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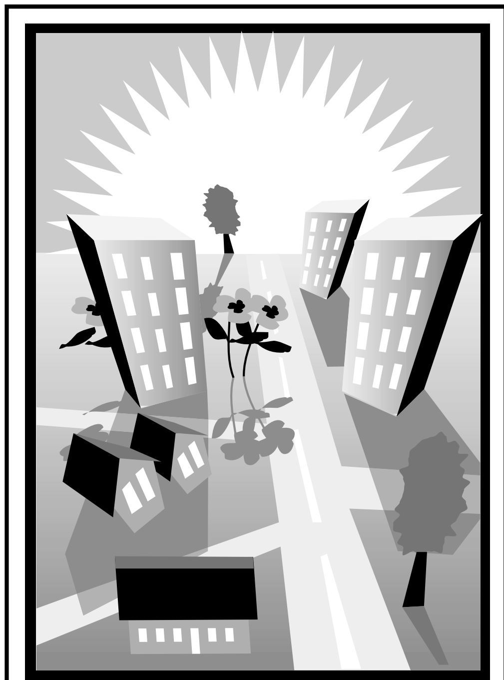
Tax Incentives for Empowerment Zones and Other Distressed Communities



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Introduction

This publication is for business owners who want to find out whether they qualify for certain tax incentives. These incentives are intended to help empowerment zones, enterprise communities, renewal communities, and other distressed communities. A distressed community is any area whose poverty rate or other conditions cause any of these tax incentives to apply. The requirements for each tax incentive are different. The following paragraphs will help guide you in using this publication.

To find out whether your area has been designated as an empowerment zone or enterprise community, read *Designated Zones and Communities* under *Empowerment Zones and Enterprise Communities.* (There is no discussion of designated renewal communities in this publication because, at the time the publication was printed, no renewal communities had been designated.)

If you know that your area has been designated as an empowerment zone or enterprise community, skip the section on designated zones and communities and begin by reading the first few paragraphs of each of the

following sections of the publication. Then, read the details of the sections that apply to you.

If you know that your area has not been designated as a zone or community, you should still read the first few paragraphs of each section. Some of these incentives are available in distressed communities that have not been designated as either empowerment zones or enterprise communities. Read the details of the sections that apply to you.

Comments and suggestions. We welcome your comments about this publication and your suggestions for future editions.

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We respond to many letters by telephone. Therefore, it would be helpful if you would include your daytime phone number, including the area code, in your correspondence.

Useful Items

You may want to see:

Publication

- ☐ **946** How To Depreciate Property

Form (and Instructions)

- ☐ **3800** General Business Credit
- ☐ **5884** Work Opportunity Credit
- ☐ **8844** Empowerment Zone Employment Credit
- ☐ **8845** Indian Employment Credit
- ☐ **8850** Pre-Screening Notice and Certification Request for the Work Opportunity and Welfare-to-Work Credits
- ☐ **8860** Qualified Zone Academy Bond Credit
- ☐ **8861** Welfare-to-Work Credit

Empowerment Zones and Enterprise Communities

This section describes the areas that have been designated empowerment zones and explains the tax benefits available to businesses in those zones. Enterprise communities are also discussed.

Designated Zones and Communities

The following paragraphs describe current and planned designations of empowerment zones and enterprise communities. The empowerment zone designations will generally remain in effect until the end of 2009. The enterprise community designations will generally remain in effect until the end of the 10th calendar year beginning on or after the date of designation.

The Community Renewal Tax Relief Act of 2000 authorizes the Secretary of Housing and Urban Development (HUD) and the Secretary of Agriculture (USDA) to designate up to 9 additional empowerment zones before January 1, 2002 (seven in urban areas and two in rural areas). Businesses in the new zones will be eligible for the same tax incentives that are available in the existing zones.

Urban designations effective December 21, 1994. The Secretary of HUD has designated 65 urban enterprise communities. The Secretary has also designated parts of the following cities as urban empowerment zones.

1) Atlanta, GA (9.29 square miles).
2) Baltimore, MD (6.8 square miles).
3) Chicago, IL (14.33 square miles).
4) Detroit, MI (18.3 square miles).
5) New York City, NY (the Bronx and Manhattan; 7.6 square miles).
6) Philadelphia, PA/Camden, NJ (4.4 square miles).

Rural designations effective December 21, 1994. The Secretary of USDA designated 30 rural enterprise communities. The Secretary has also designated the following rural empowerment zones.

1) The Kentucky Highlands (part of Wayne and all of Clinton and Jackson counties).
2) Mid-Delta, Mississippi (parts of Bolivar, Holmes, Humphreys, Leflore, Sunflower, and Washington counties).
3) Rio Grande Valley, Texas (parts of Cameron, Hidalgo, Starr, and Willacy counties).

District of Columbia Enterprise Zone (DC Zone). Effective January 1, 1998, parts of Washington, D.C. are treated as an empowerment zone. This treatment will remain in effect until the end of 2003.

Urban designations effective December 31, 1998. HUD has designated parts of the following cities as urban empowerment zones.

1) Boston, MA (about 6 square miles).
2) Cincinnati, OH (about 7 square miles).
3) Columbia/Sumter, SC (about 19 square miles).
4) Columbus, OH (about 14 square miles).
5) Cumberland County, NJ (about 4 square miles).
6) El Paso, TX (about 10 square miles).
7) Gary/East Chicago, IN (about 17 square miles).
8) Huntington, WV/Ironton, OH (about 10 square miles).
9) Knoxville/Knox County, TN (about 16 square miles).

10) Miami/Miami-Dade County, FL (about 13 square miles).

11) Minneapolis, MN (about 7 square miles).

12) New Haven, CT (about 5 square miles).

13) Norfolk/Portsmouth, VA (about 10 square miles).

14) Santa Ana, CA (about 4 square miles).

15) St. Louis, MO/East St. Louis, IL (about 14 square miles).

Rural designations effective December 31, 1998. USDA has designated the following rural empowerment zones.

1) Desert Communities Empowerment Zone, California (parts of Riverside county).

