning on January 1, 2002, and ending on December 31, 2009. Businesses in the new empowerment zones are eligible for the same tax incentives that, under this bill, are available to existing zones (i.e., a 20-percent wage credit, \$35,000 of additional section 179 expensing, the enhanced tax-exempt financing benefits, and expensing of certain environmental remediation costs).

The bill permits a taxpayer to roll over gain from the sale or exchange of any qualified empowerment zone asset held for more than 1 year where the taxpayer uses the proceeds to purchase other qualifying empowerment zone assets (in the same zone) within 60 days of the sale of the original asset. In general, a qualifying empowerment zone asset refers to a stock or partnership investment in, or assets acquired by, a qualifying business within an empowerment zone that is purchased by a taxpayer after the date of enactment of the bill.

The bill increases to 60 percent (from 50 percent) the exclusion of gain from the sale of qualifying small business stock held more than five years where such stock also satisfies the requirements of a qualifying business under the empowerment zone rules. The provision applies to qualifying small business stock that is purchased after the date of enactment of the bill.

Provide new markets tax credit

The bill creates a new tax credit for qualified equity investments made after December 31, 2000, to acquire stock in a community development entity (“CDE”). The maximum annual amount of qualifying equity investments is capped as follows:

<u>Calendar Year</u>	<u>Maximum Qualifying Equity Investment</u>
2001	\$1.0 billion
2002-2003	\$1.5 billion per year
2004-2005	\$2.0 billion per year
2006-2007	\$3.5 billion per year

The amount of the credit allowed to the investor is (1) a five-percent credit for the year in which the equity interest is purchased from the CDE and for the first two anniversary dates after the purchase from the CDE, and (2) a six percent on each anniversary date thereafter for the following four years. The credit is recaptured if the entity fails to continue to be a CDE or the interest is redeemed within seven years.

A CDE is any domestic corporation or partnership (1) whose primary mission is serving or providing investment capital for low-income communities or low-income persons, (2) that maintains accountability to residents of low-income communities through representation on governing or advisory boards, and (3) is certified by the Treasury Department as an eligible CDE.

A qualified equity investment means stock or a similar equity interest acquired directly from a CDE for cash. Substantially all of the cash must be used by the CDE to make investments in, or loans to, qualified active businesses located in low-income communities, or certain financial services to businesses and residents in low-income communities. A “low-income community” generally is defined as census tracts with either (1) poverty rates of at least 20 percent, or (2) median family income which does not exceed 80 percent of the greater of metropolitan area income or statewide median family income.

Improvements in the low-income housing tax credit

The bill increases the low-income housing credit cap to \$1.75 per resident between 2001 and 2006 as follows:

<u>Calendar Year</u>	<u>Applicable credit amount</u>
2001	\$1.35
2002	\$1.45
2003	\$1.55
2004	\$1.65
2005	\$1.70
2006	\$1.75

In addition, beginning in 2001, the per capita cap is modified so that less populous States are given a minimum of \$2 million of annual credit cap. The \$1.75 per capita credit cap and the \$2 million amount is indexed for inflation beginning in 2007. The bill also makes several programmatic changes to the credit.

Acceleration of phase-in of increase in private activity bond volume cap

The bill accelerates the scheduled phased-in increases in the present-law annual State private activity bond volume limits to \$75 per resident of each State or \$225 million (if greater). The increase is phased in as follows, beginning in calendar year 2001:

<u>Calendar Year</u>	<u>Volume Limit</u>
2001	\$55 per resident (\$165 million if greater)
2002	\$60 per resident (\$180 million if greater)
2003	\$65 per resident (\$195 million if greater)
2004, 2005, 2006	\$70 per resident (\$210 million if greater)
2007 and thereafter	\$75 per resident (\$225 million if greater)

III. EXPLANATION OF THE TAX PROVISIONS IN H.R. 4923

A. Renewal Community Provisions (secs. 101-103 of the bill)

Present Law

In recent years, provisions have been added to the Internal Revenue Code that target specific geographic areas for special Federal income tax treatment. As described in greater detail below, empowerment zones and enterprise communities generally provide tax incentives for businesses that locate within certain geographic areas designated by the Secretaries of Housing and Urban Development (“HUD”) and Agriculture.

