

**PRESENT LAW AND PROPOSALS RELATING TO
TAX INCENTIVES FOR
ECONOMICALLY DISTRESSED AREAS**

Scheduled for a Hearing

Before the

**SUBCOMMITTEE ON OVERSIGHT
of the
HOUSE COMMITTEE ON WAYS AND MEANS**

on March 21, 2000

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION



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INTRODUCTION

The Subcommittee on Oversight of the House Committee on Ways and Means has scheduled a public hearing on March 21, 2000, relating to tax incentives for economically distressed areas. This document,¹ prepared by the staff of the Joint Committee on Taxation, describes present law relating to tax incentives for economically distressed areas, and describes certain proposals that would provide incentives for such areas.

Part I of this document is a summary of present law and proposals to provide tax incentives for economically distressed areas. Part II contains a description of present law. Part III describes recent proposals to provide tax incentives for economically distressed areas.

¹ This document may be cited as follows: Joint Committee on Taxation, *Present Law and Proposals Relating to Tax Incentives for Economically Distressed Areas* (JCX-29-00), March 20, 2000.

I. SUMMARY

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.² In particular, tax incentives have been enacted that target geographic areas of poverty, unemployment, and general economic distress. These provisions are summarized below.

Empowerment zones and enterprise communities

Empowerment zones and enterprise communities, which were originally enacted in the Omnibus Budget Reconciliation Act of 1993, and later expanded in the Taxpayer Relief Act of 1997, generally provide tax incentives for businesses that locate within certain geographic areas designated by the Secretaries of Housing and Urban Development and Agriculture. The targeted areas are those that have a condition of pervasive poverty, high unemployment, and general economic distress, and that satisfy certain eligibility criteria, including specified poverty rates and population and geographic size limitations.

Businesses locating in empowerment zones authorized pursuant to the Omnibus Budget Reconciliation Act of 1993 generally 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; (2) an additional \$20,000 of section 179 expensing for qualifying property placed in service by an enterprise zone business; and (3) expanded tax-exempt financing for certain zone facilities. Empowerment zones authorized pursuant to the Taxpayer Relief Act of 1997 are not eligible for the 20-percent wage credit but otherwise qualify for the remaining tax incentives. Enterprise communities are eligible only for the expanded tax-exempt financing benefits. The tax benefits associated with an empowerment zone or enterprise community designation generally are available for a period of ten years.³

District of Columbia enterprise zone

The Taxpayer Relief Act of 1997 also created the “District of Columbia Enterprise Zone.” In addition to the tax incentives that are available generally to businesses in empowerment zones (i.e., the 20-percent wage credit, the additional \$20,000 of section 179 expensing, and the

² Unless otherwise indicated, references in this pamphlet to a section refer to the Internal Revenue Code of 1986, as amended.

³ Other tax benefits that are available (but not limited) in connection with 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.

expanded tax-exempt financing), a zero-percent capital gains rate applies to capital gains from the sale of certain qualified D.C. zone assets held for more than five years. The designation of the D.C. enterprise zone (and the corresponding tax benefits) terminates on December 31, 2002.

In addition, a \$5,000 tax credit is available to certain individual first-time homebuyers within the District of Columbia. The homebuyer tax credit applies to residences in the District of Columbia purchased before January 1, 2002.

Tax incentives for economic development on Indian reservations

Businesses may claim an employment tax credit for certain wages and health insurance costs incurred with respect to the employment of a qualified member of an Indian tribe. The tax credit equals 20 percent of the excess of eligible qualified wages and health insurance costs (up to the first \$20,000 of such costs) that an employer paid or incurred during the tax year over the amount of these costs that an employer paid or incurred during 1993. The requirements for a qualified employee include that (1) substantially all of the services performed by the employee are performed within an Indian reservation, and (2) the employee live on or near the reservation in which the services are performed. An employer's deduction otherwise allowed for wages is reduced by the amount of the credit claimed for the taxable year. The credit is not available for taxable years beginning after 2003.

Another tax incentive applies with respect to property used in connection with a trade or business within an Indian reservation. Such property qualifies for an accelerated depreciation deduction (in the form of a shorter recovery period). Property eligible for accelerated depreciation means property that is (1) used by the taxpayer predominantly in the active conduct of a trade or business within an Indian reservation, (2) not used or located outside the reservation on a regular basis, (3) not acquired (directly or indirectly) by the taxpayer from a person who is related to the taxpayer, and (4) not placed in service for purposes of conducting or housing certain gaming activities.

Specialized small business investment companies

A specialized small business investment company ("SSBIC") is a company that is licensed by the Small Business Administration and that makes long-term loans to, or equity investments in, small businesses owned by persons who are socially or economically disadvantaged. Subject to certain limitations, a taxpayer may elect to roll over without payment of tax any capital gain realized upon the sale of publicly-traded securities where the taxpayer uses the proceeds from the sale to purchase common stock in an SSBIC within 60 days after the sale. In addition, subject to certain limitations, an individual may exclude 50 percent of the gain from the sale of stock in an SSBIC that is held more than five years.

Description of proposals

President's fiscal year 2001 budget proposals

The President's Fiscal Year 2001 Budget contains three proposals that are designed to provide incentives with respect to certain economically distressed areas. The new markets tax credit proposal would create a new tax credit for qualified investments made to acquire stock (or other equity interests) in an eligible community development entity ("CDE"). The credit amount would equal six percent of the funds invested and would be available for the year in which the investor purchases the equity investment from the CDE and each of the four subsequent years. As part of the allocation process, the Treasury Department would certify entities as eligible CDEs. During the period 2001-2005, the maximum amount of investments that could qualify for the credit would be capped at an aggregate annual amount of \$3 billion (a maximum of \$15 billion for the entire period of the tax credit).

Another proposal relates to the tax incentives currently available to empowerment zones. The proposal would expand and extend the tax incentives available to the existing empowerment zones and would provide for the designation of ten new empowerment zones.

A third proposal involves tax incentives with respect to SSBICs. The proposal would expand the present-law tax-free rollover rules with respect to the sale of stock in an SSBIC, and also would provide that certain qualifying SSBICs that are organized as corporations may convert to a partnership without imposition of a tax to either the corporation or its shareholders.

H.R. 815, "The American Community Renewal Act of 1999"

H.R. 815, "The American Community Renewal Act of 1999" (106th Cong., 1st Sess.), was introduced by Reps. Watts, Davis of Illinois, Talent, and others. In general, H.R. 815 would authorize the Secretary of Housing and Urban Development to designate up to 100 areas as renewal communities that would receive certain tax benefits for a seven-year period beginning January 1, 2001, and ending December 31, 2007. The tax benefits would include the following: (1) a zero-percent capital gains tax rate on the sale of qualified community assets held for more than five years; (2) an above-the-line deduction for certain contributions to family development accounts (from which tax-free distributions could be made if used for qualified higher education expenses, qualified first-time homebuyer costs, qualified business capitalization costs, and qualified medical expenses); (3) a commercial revitalization credit for qualified revitalization expenditures incurred with respect to buildings located in a renewal community; (4) an additional \$35,000 in section 179 expensing of business property used within a renewal community; (5) expensing of environmental remediation costs (brownfields) incurred with respect to qualifying sites within a renewal community; and (6) an extension of the work opportunity tax credit to qualified individuals who live in a renewal community.