2) Steele-Griggs County Empowerment Zone, North Dakota (part of Griggs county and all of Steele county).

3) Oglala Sioux Tribe Empowerment Zone, South Dakota (parts of the Pine Ridge Indian Reservation).

4) Southernmost Illinois Delta Empowerment Zone, Illinois (parts of Alexander, Johnson, and Pulaski counties).

5) Southwest Georgia United Empowerment Zone, Georgia (parts of Crisp county and all of Dooly county).

Designations effective January 1, 2000. HUD has designated parts of the following cities as urban empowerment zones.

1) Cleveland, OH.

2) Los Angeles, CA.

More information. For more information, call HUD at **1–800–998–9999** or USDA at **1–800–645–4712.**

Or you can find out whether your area has been designated as an empowerment zone or an enterprise community by using the Internet address **www.ezec.gov.**

Empowerment Zone Employment Credit

The empowerment zone employment credit provides businesses with an incentive to hire individuals who both live and work in an empowerment zone. (Individuals who work in the DC Zone may live anywhere in the District of Columbia.) You can claim the credit if you pay or incur “qualified zone wages” to a “qualified zone employee.”

The credit is 20% of the qualified zone wages paid or incurred during a calendar year. The amount of qualified zone wages you can use to figure the credit cannot be more than $15,000 for each employee for each calendar year. As a result, the credit can be as much as $3,000 (20% of $15,000) per qualified zone employee each year.

You cannot claim this credit for wages paid before 2002 for a business you operate in one of the 15 urban or 5 rural zones whose designation was effective December 31, 1998. But you can claim the credit in these zones for wages paid after 2001.

Qualified zone employee. A qualified zone employee is any employee who meets both of the following tests.

1) The employee performs substantially all of his or her services for you within an empowerment zone and in your trade or business.

2) While performing those services, the employee has his or her main home within that empowerment zone (or within the District of Columbia, for services performed within the DC Zone).

Both full-time and part-time employees may qualify.

Nonqualified employees. The following individuals are not qualified zone employees.

1) An individual you employ for less than 90 days. However, this 90-day requirement does not apply in either of the following situations.

   a) You terminate the employee because of misconduct as determined under the state unemployment compensation law that applies.

   b) The employee becomes disabled before the 90th day. However, if the disability ends before the 90th day, you must offer to reemploy the former employee.

2) Certain related taxpayers.

3) Certain dependents.

4) Any 5% owner.

5) An individual you employ at any:

   a) Private or commercial golf course,

   b) Country club,

   c) Massage parlor,

   d) Hot tub facility,

   e) Suntan facility,

   f) Racetrack, or other facility used for gambling, or

   g) Store whose principal business is the sale of alcoholic beverages for off-premise consumption.

6) Any individual you employ in a farming trade or business if, at the close of the tax year, the sum of the following amounts is more than $500,000.

   a) The larger of the unadjusted bases or fair market value of the farm assets you own.

   b) The value of the farm assets you lease.

Qualified zone wages. Qualified zone wages are any wages you pay or incur for services performed by an employee while the employee is a qualified zone employee (defined earlier). Wages are generally defined as those wages subject to the Federal Unemployment Tax Act (FUTA) without regard to the FUTA dollar limit.

Also treat as qualified zone wages certain training and education expenses you pay or incur on behalf of a qualified zone employee.

Effect of welfare-to-work or work opportunity credit. Qualified zone wages do not include any amount you take into account in figuring the welfare-to-work credit or the work opportunity credit. In addition, reduce the $15,000 maximum qualified zone wages for each qualified zone employee by the amount of wages you use to figure either of those credits for that employee.

Claiming the credit. Use ***Form 8844*** to claim this credit. Although the empowerment zone employment credit is a component of the general business credit, a special tax liability limit applies to this credit. Therefore, you figure the credit separately and never carry it to Form 3800, *General Business Credit.*

Effect on salary and wage deduction. In general, you must reduce the deduction on your income tax return for salaries and wages and certain education and training costs by the amount of your empowerment zone employment credit.

More information. For more information about the empowerment zone employment credit, see Form 8844.

Increased Section 179 Deduction

Section 179 of the Internal Revenue Code allows you to choose to deduct all or part of the cost of certain qualifying property in the year you place it in service. You can do this instead of recovering the cost by taking depreciation deductions over a specified recovery period. There are limits, however, on the amount you can deduct in a tax year.

You may be able to claim an increased section 179 deduction if your business qualifies as an "enterprise zone business." The increase can be as much as $20,000 ($35,000 for 2002 and later years). This increased section 179 deduction applies to "qualified zone property" you place in service in an empowerment zone.

You cannot claim this increased deduction for a business you operate in an enterprise community.

Enterprise zone business. For the increased section 179 deduction, a corporation, partnership, or sole proprietorship is an enterprise zone business if all the following statements are true for the tax year.

1) Every trade or business of the corporation or partnership is the active conduct of a qualified business (defined later) within an empowerment zone. (This rule does not apply to a sole proprietorship.)
2) At least 50% of its total gross income is from the active conduct of a qualified business within a zone.
3) A substantial part of the use of its tangible property is within a zone.
4) A substantial part of its intangible property is used in the active conduct of the business.
5) A substantial part of the employees' services are performed within a zone.
6) At least 35% of the employees are residents of an empowerment zone. (This rule does not apply to businesses in the DC Zone.)
7) Less than 5% of the average of the total unadjusted bases of the property owned by the business is from:
   a) Nonqualified financial property (generally, debt, stock, partnership interests, options, futures contracts, forward contracts, warrants, notional principal contracts, and annuities), or
   b) Collectibles not held primarily for sale to customers.

For a sole proprietorship, the term "employee" in (5) and (6) includes the proprietor.

Qualified business. A qualified business is generally any trade or business except one that consists primarily of the development or holding of intangibles for sale or license.

However, the rental to others of real property located in an empowerment zone is a qualified business only if the property is not residential rental property and at least 50% of the gross rental income from the property is from enterprise zone businesses.

The rental to others of tangible personal property is a qualified business only if at least 50% of the rentals of the property are to enterprise zone businesses or zone residents.