Explanation of Provision

The bill authorizes the designation of 40 “renewal communities” within which special tax incentives will be available.

Designation process

Designation of 40 renewal communities.—The Secretary of HUD is authorized to designate up to 40 “renewal communities” from areas nominated by States and local governments. At least eight of the designated communities must be in rural areas. The Secretary of HUD is required to publish (within four months after enactment) regulations describing the nomination and selection process. Designations of renewal communities are to be made within 24 months after such regulations are published. The designation of an area as a renewal community generally will be effective on July 1, 2001, and will terminate after December 31, 2009.

Eligibility criteria.—To be designated as a renewal community, a nominated area must meet the following criteria: (1) each census tract must have a poverty rate of at least 20 percent;² (2) in the case of an urban area, at least 70 percent of the households have incomes below 80 percent of the median income of households within the local government jurisdiction; (3) the unemployment rate is at least 1.5 times the national unemployment rate; and (4) the area is one of pervasive poverty, unemployment, and general distress. Those areas with the highest average ranking of eligibility factors (1), (2), and (3) above would be designated as renewal communities. A nominated area within the District of Columbia becomes a renewal community (without regard to its ranking of eligibility factors) provided that it satisfies the area and eligibility requirements and the required State and local commitments described below.³ The Secretary of HUD shall

² Determined using 1990 census data.

³ The designation of a nominate area within the District of Columbia as a renewal community will become effective on January 1, 2003 (upon the expiration of the designation of

take into account in selecting areas for designation the extent to which such areas have a high incidence of crime, as well as whether the area has census tracts identified in the May 12, 1998, report of the General Accounting Office regarding the identification of economically distressed areas.

There are no geographic size limitations placed on renewal communities. Instead, the boundary of a renewal community must be continuous. In addition, the renewal community must have a minimum population of 4,000 if the community is located within a metropolitan statistical area (at least 1,000 in all other cases), and a maximum population of not more than 200,000. The population limitations do not apply to any renewal community that is entirely within an Indian reservation.

Required State and local commitments.--In order for an area to be designated as a renewal community, State and local governments are required to submit (1) a written course of action in which the State and local governments promise to take at least four governmental actions within the nominated area from a specified list of actions, and (2) a list of at least four economic measures the State and local governments promise to take (from a specified list of measures) if the area is designated as a renewal community.

Empowerment zones and enterprise communities seeking designation as renewal communities.--An empowerment zone or enterprise community can apply for designation as a renewal community. If a renewal community designation is granted, then an area's designation as an empowerment zone or enterprise community ceases as of the date the area's designation as a renewal community takes effect.

Tax incentives for renewal communities

The following tax incentives generally would be available during the period beginning July 1, 2001, and ending December 31, 2009.

100-percent capital gain exclusion.--The bill provides a 100-percent capital gains exclusion for gain from the sale of a qualified community asset acquired after June 30, 2001, and before January 1, 2010, and held for more than five years. A "qualified community asset" includes: (1) qualified community stock (meaning original-issue stock purchased for cash in a renewal community business); (2) a qualified community partnership interest (meaning a partnership interest acquired for cash in a renewal community business); and (3) qualified community business property (meaning tangible property originally used in a renewal community business by the taxpayer) that is purchased or substantially improved after June 30, 2001.

the District of Columbia Enterprise Zone).

A “renewal community business” is similar to the present-law definition of an enterprise zone business.⁴ Property will continue to be a qualified community asset if sold (or otherwise transferred) to a subsequent purchaser, provided that the property continues to represent an interest in (or tangible property used in) a renewal community business. The termination of an area's status as a renewal community will not affect whether property is a qualified community asset, but any gain attributable to the period before July 1, 2001, or after December 31, 2014, will not be eligible for the exclusion.

Renewal community employment credit.-- A 15-percent wage credit is available to employers for the first \$10,000 of qualified wages paid to each employee who (1) is a resident of the renewal community, and (2) performs substantially all employment services within the renewal community in a trade or business of the employer. The wage credit rate applies to qualifying wages paid after June 30, 2001, and before January 1, 2010.