II. PRESENT LAW

Empowerment zones and enterprise communities

The Omnibus Budget Reconciliation Act of 1993 (“OBRA 1993”) authorized the designation of a total of nine empowerment zones and 95 enterprise communities to provide tax incentives for businesses to locate within certain geographic areas designated by the Secretaries of Housing and Urban Development (“HUD”) and Agriculture. The targeted areas are those that have a condition of pervasive poverty, high unemployment, and general economic distress, and are required to 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.⁴ The Taxpayer Relief Act of 1997 (“1997 Act”) authorized the designation of two additional urban empowerment zones⁵ (collectively, the “11 Round I empowerment zones”). These two additional urban empowerment zones were subject to the same eligibility criteria that applied to the original six urban empowerment zones.⁶

Round I empowerment zones

Qualifying businesses located in the 11 Round I empowerment zones are eligible for the following tax incentives (described below): (1) a 20-percent wage credit for the first \$15,000 of qualifying wages paid to a zone resident (the “wage credit”);⁷ (2) an additional \$20,000 of section

⁴ Similarly, 65 of the enterprise communities are located in urban areas and 30 are located in rural areas.

The six urban empowerment zones are located in New York City, Chicago, Atlanta, Detroit, Baltimore, and Philadelphia-Camden (New Jersey). The three rural empowerment zones are located in the Kentucky Highlands (Clinton, Jackson and Wayne counties, Kentucky), Mid-Delta Mississippi (Bolivar, Holmes, Humphreys, Leflore counties, Mississippi), and Rio Grande Valley Texas (Cameron, Hidalgo, Starr, and Willacy counties, Texas).

⁵ The two additional urban empowerment zones are located in Los Angeles, California and Cleveland, Ohio.

⁶ In order to permit designation of these two additional empowerment zones, the 1997 Act increased the aggregate population cap applicable to urban empowerment zones from 750,000 to a cap of one million aggregate population for the eight urban empowerment zones.

⁷ For wages paid in calendar years 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. The wage credit for businesses located in the Los Angeles and Cleveland empowerment zones is phased down beginning in 2005 and expires after 2007. Thus, their wage credit rate is 20 percent during the

179 expensing for “qualified zone property” placed in service by an enterprise zone business; and (3) expanded tax-exempt financing for certain zone facilities.⁸ Enterprise communities are eligible only for the expanded tax-exempt financing benefits. The tax incentives for empowerment zones and enterprise communities generally are available during the period that the designation remains in effect (i.e., a 10-year period).⁹

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.¹⁰ Within the Round II empowerment zones, qualifying businesses are not eligible for the wage credit, but otherwise are eligible for the other tax incentives (i.e., an additional \$20,000 of section 179 expensing, and the expanded tax-exempt financing benefits). The tax incentives

period 2000 to 2004, 15 percent for calendar year 2005, 10 percent for calendar year 2006, and 5 percent for calendar year 2007.

⁸ Businesses located in empowerment zones and enterprise communities also qualify for other tax benefits that are limited but not unique to empowerment zones or enterprise communities. For example, businesses within empowerment zones or enterprise communities are eligible for the “brownfields” tax incentive, which allows taxpayers to expense (rather than capitalize) certain environmental remediation expenditures incurred in connection with the abatement or control of hazardous substances at a qualified contaminated site (sec. 198). Such businesses also qualify for the Work Opportunity Tax Credit with respect to wages paid to certain youths who reside within an empowerment zone or enterprise community (sec. 51).

⁹ The tax incentives with respect to the nine empowerment zones designated by OBRA 1993 are generally available during the 10-year period of 1995 through 2004. The tax incentives with respect to the Los Angeles and Cleveland empowerment zones are generally available during the 10-year period of 2000 through 2009 (except for the wage credit, which expires after 2007).

¹⁰ The 15 Round II urban empowerment zones are located in Boston; Columbia/Sumter, South Carolina; Cumberland County, New Jersey; Gary/East Chicago, Indiana; Knoxville; Minneapolis; Norfolk/Portsmouth, Virginia; St. Louis/East St. Louis; Cincinnati; Columbus, Ohio; El Paso; Huntington, West Virginia/Ironton, Ohio; Miami; New Haven, Connecticut; and Santa Ana, California. The five Round II rural empowerment zones are located in Riverside County, California; Cordele, Georgia; Ullin, Illinois; Lake Agassiz, North Dakota; and Ogala Sioux Reservation, South Dakota.

In addition, the 1997 Act modified the designation criteria with respect to empowerment zones or enterprise communities which may be designated in the future in the States of Alaska or Hawaii.

with respect to the Round II empowerment zones are generally available during the 10-year period of 2000 through 2009. The wage credit, additional section 179 expensing, and the expanded tax-exempt financing benefits are described below.

Wage credit

A 20-percent credit is available to all employers for the first \$15,000 (i.e., a maximum credit of \$3,000 per each qualified employee) of qualified wages paid to each employee who (1) is a resident of the empowerment zone, and (2) performs substantially all employment services within the empowerment zone in a trade or business of the employer.

Wages paid to a qualified employee who earns more than \$15,000 continue to be eligible for the wage credit, although only the first \$15,000 of wages are eligible for the wage credit. The wage credit is available with respect to a qualified full-time or part-time employee (employed for at least 90 days), regardless of the number of other employees who work for the employer. In general, any taxable business carrying out activities in the empowerment zone may claim the wage credit, regardless of whether the employer meets the definition of an “enterprise zone business” (which applies for the tax incentives described below).¹¹

An employer's deduction otherwise allowed for wages paid is reduced by the amount of wage credit claimed for that taxable year.¹² Wages are not to be taken into account for purposes of the wage credit if taken into account in determining the employer's work opportunity tax credit under section 51 or the welfare-to-work credit under section 51A.¹³ In addition, the \$15,000 cap is reduced by any wages taken into account in computing the work opportunity tax credit or the welfare-to-work credit.¹⁴ The wage credit may be used to offset up to 25 percent of alternative minimum tax liability.¹⁵

¹¹ However, the wage credit is not available for wages paid in connection with certain business activities described in section 144(c)(6)(B) or certain farming activities. In addition, wages are not eligible for the wage credit if paid to (1) a person who owns more than five percent of the stock (or capital or profits interests) of the employer, (2) certain relatives of the employer or, (3) if the employer is a corporation or partnership, certain relatives of a person who owns more than 50 percent of the business.

¹² Section 280C(a).

¹³ Sections 1396(c)(3)(A) and 51A(d)(2).

¹⁴ Sections 1396(c)(3)(B) and 51A(d)(2).

¹⁵ Section 38(c)(2).