Also, a qualified business does not include any business listed earlier in item (5) or item (6) under *Nonqualified employees* in the *Empowerment Zone Employment Credit* section.

Qualified zone property. For the increased section 179 deduction, qualified zone property is any depreciable tangible property if all the following are true.

1) You acquired the property after the zone designation is in effect.
2) You did not acquire the property from a related person or member of a controlled group of which you are a member.
3) Your basis in the property is not determined either by its adjusted basis in the hands of the person from whom you acquired it or under the stepped-up basis rules for property acquired from a decedent.
4) You were the first person to use the property in an empowerment zone.
5) At least 85% of the property's use is in an empowerment zone and in the active conduct of a qualified trade or business in the zone.

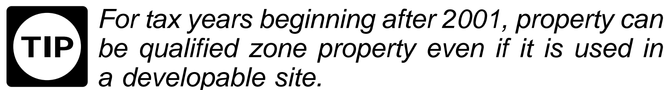
Buildings are qualified zone property, but they do not qualify for the section 179 deduction. Used property may be qualified zone property if it has not previously been used within an empowerment zone.

Special rule for substantially renovated property. Property will be treated as having met requirements (1) and (4) if you substantially renovate the property. You substantially renovate property if, during any 24-month period beginning after the zone designation takes effect, your additions to the property's basis are more than the greater of the following amounts.

1) 100% of the adjusted basis of the property at the beginning of the 24-month period.
2) $5,000.

Property used in developable sites. For tax years beginning before 2002, property is not qualified zone property if substantially all of its use is in a developable site. A developable site is a site to which both of the following apply.

1) The site could be developed for commercial or industrial purposes.
2) The site was included in one of the 15 urban or 5 rural zones whose designation was effective December 31, 1998, under an exception for developable sites that allowed it to be excluded from the poverty rate requirement.


For tax years beginning after 2001, property can be qualified zone property even if it is used in a developable site.

Section 179 deduction limits. There are limits on the amount you can deduct under section 179. The following sections explain how these limits are increased for certain qualified zone property placed in service by an enterprise zone business.

Maximum dollar limit. The total cost of section 179 property that you can deduct for a tax year generally cannot be more than the maximum section 179 dollar limit. However, if you place section 179 property that is qualified zone property in service during the year, this maximum dollar limit is increased by the smaller of the following amounts.

1) The cost of that property.
2) $20,000 ($35,000 for 2002 and later years).

The following table shows these maximum dollar limits.

Table 1. Maximum Dollar Limits

For Tax Years Beginning In:	Maximum Section 179 Dollar Limit	Maximum Dollar Limit With Qualified Zone Property
2000	$20,000	$40,000
2001	24,000	44,000
2002	24,000	59,000
Years after 2002	25,000	60,000

These maximum dollar limits are reduced if you go over the investment limit (discussed next) in any tax year.

Investment limit. For each dollar of your business cost over $200,000 for section 179 property placed in service in a tax year, reduce the maximum dollar limit by $1 (but not below zero). However, take only one-half of the cost of section 179 property that is qualified zone property into account when reducing the maximum dollar limit.

Example. In 2000, your enterprise zone business placed in service section 179 property that is qualified zone property costing $420,000. Because all of this property is qualified zone property, only $210,000 (one-half of its cost) is used to figure the investment limit. Because $210,000 is $10,000 more than $200,000, you must reduce the maximum dollar limit by $10,000. Your maximum dollar limit for 2000 is $40,000. You can claim a section 179 deduction of $30,000 ($40,000 – $10,000) for 2000 (if your taxable income from trades or businesses is at least $30,000).

Recapture. The recapture rules of section 179 apply when qualified zone property is no longer used in an empowerment zone by an enterprise zone business.

More information. For more information about the section 179 deduction, see Publication 946. For more information about the increased section 179 deduction, see sections 1397A, 1397C, and 1397D of the Internal Revenue Code.

Rollover of Gain From Sale of Empowerment Zone Assets

You may qualify for a tax-free rollover of certain gains from the sale of qualified empowerment zone assets. This means that if you buy certain replacement property and make the choice described in this section, you postpone part or all of the recognition of your gain.

You qualify to make this choice if you meet all the following tests.

1) You hold a qualified empowerment zone asset for more than 1 year and sell it at a gain.
2) Your gain from the sale is a capital gain.
3) During the 60-day period beginning on the date of the sale, you buy a replacement qualified empowerment zone asset in the same zone as the asset sold.

Qualified empowerment zone asset. This means certain stock or partnership interests in an enterprise zone business (defined earlier). It also includes certain tangible property used in an enterprise zone business. You must have acquired the asset after December 21, 2000.

The DC Zone is not treated as an empowerment zone for this purpose. For the treatment of gain from the sale of a DC Zone asset, see *Exclusion of Capital Gains From DC Zone Assets,* later.

Amount of gain recognized. If you make the choice described in this section, you must recognize gain only up to the following amount:

1) The amount realized on the sale, minus
2) The cost of any qualified empowerment zone asset that you bought during the 60-day period beginning on the date of sale (and did not previously take into account in rolling over gain on an earlier sale of qualified empowerment zone assets).

If this amount is equal to or more than the amount of your gain, you must recognize the full amount of your gain. If this amount is less than the amount of your gain, you can postpone the rest of your gain by adjusting the basis of your replacement property as described next.

Basis of replacement property. You must subtract the amount of postponed gain from the basis of the qualified empowerment zone assets you bought as replacement property.

More information. For more information about the rollover of gain from the sale of empowerment zone assets, see section 1397B of the Internal Revenue Code.

Increased Exclusion of Gain From Qualified Small Business Stock

Taxpayers other than corporations generally can exclude from income 50% of their gain from the sale or trade of qualified small business stock held more than 5 years. If the stock is in a corporation that qualifies as an enterprise zone business (defined earlier under *Increased Section 179 Deduction*) during substantially all of the time you hold the stock, you can exclude 60% of your gain.

To claim this increased exclusion, you must have acquired the stock after December 21, 2000. Gain from periods after 2014 will not qualify for the increased exclusion.