Wages that qualify for the credit are wages that are considered “qualified zone wages” for purposes of the empowerment zone wage credit (including coordination with the Work Opportunity Tax Credit). In general, any taxable business carrying out activities in the renewal community may claim the wage credit.

Commercial revitalization deduction.--The bill allows each State to allocate up to \$12 million of “commercial revitalization expenditures” to each renewal community located within the State for each calendar year after 2001 and before 2010 (\$6 million for the period of July 1, 2001 through December 31, 2001). The appropriate State agency will make the allocations pursuant to a qualified allocation plan.

A “commercial revitalization expenditure” means the cost of a new building or the cost of substantially rehabilitating an existing building. The building must be used for commercial purposes and be located in a renewal community. In the case of the rehabilitation of an existing building, the cost of acquiring the building will be treated as qualifying expenditures only to the extent that such costs do not exceed 30 percent of the other rehabilitation expenditures. The qualifying expenditures for any building cannot exceed \$10 million.

A taxpayer can elect either to (a) deduct one-half of the commercial revitalization expenditures for the taxable year the building is placed in service or (b) amortize all the expenditures ratably over the 120-month period beginning with the month the building is placed in service. No depreciation is allowed for amounts deducted under this provision. The adjusted basis is reduced by the amount of the commercial revitalization deduction, and the deduction is treated as a depreciation deduction in applying the depreciation recapture rules (e.g., sec. 1250).

The commercial revitalization deduction is treated in the same manner as the low income housing credit in applying the passive loss rules (sec. 469). Thus, up to \$25,000 of deductions

⁴ An “enterprise zone business” is defined in section 1397B and is described in connection with the expansion of the empowerment zone benefits.

(together with the other deductions and credits not subject to the passive loss limitation by reason of section 469(i)) are allowed to an individual taxpayer regardless of the taxpayer's adjusted gross income. The commercial revitalization deduction is allowed in computing a taxpayer's alternative minimum taxable income.

Additional section 179 expensing.--A renewal community business is allowed an additional \$35,000 of section 179 expensing for qualified renewal property placed in service after June 30, 2001, and before January 1, 2010. The section 179 expensing allowed to a taxpayer is phased out by the amount by which 50 percent of the cost of qualified renewal property placed in service during the year by the taxpayer exceeds \$200,000. The term "qualified renewal property" is similar to the definition of "qualified zone property" under section 1397C.

Expensing of environmental remediation costs ("brownfields").--A renewal community is treated as a "targeted area" under section 198 (which permits the expensing of environmental remediation costs). Thus, taxpayers can elect to treat certain environmental remediation expenditures that otherwise would be capitalized as deductible in the year paid or incurred. This provision applies to expenditures incurred after June 30, 2001, and before January 1, 2010.

Extension of work opportunity tax credit ("WOTC").--The bill expands the high-risk youth and qualified summer youth categories in the WOTC to include qualified individuals who live in a renewal community.

Effective Date

Renewal communities must be designated within 24 months after publication of regulations by HUD. The tax benefits available in renewal communities are effective for the period beginning July 1, 2001, and ending December 31, 2009.

B. Extension and Expansion of Empowerment Zone Incentives (secs. 201-205 of the bill)

Present Law

Round I empowerment zones

The Omnibus Budget Reconciliation Act of 1993 ("OBRA 1993") authorized the designation of nine empowerment zones ("Round I empowerment zones") and 95 enterprise communities to provide tax incentives for businesses to locate within targeted areas designated by the Secretaries of HUD and Agriculture. The targeted areas must have a condition of pervasive poverty, high unemployment, and general economic distress, and satisfy certain eligibility criteria, including specified poverty rates and population and geographic size limitations. Six of the empowerment zones are located in urban areas and three are located in

rural areas.⁵ The Taxpayer Relief Act of 1997 (“1997 Act”) authorized the designation of two additional Round I urban empowerment zones.