Additional section 179 expensing

For an enterprise zone business, the expensing allowance for qualifying depreciable business property provided under section 179 is increased by the lesser of (1) \$20,000 (so that up to \$40,000 of the cost of qualifying property placed in service in 2000 can be deducted), or (2) the cost of section 179 property that is “qualified zone property” which is placed in service during the taxable year. The amount eligible for expensing will increase as the base amount under section 179 increases each year, resulting in a maximum amount of \$45,000 in 2003 and thereafter.¹⁶

An “enterprise zone business” is defined as a corporation or partnership (or proprietorship) if for the taxable year (1) the sole trade or business of the corporation or partnership is the active conduct of a qualified business within an empowerment zone or enterprise community;¹⁷ (2) at least 50 percent of the total gross income is derived from the active conduct of a “qualified business” within a zone or community, (3) a substantial portion of the business' tangible property is used within a zone or community, (4) a substantial portion of the business' intangible property is used in the active conduct of such business, (5) a substantial portion of the services performed by employees are performed within a zone or community, (6) at least 35 percent of the employees are residents of the zone or community, and (7) less than five percent of the average of the aggregate unadjusted bases of the property owned by the business is attributable to (a) certain financial property, or (b) collectibles not held primarily for sale to customers in the ordinary course of an active trade or business.¹⁸

A “qualified business” is defined as any trade or business other than a trade or business that consists predominantly of the development or holding of intangibles for sale or license.¹⁹ In addition, the leasing of real property that is located within the empowerment zone or enterprise community is treated as a qualified business only if (1) the leased property is not residential property, and (2) at least 50 percent of the gross rental income from the real property is from

¹⁶ The additional section 179 expensing is phased out for certain taxpayers with investment in qualified property during the taxable year in excess of \$200,000. However, for an enterprise zone business, the present-law phase-out range is applied by taking into account only one-half of the cost of qualified zone property that is section 179 property.

¹⁷ However, a qualified proprietorship is not required to meet this requirement.

¹⁸ Code sec. 1397B(b).

¹⁹ Also, a qualified business does not include certain facilities described in section 144(c)(6)(B) (e.g., massage parlor, hot tub facility, or liquor store) or certain large farms.

enterprise zone businesses.²⁰ The rental of tangible personal property is not a qualified business unless at least 50 percent of the rental of such property is by enterprise zone businesses or by residents of an empowerment zone.

The term “qualified zone property” is defined as depreciable tangible property (including buildings), provided that (1) the property is acquired by the taxpayer (from an unrelated party) after the designation took effect, (2) the original use of the property in the zone commences with the taxpayer, and (3) substantially all of the use of the property is in the zone in the active conduct of a trade or business by the taxpayer. Special rules are provided in the case of property that is substantially renovated by the taxpayer.

Expanded tax-exempt financing

In addition to generally available tax-exempt financing, certain additional tax-exempt private activity bonds may be issued to finance facilities in empowerment zones and enterprise communities.²¹ For Round I empowerment zones and enterprise communities, these bonds are subject to the annual private activity bond State volume cap (currently equal to \$50 per resident of each State, or if greater, \$150 million per State).

A special rule (enacted in the 1997 Act) provides that certain “new empowerment zone facility bonds” issued for qualified enterprise zone businesses in the Round II empowerment zones are not subject to the State private activity bond volume caps generally applicable to qualified enterprise zone facility bonds. In lieu of the State private activity bond volume caps, the maximum amount of “new empowerment zone facility bonds” that can be issued is limited to \$60 million per rural zone, \$130 million per urban zone with a population of less than 100,000, and \$230 million per urban zone with a population of 100,000 or more.

Qualified enterprise zone facility bonds are bonds of which 95 percent or more of the net proceeds are used to finance (1) qualified zone property the principal user of which is an enterprise zone business, or (2) functionally related and subordinate land located in the empowerment zone or enterprise community. These bonds may only be issued while an empowerment zone or enterprise community designation is in effect.

For Round I empowerment zones and enterprise communities, the aggregate face amount of all qualified enterprise zone bonds for each qualified enterprise zone business may not exceed

²⁰ The lessor of property may rely on a lessee’s certification that such lessee is an enterprise zone business.

²¹ Qualified zone academy bonds also may be issued for certain purposes for public schools in empowerment zones and enterprise communities. Qualified zone academy bonds may also be issued with respect to public schools where at least 35 percent of the students are eligible for free or reduced price school lunches.

\$3 million per zone or community. In addition, total qualified enterprise zone bond financing for each principal user of these bonds may not exceed \$20 million for all zones and communities. These size limits do not apply to qualifying bonds issued for Round II empowerment zones.

Qualified enterprise zone facility bonds are exempt from the general restrictions on financing the acquisition of existing property set forth in section 147(d). Additionally, these bonds are exempted from the general restriction in section 147(c)(1)(A) that proceeds used to finance land (or an interest therein) generally must be less than 25 percent of a bond issue. All other tax-exempt bond rules relating to exempt facility bonds (including the restrictions on bank deductibility of interest allocable to tax-exempt bonds) apply to qualified enterprise zone facility bonds.

As with other private activity bonds, interest paid on loans financed with qualified enterprise zone facility bonds may become nondeductible in certain cases. Interest on all bond-financed loans to a business that no longer qualifies as an empowerment zone business, or on loans to finance property that ceases to be used by the business in an empowerment zone or enterprise community, becomes nondeductible, effective from the first day of the taxable year in which the disqualification or cessation of use occurs. This penalty is waived if (1) the issuer and principal user in good faith attempted to meet these requirements, and (2) any failure to meet such requirements is corrected within a reasonable period after such failure is first discovered. This penalty does not apply solely by reason of the termination or revocation of the designation of an empowerment zone or enterprise community. The good faith rule described above also applies to certain other requirements of qualified enterprise zone facility bonds. The loss of interest deductions is in addition to any loss of tax-exemption under the general “change in use” rules that apply to all tax-exempt bonds.

District of Columbia Enterprise Zone

The 1997 Act also designated certain economically depressed census tracts within the District of Columbia as the “D.C. Enterprise Zone,” within which businesses and individual residents are eligible for special tax incentives. The census tracts that compose the D.C. Enterprise Zone are (1) all census tracts that presently are part of the D.C. enterprise community designated under section 1391 (i.e., portions of Anacostia, Mt. Pleasant, Chinatown, and the easternmost part of the District), and (2) all additional census tracts within the District of Columbia where the poverty rate is not less than 20 percent. The D.C. Enterprise Zone designation remains in effect for the period from January 1, 1998, through December 31, 2002.²²

The tax incentives previously described in connection with a Round I empowerment zone are available in the D.C. Enterprise Zone (i.e., a 20-percent wage credit; an additional \$20,000 of section 179 expensing for qualified zone property, and expanded tax-exempt financing for certain

²² The status of certain census tracts within the District as an enterprise community designated under section 1391 also terminates on December 31, 2002.

zone facilities, modified as described below).²³ In addition, there are two tax incentives that are unique to the D.C. Enterprise Zone: (1) a zero-percent capital gains rate from the sale of certain qualified D.C. zone assets; and (2) a \$5,000 homebuyer tax credit for first-time homebuyers within the District of Columbia.

D.C. wage credit

A 20-percent credit is available to all employers for the first \$15,000 (i.e., a maximum credit of \$3,000 per qualified employee) of qualified wages paid to each employee who (1) is a District resident, and (2) performs substantially all employment services within the D.C. Enterprise Zone in a trade or business of the employer. In general, the wage credit is the same as the credit previously discussed in connection with empowerment zones. However, the D.C. wage credit rate remains at 20 percent for the D.C. Enterprise Zone for the period 1998 through 2002. The wage credit is effective for wages paid (or incurred) to a qualified individual for services performed after December 31, 1997, and before January 1, 2003.