The requirement that the corporation must qualify as an enterprise zone business during substantially all of the time you hold the stock will still be met if the corporation ceased to qualify after the 5-year period beginning on the date you acquired the stock. However, the gain that qualifies for the 60% exclusion cannot be more than the gain you would have had if you had sold the stock on the date the corporation ceased to qualify.

If you sell the stock after 2009, disregard the end of the empowerment zone designation on December 31, 2009, in determining whether the corporation qualified as an enterprise zone business during substantially all of the time you held the stock.

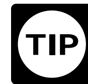
For more information about this exclusion, including a definition of qualified small business stock, see chapter 4 of Publication 550, *Investment Income and Expenses*.

Tax-Exempt Bond Financing

State or local governments can issue enterprise zone facility bonds (a type of exempt facility tax-exempt bond) to raise funds to provide an “enterprise zone business” with “qualified zone property.” At least 95% of the net proceeds from the bond issue must be used to finance:

1) Qualified zone property whose principal user is an enterprise zone business, and
2) Certain land used for a related purpose (for example, land where the business is located and a parking lot for customers and employees).

Tax-exempt bonds generally have lower interest rates than conventional financing.



Contact the appropriate state or local government agency to find out if this type of financing is available in your empowerment zone or enterprise community.

Enterprise zone business. For tax-exempt bond financing, a corporation, partnership, or sole proprietorship is generally an enterprise zone business if all the following statements are true for the tax year.

1) Every trade or business of the corporation or partnership is the active conduct of a qualified business (defined later) within an empowerment zone or an enterprise community. (This rule does not apply to a sole proprietorship.)
2) At least 50% (80% for bonds issued before August 6, 1997) of its total gross income is from the active conduct of a qualified business within a zone or community.
3) A substantial part of the use of its tangible property is within a zone or community. (For bonds issued before August 6, 1997, at least 85% of the use of its tangible property must be within a zone or community.)
4) A substantial part of its intangible property is used in the active conduct of the business. (For bonds issued before August 6, 1997, at least 85% of its intangible property must be used in, and exclusively related to, the active conduct of the business.)
5) A substantial part of the employees' services are performed within a zone or community. (For bonds issued before August 6, 1997, at least 85% of the employees' services must be performed within a zone or community.)
6) At least 35% of the employees are residents of an empowerment zone or enterprise community. (This rule does not apply to businesses in the DC Zone.)
7) Less than 5% of the average of the total unadjusted bases of the property owned by the business is from:
    a) Nonqualified financial property (generally, debt, stock, partnership interests, options, futures contracts, forward contracts, warrants, notional principal contracts, and annuities), or

b) Collectibles not held primarily for sale to customers.

For a sole proprietorship, the term “employee” in (5) and (6) includes the proprietor. Also, a business located in a zone or community that would qualify if it were separately incorporated is treated as an enterprise zone business. For example, a business that is part of a national chain could qualify, providing it would meet the definition of an enterprise zone business if it were separately incorporated.

Qualified business. A qualified business is generally any trade or business except one that consists primarily of the development or holding of intangibles for sale or license.

However, the rental to others of real property located in an empowerment zone or enterprise community is a qualified business only if the property is not residential rental property and at least 50% of the gross rental income from the property is from enterprise zone businesses.

The rental to others of tangible personal property is a qualified business only if at least 50% of the rentals of the property are to enterprise zone businesses or zone or community residents. (For bonds issued before August 6, 1997, at least 85% of the rentals of the property must be to enterprise zone businesses or zone or community residents.)

Also, a qualified business does not include any business listed earlier in item (5) or item (6) under *Nonqualified employees* in the *Empowerment Zone Employment Credit* section.

Relaxed requirements during start-up period. For bonds issued after August 5, 1997, a business will be treated as an enterprise zone business during a start-up period if both of the following apply.

1) It is reasonable, at the beginning of the start-up period, to expect the business to be an enterprise zone business by the end of the start-up period.
2) The business makes bona fide efforts to be an enterprise zone business.

The start-up period is the period that ends with the start of the first tax year beginning more than 2 years after the later of the following two dates.

1) The issue date of the bond issue financing the qualified zone property.
2) The date this property is first placed in service (or, if earlier, the date that is 3 years after the issue date).

Requirements during and after testing period. For bonds issued after August 5, 1997, a business that qualifies as an enterprise zone business at the end of the start-up period must continue to qualify during a testing period that ends 3 tax years after the start-up period ends.

After the 3-year testing period, a business will continue to be treated as an enterprise zone business as long as it meets an employee residency requirement. To meet this requirement, at least 35% of its employees must be residents of an empowerment zone or enterprise community. However, the following businesses are not treated as enterprise zone businesses even if they meet the employee residency requirement.

1) Any business that consists primarily of the development or holding of intangibles for sale or license.
2) Any business listed earlier in item (5) or item (6) under *Nonqualified employees* in the *Empowerment Zone Employment Credit* section.

A business in the DC Zone does not need to meet the employee residency requirement to continue to be treated as an enterprise zone business after the testing period.

Qualified zone property. For tax-exempt bond financing, qualified zone property is any depreciable real or tangible personal property if all the following are true.

1) You acquired the property after the zone or community designation is in effect.
2) You did not acquire the property from a related person or member of a controlled group of which you are a member.
3) Your basis in the property is not determined either by its adjusted basis in the hands of the person from whom you acquired it or under the stepped-up basis rules for property acquired from a decedent.
4) You were the first person to use the property in an empowerment zone or enterprise community.
5) At least 85% of the property's use is in an empowerment zone or enterprise community and in the active conduct of a qualified trade or business in the zone or community.

Used property may be qualified zone property if it has not previously been used within an empowerment zone or enterprise community.

Special rule for substantially renovated property. Property will be treated as having met requirements (1) and (4) if you substantially renovate the property. You substantially renovate property if, during any 24-month period beginning after the zone or community designation takes effect, your additions to the property's basis are more than the greater of the following amounts.

1) 15% (100% for bonds issued before August 6, 1997) of the adjusted basis of the property at the beginning of the 24-month period.
2) $5,000.