Businesses in the 11 Round I empowerment zones qualify for the following tax incentives: (1) a 20-percent wage credit for the first \$15,000 of wages paid to a zone resident who works in the empowerment zone,⁶ (2) an additional \$20,000 of section 179 expensing for qualifying zone property, and (3) expanded tax-exempt financing for certain qualifying zone facilities. Businesses in the enterprise communities are eligible for the expanded tax-exempt financing benefits, but not the other tax incentives available to empowerment zones.⁷ The tax incentives with respect to the empowerment zones designated by OBRA 1993 generally are available during the 10-year period of 1995 through 2004. The tax incentives with respect to the two additional Round I empowerment zones generally are available during the 10-year period of 2000 through 2009 (except for the wage credit, which expires after 2007).

Round II empowerment zones

The 1997 Act also authorized the designation of 20 additional empowerment zones (“Round II empowerment zones”), of which 15 are located in urban areas and five are located in rural areas. Businesses in the Round II empowerment zones are not eligible for the wage credit, but are eligible to receive up to \$20,000 of additional section 179 expensing. Businesses in the Round II empowerment zones also are eligible for more generous tax-exempt financing benefits than those available in the Round I empowerment zones. Specifically, the tax-exempt financing benefits for the Round II empowerment zones are not subject to the State private activity bond volume caps (but are subject to separate per-zone volume limitations), and the per-business size limitations that apply to the Round I empowerment zones and enterprise communities (i.e., \$3 million for each qualified enterprise zone business with a maximum of \$20 million for each principal user for all zones and communities) do not apply to qualifying bonds issued for Round II empowerment zones. The tax incentives with respect to the Round II empowerment zones generally are available during the 10-year period of 1999 through 2008.

Explanation of Provision

Extension of tax incentives for Round I and Round II empowerment zones

⁵ Similarly, 65 of the enterprise communities are located in urban areas and 30 are located in rural areas.

⁶ For wages paid in calendar years during the period 1994 through 2001, the credit rate is 20 percent. The credit rate is reduced to 15 percent for calendar year 2002, 10 percent for calendar year 2003, and 5 percent for calendar year 2004. No wage credit is available after 2004.

⁷ Other benefits that are available (but not limited) to empowerment zones and enterprise communities include (1) the expensing of certain environmental remediation costs, (2) tax credits for qualified zone academy bonds, and (3) the Work Opportunity Tax Credit.

The designation of empowerment zone status for Round I and II empowerment zones (other than the District of Columbia Enterprise Zone) is extended through December 31, 2009. In addition, the 20-percent wage credit is made available in all Round I and II empowerment zones for qualifying wages paid or incurred after December 31, 2001. The credit rate remains at 20 percent (rather than being phased down) through December 31, 2009, in Round I and Round II empowerment zones.

In addition, \$35,000 (rather than \$20,000) of additional section 179 expensing is available for qualified zone property placed in service in taxable years beginning after December 31, 2001, by a qualified business in any of the empowerment zones.⁸ Businesses in the D.C. Enterprise Zone are entitled to the additional section 179 expensing until the termination of the D.C. zone designation.⁹ The bill also extends an empowerment zone's status as a "targeted area" under section 198 (thus permitting expensing of environmental remediation costs). The bill applies to expenses incurred after December 31, 2001, and before January 1, 2010.

Businesses located in Round I empowerment zones (other than the D.C. Enterprise Zone)¹⁰ also are eligible for the more generous tax-exempt bond rules that apply under present law to businesses in the Round II empowerment zones (sec. 1394(f)). The bill applies to tax-exempt bonds issued after December 31, 2001. Bonds that have been issued by businesses in Round I zones before January 1, 2002, are not taken into account in applying the limitations on the amount of new empowerment zone facility bonds that can be issued under the bill.

Nine new empowerment zones

The Secretaries of HUD and Agriculture are authorized to designate nine additional empowerment zones ("Round III empowerment zones"). Seven of the Round III empowerment zones would be located in urban areas, and two would be located in rural areas.