Additional expensing under section 179

The expensing allowance under section 179 for certain depreciable business property used by a D.C. Zone business is increased by the lesser of (1) \$20,000, or (2) the cost of section 179 property that is “qualified zone property” and that is placed in service during the taxable year. In general, the additional section 179 expensing for businesses in the D.C. Enterprise Zone is the same as the provision previously discussed in connection with empowerment zones.

For purposes of the additional expensing under section 179 (as well as generally for purposes of the tax-exempt financing provisions and the zero-percent capital gains rate described below), a qualified D.C. Zone business is defined in the same manner as an “enterprise zone business” previously described, except that the requirement that at least 35 percent of the employees of a qualified D.C. Zone business be residents of the D.C. Enterprise Zone does not apply.

The additional expensing under section 179 is effective for qualified D.C. Zone property placed in service beginning after December 31, 1997, and before January 1, 2003.

²³ In addition, the expensing of certain environmental remediation expenditures (the “brownfields” incentive) is available for businesses within the D.C. Enterprise Zone.

Tax-exempt financing

A qualified D.C. Zone business is permitted to borrow proceeds from the issuance of qualified enterprise zone facility bonds (as defined in section 1394) by the District of Columbia.²⁴ The D.C. Enterprise Zone generally is treated like a Round I empowerment zone; therefore, the issuance of such bonds is subject to the District's annual private activity bond volume limitation.²⁵ However, the aggregate face amount of all outstanding qualified enterprise zone facility bonds per qualified D.C. Zone business may not exceed \$15 (rather than \$3 million, as is the case with respect to Round I empowerment zones). A qualified enterprise zone facility bond means any bond of which 95 percent or more of the net proceeds are used to finance (1) qualified D.C. Zone property of which the principal user is a qualified D.C. Zone business, and (2) functionally related and subordinate land located in the D.C. Enterprise Zone.

In general, the rules previously described in connection with empowerment zones (such as the exceptions from section 147, and the change in use rules), apply to the issuance of qualified enterprise zone facility bonds for the District of Columbia.

These bonds may only be issued while the D.C. Enterprise Zone designation is in effect. Thus, the expanded tax-exempt bond provisions apply to bonds issued after December 31, 1997, and prior to January 1, 2003.

Zero-percent capital gains

A zero-percent capital gains rate applies to capital gains from the sale of certain qualified D.C. Zone assets held for more than five years. In general, a qualified "D.C. Zone asset" means stock or partnership interests held in, or tangible property held by, a D.C. Zone business. For purposes of the zero-percent capital gains rate, the D.C. Enterprise Zone is defined to include all census tracts within the District of Columbia where the poverty rate is not less than 10 percent. The definition of a qualified D.C. Zone business generally is the same as the definition applicable for purposes of the additional section 179 expensing described above, except that the business must derive at least 80 percent (as opposed to 50 percent) of its total gross income from the active conduct of a qualified business within the D.C. Enterprise Zone.

²⁴ Portions of the District of Columbia were designated as an enterprise community under section 1391 in 1994. Accordingly, the District of Columbia was entitled to issue tax-exempt enterprise zone facility bonds under section 1394. In fact, however, the District did not issue any such bonds.

²⁵ The exception to the volume cap that is available with respect to new empowerment zone facility bonds (described in section 1394(f)) does not apply to D.C. Enterprise Zone facility bonds.

“D.C. Zone business stock” is stock in a domestic corporation originally issued after December 31, 1997, that, at the time of issuance²⁶ and during substantially all of the taxpayer's holding period, was a qualified D.C. Zone business, provided that such stock was acquired by the taxpayer on original issue from the corporation solely in exchange for cash before January 1, 2003.²⁷ A “D.C. Zone partnership interest” is a domestic partnership interest originally issued after December 31, 1997, that is acquired by the taxpayer from the partnership solely in exchange for cash before January 1, 2003, provided that, at the time such interest was acquired²⁸ and during substantially all of the taxpayer's holding period, the partnership was a qualified D.C. Zone business.

The term “D.C. Zone business property” is defined as tangible property²⁹ purchased by the taxpayer after December 31, 1997, and before January 1, 2003, provided that the original use of such property in the D.C. Enterprise Zone commences with the taxpayer and substantially all of the use of such property during substantially all of the taxpayer's holding period was in a qualified D.C. Zone business of the taxpayer. Special rules are provided for buildings that are substantially renovated.

In general, gain eligible for the zero-percent tax rate means gain from the sale or exchange of a qualified D.C. Zone asset that is (1) a capital asset or (2) property used in the trade or business as defined in section 1231(b). Gain that is attributable to real property, or to intangible assets, qualifies for the zero-percent rate, provided that such real property or intangible

²⁶ In the case of a new corporation, it is sufficient if the corporation is being organized for purposes of being a qualified D.C. Zone business.

²⁷ D.C. Zone business stock does not include any stock acquired from a corporation which made a substantial stock redemption or distribution (without a bona fide business purpose therefor) in an attempt to avoid the purposes of the provision. A similar rule applies with respect to D.C. Zone partnership interests.

²⁸ In the case of a new partnership, it is sufficient if the partnership is being formed for purposes of being a qualified D.C. Zone business.

²⁹ D.C. Zone business property is limited to tangible property. Thus, for example, D.C. Zone businesses that are qualified proprietorships cannot claim the zero-percent rate on capital gain from the sale of any intangible property. Similarly, corporations or partnerships cannot claim the zero-percent rate on capital gain from the direct sale of intangible property. However, the zero-percent rate does apply to qualified gain from the sale of D.C. Zone business stock or a D.C. Zone partnership interest that is attributable to the value of intangible assets held by the entity, provided such assets are an integral part of a D.C. Zone business.

asset is an integral part of a qualified D.C. Zone business.³⁰ However, no gain attributable to periods before January 1, 1998, and after December 31, 2007, is qualified capital gain. In addition, no gain that is attributable to a transaction with a related person qualifies for the rate.

Property that ceases to be a qualified D.C. Zone asset because the property is no longer used in (or no longer represents an ownership interest in) a qualified D.C. Zone business after the five-year period continues to be treated as a qualified D.C. Zone asset. The amount of gain eligible for the zero-percent capital gains rate cannot exceed the amount which would be qualified capital gain had the property been sold on the date of such cessation. Special rules are provided for gains attributable to holding an interest in a pass-thru entity.

First-time homebuyer tax credit

First-time homebuyers of a principal residence in the District of Columbia³¹ qualify for a tax credit of up to \$5,000. The \$5,000 maximum credit amount applies both to individuals and married couples. The credit phases out for individual taxpayers with adjusted gross income between \$70,000 and \$90,000 (\$110,000-\$130,000 for joint filers). The credit is available with respect to purchases of existing property as well as new construction.

A “first-time homebuyer” means any individual if such individual (and, if married, such individual's spouse) did not have a present ownership interest in a principal residence in the District of Columbia during the one-year period ending on the date of the purchase of the principal residence to which the credit applies. A taxpayer will be treated as a first-time homebuyer with respect to only one residence--i.e., a taxpayer may claim the credit only once. A taxpayer's basis in a property is reduced by the amount of any homebuyer tax credit claimed with respect to such property.