Special rule for bonds issued after July 30, 1996. Generally for bonds issued after July 30, 1996, property that you reasonably expect by exercising due diligence to be qualified zone property by an initial testing date will be treated as qualified zone property for the period before that date.

The ***initial testing date*** is generally the date that is 18 months after the later of the following dates.

1) The issue date of the bond issue financing the qualified zone property.

2) The date this property is first placed in service (or, if earlier, the date that is 3 years (5 years for certain construction projects) after the issue date).

However, the issuer of the bonds can choose to use any earlier date that comes after the bond issue date as the initial testing date.

Interest not deductible. No deduction will be allowed for interest on any financing provided from a bond if the interest accrues during the period beginning on the first day of the calendar year in which either of the following occurs.

1) Substantially all of the facility that was financed ceases to be used in an empowerment zone or enterprise community.

2) The principal user of the facility ceases to be an enterprise zone business.

This rule does not apply if the use of the facility ceases to qualify because of bankruptcy or the termination or revocation of the designation as an empowerment zone or enterprise community.

In addition, interest will remain deductible if the issuer and principal user try in good faith to meet the requirements and any failure is corrected within a reasonable period after discovery.

More information. For more information, see section 1394 of the Internal Revenue Code and the regulations under that section.

Renewal Communities

The Community Renewal Tax Relief Act of 2000 authorizes up to 40 renewal communities in which businesses will be eligible for tax incentives. The tax incentives will be available January 1, 2002, through December 31, 2009.

State and local governments will nominate areas to be designated as renewal communities. Each renewal community must meet eligibility criteria related to population, unemployment, poverty, and general distress.

The Secretary of HUD will designate the renewal communities by December 31, 2001. At least 12 of the designated renewal communities must be in rural areas.

The designation will generally remain in effect until December 31, 2009. The designation may be revoked if the state or local government modifies the boundaries of the area or does not keep certain commitments.

Businesses that qualify and operate in a renewal community will be eligible for the following tax incentives.

- Renewal community employment credit.
- Increased section 179 deduction.
- Commercial revitalization deduction.
- Capital gain exclusion.

Renewal Community Employment Credit

The renewal community employment credit provides businesses with an incentive to hire individuals who both live and work in a renewal community. You can claim the credit if you pay or incur “qualified wages” to a “qualified employee.” The credit is for wages paid or incurred after 2001.

The credit is 15% of the qualified wages paid or incurred during a calendar year. The amount of qualified wages you can use to figure the credit cannot be more than $10,000 for each employee for each calendar year. As a result, the credit can be as much as $1,500 (15% of $10,000) per qualified employee each year.

Qualified employee. A qualified employee is any employee who meets both of the following tests.

- The employee performs substantially all of his or her services for you within a renewal community and in your trade or business.
- While performing those services, the employee has his or her main home within that renewal community.

Both full-time and part-time employees may qualify.

Nonqualified employees. Certain individuals cannot be qualified employees. For a list of those individuals, see *Nonqualified employees* under *Empowerment Zone Employment Credit,* earlier.

Qualified wages. Qualified wages are any wages you pay or incur for services performed by an employee while the employee is a qualified employee (defined earlier). Wages are generally defined as those wages subject to the Federal Unemployment Tax Act (FUTA) without regard to the FUTA dollar limit.

Also treat as qualified wages certain training and education expenses you pay or incur on behalf of a qualified employee.

Effect of welfare-to-work or work opportunity credit. Qualified wages do not include any amount you take into account in figuring the welfare-to-work credit or the work opportunity credit. In addition, reduce the $10,000 maximum qualified wages for each qualified employee by the amount of wages you use to figure either of those credits for that employee.

Effect on salary and wage deduction. In general, you must reduce the deductions on your income tax return for salaries and wages and certain education and training costs by the amount of your renewal community employment credit.

Increased Section 179 Deduction

Section 179 of the Internal Revenue Code allows you to choose to deduct all or part of the cost of certain qualifying property in the year you place it in service. You can do this instead of recovering the cost by taking depreciation deductions over a specified recovery period. There are limits, however, on the amount you can deduct in a tax year.

You may be able to claim an increased section 179 deduction if your business qualifies as a renewal community business. The increase can be as much as $20,000 ($35,000 for 2002 and later years). This increased section 179 deduction applies to “qualified renewal property” you acquire after December 31, 2001, and before January 1, 2010, and place in service in a renewal community.

Renewal community business. For the increased section 179 deduction, a corporation, partnership, or sole proprietorship is a renewal community business if all the following statements are true for the tax year.

1) Every trade or business of the corporation or partnership is the active conduct of a qualified business (defined later) within a renewal community. (This rule does not apply to a sole proprietorship.)
2) At least 50% of its total gross income is from the active conduct of a qualified business within a renewal community.
3) A substantial part of the use of its tangible property is within a renewal community.
4) A substantial part of its intangible property is used in the active conduct of the business.
5) A substantial part of the employees' services are performed within a renewal community.
6) At least 35% of the employees are residents of a renewal community.
7) Less than 5% of the average of the total unadjusted bases of the property owned by the business is from:
    a) Nonqualified financial property (generally, debt, stock, partnership interests, options, futures contracts, forward contracts, warrants, notional principal contracts, and annuities), or
    b) Collectibles not held primarily for sale to customers.

For a sole proprietorship the term “employee” in (5) and (6) includes the proprietor.

Qualified business. A qualified business is generally any trade or business except one that consists primarily of the development or holding of intangibles for sale or license.

However, the rental to others of real property located in a renewal community is a qualified business only if the property is not residential rental property and at least 50% of the gross rental income from the property is from renewal community businesses.

The rental to others of tangible personal property is a qualified business only if at least 50% of the rentals of the property are to renewal community businesses or community residents.

Also, a qualified business does not include any business listed earlier in item (5) or item (6) under *Nonqualified employees* in the *Empowerment Zone Employment Credit* section.

Qualified renewal property. This is any depreciable tangible property if all the following are true.