The eligibility and selection criteria for the Round III empowerment zones are the same as the criteria that applied to the Round II empowerment zones. The Round III empowerment zones must be designated by January 1, 2002, and the tax incentives with respect to the Round III empowerment zones generally are available during the period beginning on January 1, 2002, and ending on December 31, 2009.

⁸ The additional \$35,000 of section 179 expensing is available throughout all areas that are part of a designated empowerment zone, including the non-contiguous "developable sites" that were allowed to be part of the designated Round II empowerment zones under the 1997 Act.

⁹ The D.C. Enterprise Zone is scheduled to terminate on December 31, 2002.

¹⁰ The present-law rules of sections 1394 and 1400A would continue to apply with respect to the D.C. Enterprise Zone through its scheduled expiration of December 31, 2002.

Businesses in the Round III empowerment zones are eligible for the same tax incentives that, under the bill, are available to Round I and Round II empowerment zones (i.e., a 20-percent wage credit, an additional \$35,000 of section 179 expensing, and the enhanced tax-exempt financing benefits presently available to Round II empowerment zones). The Round III empowerment zones also are considered “targeted areas” for purposes of permitting expensing of certain environmental remediation costs under section 198.

Effective Date

The extension of the existing empowerment zone designations is effective after the date of enactment.

The extension of the tax benefits to existing empowerment zones (i.e., the expanded wage credit, the additional section 179 expensing, the brownfields designation, and the more generous tax-exempt bond rules) generally is effective after December 31, 2001.

The new Round III empowerment zones must be designated by January 1, 2002, and the tax incentives with respect to the Round III empowerment zones generally are available during the period beginning on January 1, 2002, and ending on December 31, 2009.

C. Rollover of gain from the sale of a qualified empowerment zone investment (sec. 206 of the bill)

Present Law

In general, gain or loss is recognized on any sale, exchange, or other disposition of property. A taxpayer (other than a corporation) may elect to roll over without payment of tax any capital gain realized upon the sale of qualified small business stock held for more than six months where the taxpayer uses the proceeds to purchase other qualified small business stock within 60 days of the sale of the original stock.

Explanation of Provision

Under the bill, a taxpayer can elect to roll over capital gain from the sale or exchange of any qualified empowerment zone asset purchased after the date of enactment and held for more than one year (“original zone asset”) where the taxpayer uses the proceeds to purchase other qualifying empowerment zone assets in the same zone (“replacement zone asset”) within 60 days of the sale of the original zone asset. The holding period of the replacement zone asset includes the holding period of the original zone asset, except that the replacement asset must actually be held for more than one year to qualify for another tax-free rollover. The basis of the replacement zone asset is reduced by the gain not recognized on the rollover. However, if the replacement zone asset is qualified small business stock (as defined in sec. 1202), the exclusion under section

1202 would not apply to gain accrued on the original zone asset.¹¹ A “qualified empowerment zone asset” means an asset that would be a qualified community asset if the empowerment zone were a renewal community (and the asset is acquired after the date of enactment of the bill). Assets in the D.C. Enterprise Zone are not eligible for the tax-free rollover treatment.¹²

Effective Date

The provision is effective for qualifying assets purchased after the date of enactment.

D. Increased exclusion of gain from the sale of qualifying empowerment zone stock (sec. 207 of the bill)

Present Law

Under present law, an individual, subject to limitations, may exclude 50 percent of the gain¹³ from the sale of qualifying small business stock held more than five years (sec. 1202).

Explanation of Provision

The exclusion for small business stock is increased to 60 percent for stock purchased after the date of enactment in a corporation that is a qualified business entity and that is held for more than five years. A “qualified business entity” means a corporation that satisfies the requirements of a qualifying business under the empowerment zone rules (sec. 1397B(b)) during substantially all the taxpayer’s holding period.

Effective Date

The provision is effective for qualified stock purchased after the date of enactment.

E. New markets tax credit (sec. 301 of the bill)

Present Law

¹¹ See section 1045 for rollover of qualified small business stock to other small business stock.

¹² However, a qualifying D.C. Zone asset held for more than five years is eligible for a 100-percent capital gains exclusion (sec. 1400B).