The first-time homebuyer credit is a nonrefundable personal credit and may offset the regular tax and the alternative minimum tax. Any credit in excess of tax liability may be carried forward indefinitely. The homebuyer credit is available for property purchased after August 4, 1997, and before January 1, 2002.

³⁰ However, as described above, sole proprietorships and other taxpayers selling assets directly cannot claim the zero-percent rate on capital gain from the sale of any intangible property (i.e., the integrally related test does not apply).

³¹ The homebuyer credit applies to the purchase of a principal residence anywhere in the District of Columbia. It is not limited to the D.C. Enterprise Zone area.

Tax incentives for economic development on Indian reservations

The following special tax incentives are provided for businesses that are located on Indian reservations: (1) an employment wage credit, and (2) accelerated depreciation for property located on an Indian reservation.

Indian employment wage credit

Employers may claim a nonrefundable tax credit for certain wages and health insurance costs incurred with respect to qualifying full-time or part-time employees. The credit amount equals 20 percent of the excess of eligible qualified wages and health insurance costs that an employer paid or incurred during the tax year over the amount of such costs that an employer paid or incurred during 1993.³² An employer's deduction otherwise allowed for wages is reduced by the amount of the credit claimed for the taxable year. The credit is available only for the first \$20,000 of aggregate qualified wages and health insurance costs paid for each qualified employee in a taxable year. The credit is not available for taxable years beginning after 2003.

In general, an individual is a qualified employee of an employer for any period if (1) the individual is an enrolled member of an Indian tribe or the spouse of an enrolled member, (2) substantially all of the services performed by the employee for such employer are performed within an Indian reservation, and (3) the principal place of abode of the employee while performing such services is on or near the Indian reservation within which the services are performed. An employee will be treated as a qualified employee for a taxable year of the employer only if more than 50 percent of the wages paid or incurred by the employer to such employee during such taxable year are for services performed in a trade or business of the employer. An employee will not be treated as a qualified employee for any taxable year of the employer if the total amount of wages paid or incurred by the employer with respect to such employee during such taxable year (whether or not for services rendered within the Indian reservation) exceeds an amount determined at an annual rate of \$30,000 (as adjusted for inflation after 1994).³³

³² Qualified wages are wages paid or incurred by an employer for services performed by a qualified employee. Qualified health insurance costs are costs paid or incurred by the employer for health insurance coverage (other than health insurance provided pursuant to a salary reduction arrangement) provided to a qualified employee.

³³ Qualified employees also do not include certain relatives or dependents of the employer, or, if the employer is a corporation, certain relatives of a person who owns more than 50 percent of the corporation. In addition, any person who owns more than five percent of the stock of the employer (or more than five percent of the capital or profits interests in the employer) cannot be a qualified employee. Finally, a qualified employee does not include any individual who performs services in certain gaming activities or whose services are performed in a building housing such gaming activities.

An 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 Act³⁴ that is recognized as eligible for the special programs and services provided by the United States to Indians because of their status as Indians. An Indian reservation is defined to mean a reservation that is defined in either (1) section 3(d) of the Indian Financing Act of 1974,³⁵ or (2) section 4(10) of the Indian Child Welfare Act of 1978.³⁶

If an employee is terminated less than one year after the date of initial employment, the amount of credits previously claimed by the employer with respect to that employee generally is recaptured (unless the employee voluntarily leaves, becomes disabled, or is fired due to misconduct). Furthermore, no wages or health insurance costs for that employee may be considered by the employer for the tax year in which such employment is terminated. Any credit carryback or carryover also is adjusted. The wage credit is one of the components of the general business credit. The credit is subject to the general business credit limitations and carryover rules, and it cannot be used to reduce tentative alternative minimum tax.

Accelerated depreciation of Indian reservation property

The depreciation deduction for certain property used in connection with the conduct of a trade or business within an Indian reservation is calculated using the following recovery periods:

3-year property.....	2 years
5-year property.....	3 years
7-year property.....	4 years
10-year property.....	6 years
15-year property.....	9 years
20-year property.....	12 years
Nonresidential real property.....	22 years

"Qualified Indian reservation property" eligible for these shorter recovery periods includes property that is (1) used by the taxpayer predominantly in the active conduct of a trade or business within an Indian reservation, (2) not used or located outside the reservation on a regular basis, (3) not acquired (directly or indirectly) by the taxpayer from a person who is related

³⁴ 43 U.S.C. sec. 1601 et seq.

³⁵ 25 U.S.C. sec.1452(d). Section 168(j)(6) applies section 3(d) of the Indian Financing Act of 1974 by treating the term "former Indian reservations in Oklahoma" as including only lands which are within the jurisdictional area of an Oklahoma Indian tribe (as determined by the Secretary of Interior) and are recognized as eligible for trust land status under 25 CFR Part 151.

³⁶ 25 U.S.C. sec. 1903(10).

to the taxpayer (within the meaning of section 465(b)(3)(C)), and (4) not placed in service for purposes of conducting or housing certain gaming activities.³⁷

A special rule applies to "qualified infrastructure property," which may be eligible for the accelerated depreciation even if located outside an Indian reservation, provided that the purpose of such property is to connect with qualified infrastructure property located within the reservation (e.g., roads, power lines, water systems, railroad spurs, and communications facilities). For this purpose, "qualified infrastructure property" must be property that (1) benefits the tribal infrastructure, (2) is available to the general public, and (3) is placed in service in connection with the taxpayer's active conduct of a trade or business within an Indian reservation.³⁸

The depreciation deduction allowed for regular tax purposes also is allowed for purposes of the alternative minimum tax.

Specialized small business investment company tax incentives

Under present law, a taxpayer may elect to roll over without payment of tax any capital gain realized upon the sale of publicly-traded securities where the taxpayer uses the proceeds from the sale to purchase common stock in a specialized small business investment company ("SSBIC") within 60 days after the sale. The maximum amount of gain that an individual may roll over under this provision for a taxable year is limited to the lesser of (1) \$50,000 or (2) \$500,000 reduced by any gain previously excluded under this provision. For corporations, these limits are \$250,000 and \$1 million.

In addition, under present law, an individual may exclude 50 percent of the gain³⁹ from the sale of qualifying small business stock held more than five years. An SSBIC is automatically deemed to satisfy the active business requirement that a corporation must satisfy to qualify its stock for the exclusion.

Regulated investment companies are entitled to deduct dividends paid to shareholders. To qualify for the deduction, 90 percent of the company's income must be derived from dividends, interest and other specified passive income, the company must distribute 90 percent of its investment income, and at least 50 percent of the value of its assets must be invested in certain diversified investments.

³⁷ For this purpose, gaming activities include class I, II, or III gaming, as defined in section 4 of the Indian Regulatory Act (25 U.S.C. sec. 2703).

³⁸ The rental to others of real property located within an Indian reservation is treated as the active conduct of a trade or business within an Indian reservation.

³⁹ 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.

For purposes of these provisions, an SSBIC means any partnership or corporation that is licensed by the Small Business Administration under section 301(d) of the Small Business Investment Act of 1958 (as in effect on May 13, 1993). SSBICs make long-term loans to, or equity investments in, small businesses owned by persons who are socially or economically disadvantaged.