1) You acquired the property after the renewal community designation is in effect.
2) You did not acquire the property from a related person or member of a controlled group of which you are a member.
3) Your basis in the property is not determined either by its adjusted basis in the hands of the person from whom you acquired it or under the stepped-up basis rules for property acquired from a decedent.
4) You were the first person to use the property in a renewal community.
5) At least 85% of the property's use is in a renewal community and in the active conduct of a qualified trade or business in the community.

Buildings are qualified renewal property, but they do not qualify for the section 179 deduction. Used property may be qualified renewal property if it has not previously been used within a renewal community.

More information. See the earlier discussion of the increased 179 deduction under *Empowerment Zones and Enterprise Communities* for a special rule for renovated property, the section 179 deduction limits, and the recapture rules, all of which also apply in renewal communities. That earlier discussion also tells where to get additional information about the section 179 deduction.

Commercial Revitalization Deduction

You can choose to treat qualified revitalization expenses chargeable to a capital account for any qualified revitalization building in either of the following ways:

1) Deduct half of the expenses for the tax year the building is placed in service, or
2) Amortize all the expenses over a 120-month period beginning with the month the building is placed in service.

Qualified revitalization building. This is a building and its structural components that you place in service in a renewal community before 2010. If the building is new, the original use of the building must begin with you. If the building is not new, you must substantially rehabilitate the building and then place it in service.

Qualified revitalization expense. This is an expense chargeable to a capital account for depreciable property that is:

1) Nonresidential real property, or
2) Section 1250 property that is related to nonresidential real property. Section 1250 property is depreciable real property that is not and never has been section 1245 property. Section 1245 property is defined in Publication 544, *Sales and Other Dispositions of Assets*.

Expenses that do not qualify. The following do not count as revitalization expenses.

1) The cost of acquiring a building that you substantially rehabilitate, to the extent that cost is more than 30% of the total qualified revitalization expenses for the building (not counting the cost of the building itself).
2) Expenses you use to figure any allowable credit.

Dollar limit. The total amount of qualified revitalization expenses for any qualified revitalization building cannot be more than the smaller of:

1) $10 million, or
2) The commercial revitalization expense amount allocated to the building by the commercial revitalization agency for the state in which the building is located.

More information. For more information, see section 1400I of the Internal Revenue Code.

Capital Gain Exclusion

If you hold a qualified community asset more than 5 years, you will not have to include any "qualified capital gain" from its sale or exchange in your gross income. This exclusion applies to an interest in, or property of, certain businesses operating in a renewal community.

Qualified community asset. The following are qualified community assets.

1) Qualified community stock.
2) Qualified community partnership interest.
3) Qualified community business property.

Qualified community stock. This is any stock in a U.S. corporation, if all the following requirements are met.

1) You acquired the stock after December 31, 2001, and before January 1, 2010, at its original issue solely in exchange for cash. (This requirement is also met if you acquired the stock before, on, or after January 1, 2010, from another person in whose hands it was qualified community stock).
2) The corporation was a renewal community business (or was being organized as a renewal community business) at the time the stock was issued.
3) The corporation qualified as a renewal community business during substantially all of your holding period for the stock. (This requirement is also met if the corporation ceased to qualify as a renewal community business after the 5-year period beginning on the date you acquired the stock. However, your qualified capital gain cannot be more than what it would have been if you had sold the stock on the date the corporation ceased to qualify).

Redemptions of stock. Stock will not qualify as qualified community stock if the issuing corporation makes certain redemptions of its stock within 2 years before or 2 years after the date the stock was issued. For details, see sections 1400F(b)(2)(B) and 1202(c)(3) of the Internal Revenue Code.

Qualified community partnership interest. This is any capital or profits interest in a U.S. partnership, if all the following requirements are met.

1) You acquired the partnership interest from the partnership after December 31, 2001, and before January 1, 2010, in exchange for cash.
2) The partnership was a renewal community business (or was being organized as a renewal community business) at the time the partnership interest was acquired.
3) The partnership qualified as a renewal community business during substantially all of your holding period for the partnership interest. (This requirement is also met if the partnership ceased to qualify as a renewal community business after the 5-year period beginning on the date you acquired the partnership interest. However, your qualified capital gain cannot be more than what it would have been if you had sold the partnership interest on the date the partnership ceased to qualify).

Redemptions of partnership interest. A partnership interest will not qualify as a qualified community partnership interest if the partnership makes certain acquisitions of its partnership interests within 2 years before or 2 years after the date the partnership interest was issued. For details, see sections 1400F(b)(3), 1400F(b)(2)(B), and 1202(c)(3) of the Internal Revenue Code.

Qualified community business property. This is tangible property that meets all the following requirements.

1) You acquired the property after December 31, 2001, and before January 1, 2010.
2) You did not acquire the property from a related person or member of a controlled group of which you are a member.
3) Your basis in the property is not determined either by its adjusted basis in the hands of the person from whom you acquired it or under the stepped-up basis rules for property acquired from a decedent.
4) You were the first person to use the property in the renewal community.
5) Substantially all of the use of the property was in your renewal community business during substantially all of your holding period for that property. (This requirement is also met if you stopped using the property in your renewal community business, or your business ceased to qualify as a renewal community business, after the 5-year period beginning on the date you acquired the property. However, your qualified capital gain cannot be more

than what it would have been if you had sold the property on the date you stopped using it in your renewal community business or on the date your business ceased to qualify).

Special rule for substantially improved buildings. Buildings (and land on which they are located) will be treated as having met requirements (1) and (4) if you substantially improve the buildings before January 1, 2010. You substantially improve a building if, during any 24-month period beginning after 2001, your additions to the basis of the property are more than the greater of the following amounts.

1) 100% of the adjusted basis of the property at the beginning of the 24-month period.
2) $5,000.

Renewal community business. This term is defined earlier under *Increased Section 179 Deduction.*

Qualified capital gain. This is generally any gain recognized on the sale or exchange of a capital asset or property used in a trade or business as defined in section 1231(b) of the Internal Revenue Code (generally real property or depreciable personal property). But it does not include any gain attributable to periods before 2002 or after 2014.

More information. For more information, see section 1400F of the Internal Revenue Code.