¹³ The portion of the capital gain included in income is subject to a maximum regular tax rate of 28 percent, and 42 percent of the excluded gain is a minimum tax preference.

Some tax incentives are available to taxpayers making investments and loans in low-income communities. For example, tax incentives are available to taxpayers that invest in specialized small business investment companies licensed by the Small Business Administration to make loans to, or equity investments in, small businesses owned by persons who are socially or economically disadvantaged.

Explanation of Provision

The bill creates a new tax credit for qualified equity investments made to acquire stock in a selected community development entity (“CDE”). The maximum annual amount of qualifying equity investments is capped as follows:

<u>Calendar Year</u>	<u>Maximum Qualifying Equity Investment</u>
2001	\$1.0 billion
2002-2003	\$1.5 billion per year
2004-2005	\$2.0 billion per year
2006-2007	\$3.5 billion per year

The amount of the new tax credit to the investor (either the original purchaser or a subsequent holder) is (1) a five-percent credit for the year in which the equity interest is purchased from the CDE and the first two anniversary dates after the interest is purchased from the CDE, and (2) a six percent credit on each anniversary date thereafter for the following four years.¹⁴ The taxpayer’s basis in the investment is reduced by the amount of the credit (other than for purposes of calculating the capital gain exclusion under sections 1202, 1400B, and 1400F). The credit is subject to the general business credit rules.

A CDE is any domestic corporation or partnership (1) whose primary mission is serving or providing investment capital for low-income communities or low-income persons, (2) that maintains accountability to residents of low-income communities through representation on governing or advisory boards, or otherwise and (3) is certified by the Treasury Department as an eligible CDE.¹⁵ No later than 60 days after enactment, the Treasury Department shall issue regulations that specify objective criteria to be used by the Treasury to allocate the credits among eligible CDEs. 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.

¹⁴ Thus, a credit would be available on the date on which the investment is made and for each of the six anniversary dates thereafter.

¹⁵ A specialized small business investment company and a community development financial institution are treated as satisfying the requirements for a CDE.

If a CDE fails to sell equity interests to investors up to the amount authorized within five years of the authorization, then the remaining authorization is canceled. The Treasury Department can authorize another CDE to issue equity interests for the unused portion. No authorization can be made after 2014.

A “qualified equity investment” is defined as stock or a similar equity interest acquired directly from a CDE in exchange for cash. Substantially all of the investment proceeds must be used by the CDE to make “qualified low-income community investments,” meaning equity investments in, or loans to, qualified active businesses located in low-income communities, certain financial counseling and other services specified in regulations to businesses and residents in low-income communities.¹⁶

The stock or equity interest cannot be redeemed (or otherwise cashed out) by the CDE for at least seven years. If an entity fails to be a CDE during the seven-year period following the taxpayer’s investment, or if the equity interest is redeemed by the issuing CDE during that seven-year period, then any credits claimed with respect to the equity interest are recaptured (with interest) and no further credits are allowed.

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) median family income which does not exceed 80 percent of the greater of metropolitan area income or statewide median family income (for a non-metropolitan census tract, 80 percent of non-metropolitan statewide median family income).

A “qualified active business” is defined as a business which satisfies the following requirements: (1) at least 50 percent of the total gross income of the business is derived from the active conduct of trade or business activities in low-income communities; (2) a substantial portion of the use of the tangible property of such business is used within low-income communities; (3) a substantial portion of the services performed for such business by its employees is performed in low-income communities; and (4) less than 5 percent of the average aggregate of unadjusted bases of the property of such business is attributable to certain financial property or to collectibles (other than collectibles held for sale to customers). There is no requirement that employees of the business be residents of the low income community.

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. In addition, a qualified active business does not include (a) any business consisting predominantly of the development or holding of intangibles for sale or license; (b) operation of

¹⁶ If at least 85 percent of the aggregate gross assets of the CDE are invested (directly or indirectly) in equity interests in, or loans to, qualified active businesses located in low-income communities, then there would be no need to trace the use of the proceeds from the particular stock (or other equity ownership) issuance with respect to which the credit is claimed.

any facility described in sec. 144(c)(6)(B); or (c) any business if a significant equity interest in such business is held by a person who also holds a significant equity interest in the CDE. A qualified active business can include an organization that is organized on a non-profit basis.