III. DESCRIPTION OF PROPOSALS

A. President's Fiscal 2001 Budget Proposal

1. New markets tax credit⁴⁰

The President's Fiscal year 2001 budget proposal would create a new tax credit for qualified investments made to acquire stock (or other equity interests) in a selected community development entity ("CDE"). The credits would be allocated to CDEs pursuant to Treasury Department regulations. During the period 2001-2005, the maximum amount of investments that would qualify for the credit would be capped at an aggregate annual amount of \$3 billion (a maximum of \$15 billion for the entire period of the tax credit). 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 would be canceled, and the Treasury Department could authorize another CDE to issue equity interests for the unused portion.⁴¹

The credit allowed to the investor (either the original purchaser or a subsequent holder) would be a six-percent credit for the year in which the equity interest is purchased from the CDE and each anniversary date (for four years) after the qualified equity interest is purchased from the CDE. The taxpayer's basis in the investment would be reduced by the amount of the credit. The credit would be subject to the general business credit rules.

A "qualified equity investment" refers to common stock or a similar equity interest acquired directly from a CDE in exchange for cash.⁴² The stock or equity interest must not be redeemed (or otherwise cashed out) by the CDE for at least five years. 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 provided to businesses

⁴⁰ Similar tax proposals have been introduced in the 106th Congress by Rep. Rangel and others (H.R. 2713), by Rep. Watts and others (H.R. 2848), and, in the Senate, by Sen. Rockefeller and others (S. 1526).

⁴¹ In making credit allocations, the Treasury Department would give priority to entities with records of having successfully provided capital or technical assistance to disadvantaged businesses or communities.

⁴² To ensure that credits are available only for new equity investments in CDEs, the term "qualified equity investment" would not include any stock or other equity interest acquired from a CDE which made a substantial stock redemption or distribution (determined under rules similar to current-law section 1202(c)(3)).

and residents in low-income communities.⁴³ Qualified low-income community investments could be made directly by a CDE, or could be made indirectly through another CDE.⁴⁴

As part of the credit allocation process, the Treasury Department would certify entities as eligible CDEs. To be selected for a credit allocation, the CDE's primary mission must be serving or providing investment capital for low-income communities or low-income persons. The CDE also must maintain accountability to residents of low-income communities through representation on governing or advisory boards, or otherwise. Certified entities would be required to file annual reports demonstrating that they continue to meet the requirements for initial certification. The certified entities also would be required to identify the amount (and purchasers) of equity interests with respect to which allocated credits may be claimed by the purchaser and to demonstrate that the entity monitors its investments to ensure that capital is used in low-income communities. If an entity fails to be a CDE during the five-year period following the taxpayer's purchase of an equity interest in the entity, or if the equity interest is redeemed by the issuing entity during that five-year period, then any credits claimed with respect to the equity interest would be recaptured (with interest) and no further credits would be allowed.

A "low-income community" would be 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 (or for a non-metropolitan census tract, 80 percent of non-metropolitan statewide median family income). In addition, any area that is part of an "empowerment zone" or "enterprise community" designated by section 1391 would be treated as a low-income community for purposes of the proposal.

A "qualified active business" generally would be defined as a business⁴⁵ that 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

⁴³ 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.

⁴⁴ A CDE would be treated as indirectly making "qualified low-income community investment" when it purchases loans previously made by another CDE that, in turn, uses the proceeds to provide additional capital (or financial or other services) to qualified active businesses located in low-income communities.

⁴⁵ As under present-law section 1394(b)(3)(D), the term "qualified active business" would include any trade or business that would qualify as such a business if the trade or business were separately incorporated.

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 (e.g. debt, stock, partnership interests, options, futures contracts) or to collectibles (other than collectibles held primarily for sale to customers). For purposes of the credit, there would be no requirement that employees of a “qualified active business” be residents of the low income community.

Rental of improved commercial real estate located in a low-income community (e.g., an office building or shopping mall) would be a qualified active business, regardless of the characteristics of the commercial tenants of the property. In addition, a qualified active business that receives a loan from a CDE could include an organization that is organized and operated on a non-profit basis. The purchase and holding of unimproved real estate would not be a qualified active business. In addition, a qualified active business would not include (1) any business consisting predominantly of the development or holding of intangibles for sale or license, (2) operation of any facility described in sec. 144(c)(6)(B), or (3) 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.

The Treasury Department would be granted authority to prescribe such regulations as may be necessary or appropriate to carry out the purposes of the proposal, including regulations limiting the benefit of the proposed tax credit in circumstances where investments are directly or indirectly being subsidized by other Federal programs (e.g., low-income housing credit and tax-exempt bonds), regulations preventing abuse of the credit through the use of related parties and regulations that apply the provisions to newly-formed entities. The Treasury Department would issue regulations describing the certification process for CDEs, and annual reporting requirements for selected entities.

The proposal would be effective for qualified investments made after December 31, 2000.

2. Empowerment zone incentives

The proposal would expand the tax incentives available to the existing empowerment zones and provide for the designation of ten new empowerment zones.

Specifically, the empowerment zone status for Round I and II empowerment zones would be extended through December 31, 2009. Furthermore, the 20-percent wage credit would be made available in all Round I and II empowerment zones. The credit rate would remain at 20 percent (rather than being phased down) through December 31, 2009, in all empowerment zones. Also, an additional \$35,000 (rather than \$20,000) of section 179 expensing would be available

for qualified zone property placed in service after December 31, 2000, and prior to December 31, 2009, by a qualified business in any of the empowerment zones.⁴⁶

In addition, the Secretaries of the Department of HUD and the Department of Agriculture would be authorized to designate 10 additional empowerment zones (the “Round III empowerment zones”). Eight 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 10 Round III empowerment zones would be the same as the criteria that applied to the Round II empowerment zones authorized by the 1997 Act. During the period 2002 through 2009, businesses located in the Round III empowerment zones would be eligible for the 20-percent wage credit, an additional \$35,000 of section 179 expensing, expanded tax-exempt financing benefits,⁴⁷ and brownfields expensing.

The proposal would be effective after December 31, 2000.

3. Specialized small business investment company tax incentives

Under the proposal, the tax-free rollover provision would be expanded by (1) extending the 60-day period to 180 days, (2) making preferred stock (as well as common stock) in an SSBIC an eligible investment, and (3) increasing the lifetime caps to \$750,000 in the case of an individual and to \$2 million in the case of a corporation, and repealing the annual caps.⁴⁸

The proposal also would provide that an SSBIC that is organized as a corporation may convert to a partnership without imposition of a tax to either the corporation or its shareholders, by transferring its assets to a partnership in which it holds at least an 80-percent interest and then liquidating. The corporation would be required to distribute all its earnings and profits before liquidating. The transaction must take place within 180 days of enactment of the proposal. The partnership would be liable for a tax on any “built-in” gain in the assets transferred by the corporation at the time of the conversion.

The 50-percent exclusion for gain on the sale of qualifying small business stock would be increased to 60 percent where the taxpayer, or a pass-through entity in which the taxpayer holds an interest, sells qualifying stock of an SSBIC.

⁴⁶ The additional \$35,000 of section 179 expensing would be available throughout all areas that are part of a designated empowerment zone.

⁴⁷ The Round III empowerment zones would be eligible for the same tax-exempt financing benefits that are available with respect to the Round I empowerment zones.

⁴⁸ These provisions were included in the Financial Freedom Act of 1999, as passed by the House of Representatives.