New Markets Credit

You can claim a tax credit for a qualified equity investment in a qualified community development entity made after December 31, 2000. This is called the new markets credit.

Amount of credit. You claim the credit over a period of up to 7 years. To find the amount of your credit each year, multiply the amount you paid the qualified community development entity for your investment by a percentage. The percentage is:

- 5% for the year the investment is made and each of the next 2 years, and
- 6% for each of the next 4 years.

Thus the credit totals 39% of your investment over a 7-year period.

To claim the credit for a year, you must hold the qualified equity investment on the credit allowance date for that year. The credit allowance date is the date you make the initial investment and each of the next 6 anniversary dates.

Qualified equity investment. Generally, this is the cost of any stock in a corporation or any capital interest in a partnership if the following requirements are met.

- The corporation or partnership is a qualified community development entity (defined next).
- You acquire the investment on the original issue date for cash.
- Substantially all of the cash is used to make qualified low-income community investments (defined later), or at least 85% of the entity's total gross assets are in qualified low-income community investments.
- The qualified community development entity designates the investment for purposes of the new markets credit.

Qualified community development entity. This is any U.S. corporation or partnership that meets the following requirements.

- Its primary mission is serving, or providing investment capital for, low-income communities or persons.
- It maintains accountability to residents of low-income communities through their representation on any governing or advisory boards of the entity.
- It is certified by the Secretary of the Treasury as a qualified community development entity.

Qualified low-income community investment. This means one of the following.

- Any capital or equity investment in, or loan to, any qualified active low-income community business (defined next).
- The purchase from another qualified community development entity of any loan made by that entity that is a qualified low-income community investment.
- Financial counseling and other services specified in regulations to businesses located in, and residents of, low-income communities.
- Any equity investment in, or loan to, any qualified community development entity.

Qualified active low-income community business. This is any corporation (including a nonprofit corporation), partnership, or sole proprietorship, if all the following statements are true for the tax year.

1) At least 50% of its total gross income is from the active conduct of a qualified business (defined next) within a low-income community.
2) A substantial part of the use of its tangible property (whether owned or leased) is within a low-income community.
3) A substantial part of the employees' services are performed in a low-income community.
4) Less than 5% of the average of the total unadjusted bases of the property of the business is from:
   a) Nonqualified financial property (generally, debt, stock, partnership interests, options, futures contracts, forward contracts, warrants, notional principal contracts, and annuities), or

b) Collectibles not held primarily for sale to customers.

Also, a business that would qualify if it were separately incorporated is treated as a qualified active low-income community business.

Qualified business. This is generally any trade or business except one that consists primarily of developing or holding intangibles for sale or license. However, the rental to others of real property located in a low-income community is a qualified business only if there are substantial improvements located on the property. Also, a qualified business does not include any business listed earlier in item (5) or item (6) under *Nonqualified employees* in the *Empowerment Zone Employment Credit* section.

Low-income community. A low-income community generally means any population census tract if any of the following apply.

- The poverty rate is at least 20%.
- If the tract is not located within a metropolitan area, the median family income is not more than 80% of statewide median family income.
- If the tract is located within a metropolitan area, the median family income is not more than 80% of the greater of the statewide median family income or the metropolitan area median family income.

Recapture. The credit is recaptured if, within the 7-year credit period, the community development entity is no longer qualified, substantially all of the proceeds of the investment are no longer used for a qualifying purpose, or the investment is redeemed.

More information. For more information about the new markets credit, see section 45D of the Internal Revenue Code.

Environmental Cleanup Cost Deduction

This deduction provides businesses with an incentive to clean up certain sites that are contaminated with hazardous substances. Your business does not have to be in an empowerment zone, enterprise community, or renewal community to qualify for this deduction.

You can choose to deduct "qualified environmental cleanup costs" in the tax year you pay or incur the cost. You can do this instead of adding the cost to the basis of your property (and, if the property is depreciable, recovering the cost by taking depreciation deductions over a specified recovery period).

This special tax treatment is generally available for qualified environmental cleanup costs you pay or incur after August 5, 1997, and before January 1, 2004.

Qualified environmental cleanup costs. Qualified environmental cleanup costs are generally costs you pay or incur to abate or control a hazardous substance (as defined by Internal Revenue Code section 198(d)) at a "qualified contaminated site."

Qualified contaminated site. A qualified contaminated site must meet both of the following requirements.

1) You hold it for use in a trade or business, for the production of income, or as inventory.
2) There has been a release, threat of release, or disposal of a hazardous substance at or on the site.

You must get a statement from the designated state environmental agency that the site meets requirement (2).

A site is not eligible if it is on, or proposed for, the national priorities list under section 105(a)(8)(B) of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980. To find out if a site is on the national priorities list, contact the U.S. Environmental Protection Agency.

Recapture. This deduction may have to be recaptured as ordinary income under section 1245 when you sell or otherwise dispose of the property that would have received an addition to basis if you had not elected this deduction.

More information. For more information about the environmental cleanup cost deduction, see section 198 of the Internal Revenue Code.

Qualified Zone Academy Bonds

Beginning in 1998, state or local governments can issue qualified zone academy bonds to raise funds for the use of a "qualified zone academy." However, these bonds require a private business contribution. Certain banks, insurance companies, and corporations actively engaged in the business of lending money can receive a tax credit as an incentive to hold these bonds. For more information about claiming the credit, see ***Form 8860.***

Contact the appropriate state or local government agency to find out if qualified zone academy bonds are available in your area.

Qualified zone academy. A qualified zone academy is a public school (or academic program within a public school) at the secondary level or below that meets certain requirements. It must be located in either an empowerment zone or an enterprise community, or there must be a reasonable expectation when the bonds are issued that at least 35% of the school's students (or program's participants) will be eligible for free or reduced-cost lunches under the school lunch program established under the National School Lunch Act. A qualified zone academy must also meet other requirements.

Private business contribution requirement. Before qualified zone academy bonds can be issued, the local educational agency (as defined in section 14101 of the Elementary and Secondary Education Act of 1965) must obtain written commitments from private entities

for qualified contributions with a present value (as of the bond issue date) of not less than 10% of the proceeds of the bond issue.