Effective Date

The provision is effective for qualified investments made after December 31, 2000.

**F. Increase low-income housing tax credit cap and related program modifications
(secs. 401-407 of the bill)**

Present Law

The low-income housing tax credit may be claimed annually over a 10-year period for the cost of rental housing occupied by tenants having incomes below specified levels. The credit percentage for newly constructed or substantially rehabilitated housing that is not Federally subsidized is adjusted monthly by the IRS so that the 10 annual installments have a present value of 70 percent of the total qualified expenditures. The credit percentage for new substantially rehabilitated housing also receiving most other Federal subsidies and for existing housing is calculated to have a present value of 30 percent of the total qualified expenditures. The new credit authority provided annually is \$1.25 per resident of each State. Projects that also receive financing with proceeds of tax-exempt bonds issued subject to the private activity bond volume limit and receive the low income housing credit outside the State's credit cap.

Explanation of Provision

The bill increases the annual State credit caps from \$1.25 to \$1.75 per resident during the period between years 2001 and 2006 as follows:

<u>Calendar Year</u>	<u>Applicable credit amount</u>
2001	\$1.35
2002	\$1.45
2003	\$1.55
2004	\$1.65
2005	\$1.70
2006	\$1.75

In addition, beginning in 2001, the per capita cap is modified so that small population states are given a minimum of \$2 million of annual credit cap. The \$1.75 per capita credit cap and the \$2 million amount are indexed for inflation beginning in 2007. The bill also makes several programmatic changes to the credit.

Effective Date

The provisions generally are effective for calendar years after December 31, 2000, and buildings placed in service after such date in the case of projects that also receive financing with proceeds of tax-exempt bonds subject to the private activity bond volume limit which are issued after such date.

G. Increase in private activity bond State volume limits (sec. 501 of the bill)

Present Law

Interest on bonds issued by States and local governments is excluded from income if the proceeds of the bonds are used to finance activities conducted or paid for by the governmental units. Interest on bonds issued by these governmental units to finance activities carried out and paid for by private persons ("private activity bonds") is taxable unless the activities are specified in the Code. Private activity bonds on which interest may be tax exempt include bonds for privately-operated transportation facilities (airports, docks and wharves, mass transit, and high speed rail facilities), privately-owned or privately-provided municipal services (water, sewer, solid waste disposal, and certain electric and heating facilities), economic development (small manufacturing facilities and redevelopment in economically depressed areas), certain social programs (low-income rental housing, qualified mortgage bonds, student loan bonds, and exempt activities of charitable organizations described in Code sec. 501(c)(3)).

The volume of tax-exempt private activity bonds that States and local governments may issue in each calendar year is limited by State-wide volume limits. The volume limits do not apply to private activity bonds to finance airports, docks and wharves, certain governmentally owned, but privately operated, solid waste disposal facilities, certain high speed rail facilities, and certain types of private activity tax-exempt bonds that are subject to other limits on their volume (qualified veterans' mortgage bonds and certain empowerment zone and enterprise community bonds). The current annual volume limits are \$50 per resident of the State or \$150 million (if greater). An increase in these volume limits to \$75 per resident or \$225 million (if greater) is scheduled to be phased-in during calendar years 2003-2007.

Explanation of Provision

The bill accelerates the currently scheduled phased increase in the present-law annual State private activity bond volume limits to \$75 per resident of each State or \$225 million (if greater). The increase is phased-in as follows, beginning in calendar year 2001:

Calendar Year

Volume Limit

2001	\$55 per resident (\$165 million if greater)
2002	\$60 per resident (\$180 million if greater)
2003	\$65 per resident (\$195 million if greater)
2004, 2005, 2006	\$70 per resident (\$210 million if greater)
2007 and thereafter ¹⁷	\$75 per resident (\$225 million if greater)

Effective Date

The volume limit increases are effective beginning in calendar year 2001.

¹⁷ The volume limits in calendar years 2007 and thereafter are unchanged from present law.