For purposes of determining status as a regulated investment company eligible for the dividends received deduction, the proposal would treat income derived by a SSBIC from its limited partner interest in a partnership whose business operations the SSBIC does not actively manage as income qualifying for the 90-percent test. In addition, the proposal would treat the SSBIC as satisfying the 90-percent distribution requirement if it distributes all its income that it is permitted to distribute under the Small Business Investment Act of 1958. It also would deem the diversification of assets requirement to be met to the extent the SSBIC's investments are permitted under that Act.

The rollover and small business stock provisions of the proposal would be effective for sales after date of enactment. The regulated investment company provisions would be effective for taxable years beginning after date of enactment.

B. H.R. 815, "The American Community Renewal Act of 1999"⁴⁹

H.R. 815, "The American Community Renewal Act of 1999" was introduced by Reps. Watts, Davis, Talent, and others. In general, the bill would authorize the designation of 100 "renewal communities" within which special tax incentives would be available. The following is a description of the designation process and the tax incentives that would be available within the proposed renewal communities.⁵⁰

Designation process

Under the bill, the Secretary of HUD would be authorized to designate up to 100 "renewal communities" from areas nominated by State and local governments. At least 20 percent of the designated communities must be in rural areas.⁵¹ The Secretary of HUD would be required to publish (within four months after enactment) regulations describing the selection process, and all designations of renewal communities have to be made within 24 months after the

⁴⁹ Variations of H.R. 815 have been included in other legislation passed by the House of Representatives. For example, H.R. 3081, the Small Business Tax Fairness Act, passed by the House of Representatives on March 9, 2000, includes a version of H.R. 815 that would authorize the designation of 15 renewal communities (within which special tax incentives similar to those described below would be available).

⁵⁰ H.R. 815 also includes several non-tax provisions (regarding the transfer of certain HUD-held housing, amendments to the Public Health Service Act, and amendments to the Community Reinvestment Act of 1977) that are not described in this pamphlet.

⁵¹ A rural area would be defined as an area that (1) is within local government jurisdictions with a population less than 50,000, (2) is outside of a metropolitan statistical area, or (3) is determined by HUD to be a rural area.

publication of the regulations. Designations generally remain in effect through December 31, 2007.

The proposal would allow the previously designated empowerment zones and enterprise communities to be eligible for designation as renewal communities. Thus, with respect to the first 50 percent of the designations, half are to be chosen from areas that are empowerment zones or enterprise communities under present law and which otherwise meet the requirements of the proposal for designation as a renewal community.⁵² If a previously designated empowerment zone or enterprise community is selected as a renewal community, then the area's designation as an empowerment zone or enterprise community would remain in effect and the same area also would be designated as a renewal community. For such an area obtaining dual-designation status, the special tax incentives available for empowerment zones (or enterprise communities, as the case may be) and for renewal communities are available. If an area previously designated as an empowerment zone or enterprise community does not seek designation (or is not selected by the Secretary of HUD) as a renewal community, then the present-law empowerment zone and enterprise community provisions continue to apply to that area.

To be designated as a renewal community, a nominated area must meet all of the following criteria: (1) each census tract must have a poverty rate of at least 20 percent; (2) 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.

Except with respect to the designation of the first 50 percent of renewal communities under which priority is given to existing empowerment zones and enterprise communities (as described above), those areas with the highest average ranking of factors (1), (2), and (3) above would be designated as renewal communities. The Secretary of HUD also could 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 Government Accounting Office regarding the identification of economically distressed areas.

There are no geographic size or maximum population limitations placed on the designated renewal communities. The proposal requires that the boundary of a designated community be "continuous" and that it have a population of at least 4,000 if the community is located within a metropolitan statistical area (at least 1,000 in all other cases, or the community must be entirely within an Indian reservation).

In order for an area to be designated as a renewal community, the proposal requires State and local governments to submit a written course of action that promises within the nominated area at least five of the following: (1) a reduction of tax rates or fees; (2) an increase in the level

⁵² Twenty percent are to be chosen from rural areas.

of efficiency of local services; (3) crime reduction strategies; (4) actions to remove or streamline governmental requirements; (5) involvement by private entities and community groups, such as to provide jobs and job training and financial assistance; (6) State or local income tax benefits for fees paid for services performed by a nongovernmental entity which were formerly performed by a government entity; and (7) the gift (or sale at below fair market value) of surplus realty by the State or local government to community organizations or private companies.

In addition, the bill would require that the nominating State and local governments promise to promote economic growth in the nominated area by repealing or not enforcing (1) licensing requirements for occupations that do not ordinarily require a professional degree, (2) zoning restrictions on home-based businesses that do not create a public nuisance, (3) permit requirements for street vendors who do not create a public nuisance, (4) zoning or other restrictions that impede the formation of schools or child care centers, and (5) franchises or other restrictions on competition for businesses providing public services, including but not limited to taxicabs, jitneys, cable television, or trash hauling, unless such regulations are “necessary for and well-tailored to the protection of health and safety.”

Tax incentives for renewal communities

The following tax incentives generally would be available during the seven-year period beginning January 1, 2001, and ending December 31, 2007.

100-percent capital gain exclusion.--The bill provides for a 100-percent capital gains exclusion for qualified capital gain from the sale of a qualified community asset acquired after December 31, 2000, and before January 1, 2008, and held for more than five years.⁵³ A “qualified community asset” includes (1) qualified community stock (meaning original-issue stock acquired for cash from a corporation that is a “renewal community business,” defined below), (2) qualified community partnership interest (meaning a partnership interest acquired for cash from a partnership that is a renewal community business), and (3) qualified community business property (meaning tangible real and personal property used in a renewal community business, if acquired (or substantially improved) by the taxpayer after December 31, 2000, and before January 1, 2008). The exclusion is available only if during substantially all of the taxpayer’s holding period, the corporation or partnership qualifies as a renewal community business, or substantially all of the use of the property is in a renewal community business. Property continues 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 is tangible property used in) a renewal community business. If an area’s status as a renewal community terminates, the amount of gain eligible for the exclusion cannot exceed the amount that would have been excludable had the property been sold on the date of the termination of

⁵³ Thus, the 100-percent capital gain exclusion would apply to gain from the sale of a qualified community asset sold after the termination of the renewal community designation provided that the other requirements of the proposal are satisfied.

status. Any gain attributable to the period before January 1, 2001, or after December 31, 2012, is not eligible for the 100-percent capital gains exclusion.

A “renewal community business” for purposes of the capital gain exclusion, as well as for purposes of the additional expensing under section 179 (described below), generally must satisfy the requirements of an “enterprise zone business” under present law; however, at least 80 percent (as opposed to 50 percent) of the total gross income of the business must be derived from the active conduct of a “qualified business” within a renewal community.

Family development accounts.--Under the proposal, individual taxpayers would be allowed to claim an above-the-line deduction for certain amounts paid in cash to a family development account (“FDA”) established for the benefit of a “qualified individual.” A qualified individual is one who both resides in a renewal community throughout the taxable year and who was allowed to claim the earned income credit (“EIC”) during the preceding taxable year. An FDA is subject to rules similar to the rules for Individual Retirement Arrangements (“IRAs”). No deduction is allowed for any amount paid to an FDA for a taxable year beginning after December 31, 2007.

A qualified individual may claim a deduction for a taxable year for amounts contributed to his or her FDA(s) of up to the lesser of (1) \$2,000 or (2) the amount of the individual’s compensation included in gross income for the year. Any other person may deduct up to \$1,000 per year for amounts contributed to an FDA established on behalf of a qualified individual. Under the provision, no more than \$3,000 of contributions (excluding certain demonstration program matching contributions described below) can be made to the FDAs of a qualified individual in any taxable year. Contributions to an FDA may be made on or before April 15th of the following taxable year. The provision allows (but does not require) individuals to direct that the IRS directly deposit their EIC refunds into an FDA on behalf of such individual.

The bill provides that up to five of the renewal communities may be designated by the Secretary of HUD as “FDA matching demonstration areas,” with respect to which the Secretary of the Treasury, at the request of a qualified individual (and to the extent provided in appropriation Acts), will match amounts contributed to FDAs, up to \$1,000 per individual per taxable year (with a \$2,000 lifetime cap). At least two of the FDA matching demonstration areas must be rural areas. The Secretary of HUD may designate renewal communities as FDA matching demonstration areas only during the 24-month period after such Secretary prescribes regulations regarding such areas. The matching grant amounts made under this demonstration program are excluded from the gross income of the account holder, and no deduction is allowed for matching grant amounts. The Secretary of the Treasury is required to notify residents of FDA matching demonstration areas of the availability of matching contributions.

The bill provides that an FDA is exempt from taxation (other than the unrelated business income tax imposed by present-law section 511). Distributions from an FDA that are qualified family development distributions are not included in gross income. A distribution from an FDA

is a qualified family development distribution if the distribution is used exclusively to pay (1) qualified higher education expenses, (2) certain first-time homebuyer expenses, (3) certain qualified business capitalization costs, or (4) qualified medical expenses. Such qualified expenses must be incurred on behalf of the FDA account holder, or the spouse or dependent of the account holder. Distributions from an FDA that are not qualified family development distributions are included in gross income and subject to either a 100-percent penalty tax (in the case of a distribution attributable to a demonstration matching contribution) or a 10-percent penalty tax (in the case of a distribution that is not attributable to a demonstration matching contribution). The 100-percent and 10-percent penalty taxes do not apply to distributions that are made on or after the account holder attains age 59-1/2, dies, or becomes disabled. Any distribution from an FDA that is not a qualified family development distribution is deemed to have been made from demonstration matching contributions (and, therefore, subject to a 100-percent penalty) until all such demonstration matching contributions have been withdrawn.

The bill permits tax-free (and penalty-free) rollovers of amounts in an FDA into another account established for the benefit of an individual who (1) both resides in a renewal community throughout the taxable year and was allowed to claim the earned income tax credit during the preceding taxable year, and (2) either is the account holder or is a spouse or dependent of the account holder.

Commercial revitalization credit.--The bill would allow taxpayers to claim a nonrefundable "commercial revitalization credit" equal to (1) a 20-percent credit rate for the year a qualified building is placed in service, or if the taxpayer elects, or (2) a 5-percent credit rate for each year during a 10-year period after the building is placed in service for costs (up to \$10 million per building) of constructing or substantially rehabilitating one or more buildings used for commercial purposes in a renewal community. A qualified building must be located in a renewal community and be placed in service after December 31, 2000, and before January 1, 2008. Under the provision, each State is allowed to allocate no more than \$2 million of credits to each renewal community located within the State for each calendar year. The appropriate State agency would make the allocations pursuant to a qualified allocation plan. The qualified allocation plan would (1) set forth the selection criteria to be used to determine priorities as appropriate to local conditions, (2) consider how the building project would contribute to the renewal community and its residents, and (3) provide a procedure that the agency would follow to monitor compliance. Any unused credit cannot be carried back to a taxable year ending before the date of enactment of this provision.

Additional section 179 expensing.--A renewal community business would be allowed an additional \$35,000 of section 179 expensing for qualified renewal property placed in service after December 31, 2000, and before January 1, 2008, in a renewal community. Thus, if a renewal community business is located in an area that is designated as both an empowerment zone and a renewal community, such business could be allowed an additional \$55,000 of section 179 expensing (i.e., \$20,000 of additional expensing because the area is designated an empowerment zone plus \$35,000 of additional expensing because the area is designated a renewal community).

The additional section 179 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” that is applied in connection with the additional section 179 expensing for empowerment zones (sec. 1397C).

Expensing of environmental remediation costs (“brownfields”).—A renewal community would be treated as a “targeted area” under section 198, which permits expensing of certain 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. The expenditure must be incurred in connection with the abatement or control of environmental contaminants, as required by Federal and State law, at a trade or business site located within a designated renewal community. This provision applies to qualifying expenditures incurred after December 31, 2000, and before January 1, 2008.

Extension of work opportunity tax credit (“WOTC”).--The bill would make two changes to the WOTC. First, the provision expands the high-risk youth and qualified summer youth categories in the WOTC to include qualified individuals who live in a renewal community.

Second, in the event that the WOTC program expires, the bill would permit employers engaged in a trade or business in a renewal community to claim a tax credit with respect to individuals hired from one or more targeted groups that live and perform substantially all of their work in a renewal community. The tax credit equals 15 percent of the qualified first-year wages and 30 percent of the qualified second-year wages through December 31, 2007.⁵⁴ No more than \$10,000 of wages may be taken into account in each year. Thus, the maximum credit for a qualifying individual is \$1,500 with respect to qualified first-year wages and \$3,000 with respect to qualified second-year wages.

Targeted groups eligible for the tax credit include the following: (1) certain individuals certified by the designated local agency as being a member of a family receiving assistance under a IV-A program for any nine months during the 18-month period ending on the hiring date; (2) certain ex-felons having a hiring date within one year of release from prison or date of conviction; (3) individuals who are at least 18 but not 25 years of age and have a principal place of abode within an empowerment zone, enterprise community, or renewal community; (4) individuals who are at least 18 but not 25 years of age who are certified as being a member of a family receiving assistance under a food stamp program under the Food Stamp Act of 1977 for a period of at least six months ending on the hiring date; (5) individuals who have a physical or mental disability that constitutes a substantial handicap to employment and who have been referred to the employer while receiving, or after completing, vocational rehabilitation services; (6) individuals who are 16 or 17 years of age, perform services during any 90-day period between May 1 and September 15, and have a principal place of abode within an empowerment zone,

⁵⁴ The Work Opportunity Tax Credit is scheduled to expire on December 31, 2001.

enterprise community, or renewal community; (7) certain veterans who receive food stamps; and (8) recipients of certain Supplemental Security Income benefits.

HUD reports.--The bill would provide that, not later than the close of the fourth calendar year after the year the Secretary of HUD first designates an area as a renewal community and for every four years thereafter, the Secretary of HUD shall report to Congress on the effects of such designation in stimulating the creation of new jobs, particularly for disadvantaged workers and long-term unemployed individuals, and promoting the revitalization of economically distressed areas.

Effective Date

Under the bill, renewal communities must be designated within 24 months after publication of certain regulations by HUD. The tax benefits available in renewal communities generally are effective for the seven-year period beginning January 1, 2001, and ending December 31, 2007.