A qualified contribution is a contribution made with the approval of the local educational agency of any property or service from the following list.

1) Equipment for use in the qualified zone academy.
2) Technical assistance in developing curriculum or in training teachers to promote appropriate market driven technology in the classroom.
3) Services of employees as volunteer mentors.
4) Internships, field trips, or other educational opportunities outside the academy for students.
5) Any other property or service specified by the local educational agency.

More information. For more information about qualified zone academy bonds, see section 1397E of the Internal Revenue Code and the regulations under that section.

Work Opportunity Credit

The work opportunity credit provides businesses with an incentive to hire individuals from groups that have a particularly high unemployment rate or other special employment needs. Your business does not have to be in an empowerment zone, enterprise community, or renewal community to qualify for this credit. You can claim the credit if you pay or incur "qualified first-year wages" to a "targeted group employee."

At the time this publication was printed, this credit was set to expire for individuals who begin work for you after December 2001.

Targeted group employee. A targeted group employee is any employee who has been certified by your state employment security agency (SESA) as a:

1) Recipient of assistance under Temporary Assistance for Needy Families (TANF),
2) Veteran,
3) Ex-felon,
4) High-risk youth,
5) Vocational rehabilitation referral,
6) Summer youth employee,
7) Food stamp recipient, or
8) Supplemental security income (SSI) recipient.

The employee must meet the requirements explained in the instructions to Form 8850.

State certification required. An employee is not considered a targeted group employee without SESA certification. To receive certification, submit ***Form 8850*** to your SESA.

You must either:

1) Receive the certification by the day the individual begins work, or
2) Do both of the following:
   a) Complete Form 8850 by the day you offer the individual a job, and
   b) Submit the form to your SESA by the 21st day after the individual begins work.

Qualified first-year wages. Qualified first-year wages are qualified wages you pay or incur for work performed by a targeted group employee during the 1-year period beginning on the date the individual begins work for you. Qualified wages are generally wages subject to the Federal Unemployment Tax Act (FUTA) without regard to the FUTA dollar limit, but not more than $6,000 each tax year for each employee ($3,000 each tax year for a summer youth employee).

If the work performed by the employee during more than half of any pay period qualifies under FUTA as agricultural labor, the first $6,000 of that employee's wages subject to social security and Medicare taxes are qualified wages. For a special rule that applies to railroad employees, see section 51(h)(1)(B) of the Internal Revenue Code.

Nonqualified wages. See Form 5884 for a complete list of wages that do not qualify for the credit. Some of the most common wages that do not qualify include wages you pay or incur to an employee who:

1) Has worked for you for more than 1 year,
2) Is your relative or dependent,
3) You rehired, if he or she was not a targeted group employee when employed earlier, or
4) Does not work for you for at least 120 hours.

Amount of credit. The following table shows the rate you apply to qualified first-year wages you pay or incur each tax year to a targeted group employee who works the number of hours shown. The table also shows the maximum credit you can claim each tax year for each targeted group employee.

Table 2. Rate and Maximum Credit Each Tax Year for Each Targeted Group Employee

Hours Worked	Rate	Maximum Qualified First-Year Wages	Maximum Credit
At least 400	40%	$6,000*	$2,400
Fewer than 400 but at least 120	25%	6,000*	1,500

*$3,000 for a summer youth employee

Claiming the credit. Use ***Form 5884*** to claim this credit.

Effect on salary and wage deduction. In general, you must reduce the deduction on your income tax return for salaries and wages by the amount of your work opportunity credit.

Effect on empowerment zone and renewal community employment credits. Wages you use to claim the work opportunity credit cannot be used to figure the empowerment zone or renewal community employment credits. In addition, they reduce the maximum wage amount you can use to figure either of those credits.

Effect of welfare-to-work credit. You cannot claim both the work opportunity credit and the welfare-to-work credit for the same employee during the same tax year.

More information. For more information about the work opportunity credit, see Form 5884.

Welfare-to-Work Credit

The welfare-to-work credit provides businesses with an incentive to hire long-term family assistance recipients. Your business does not have to be in an empowerment zone, enterprise community, or renewal community to qualify for this credit. You can claim the credit if you pay or incur "qualified wages" during the first 2 years of employment to a "long-term family assistance recipient" who begins work for you after December 1997.

At the time this publication was printed, this credit was set to expire for individuals who begin work for you after December 2001.

Long-term family assistance recipient. A long-term family assistance recipient is an individual who has been certified by your state employment security agency (SESA) as a member of a family that:

1) Has received assistance payments from Temporary Assistance for Needy Families (TANF) for at least 18 consecutive months ending on the hiring date,
2) Receives assistance payments from TANF for any 18 months (whether or not consecutive) beginning after August 5, 1997, and is hired not more than 2 years after the end of the earliest 18-month period, or
3) Stops being eligible after August 5, 1997, for assistance payments because federal or state law limits the maximum period that assistance is payable, and is hired not more than 2 years after that eligibility for assistance ends.

State certification required. An individual is not considered a long-term family assistance recipient without SESA certification. To receive certification, submit ***Form 8850*** to your SESA.

You must either:

1) Receive the certification by the day the individual begins work, or
2) Do both of the following:
   a) Complete Form 8850 by the day you offer the individual a job, and
   b) Submit the form to your SESA by the 21st day after the individual begins work.

Qualified wages. Qualified wages are generally wages subject to the Federal Unemployment Tax Act (FUTA) without regard to the FUTA dollar limit, but not more than $10,000 each tax year for each employee.

If the work performed by the employee during more than half of any pay period qualifies under FUTA as agricultural labor, the first $10,000 of that employee's wages subject to social security and Medicare taxes are qualified wages. For a special rule that applies to railroad employees, see section 51A(b)(5)(C) of the Internal Revenue Code.

For this credit, qualified wages also generally include the following amounts paid or incurred by the employer that are normally excludable from the employee's gross income.

1) Amounts received for medical care under accident and health plans.
2) Employer-provided coverage under accident and health plans.
3) Certain amounts excludable under an educational assistance program, or that would be excludable but for the expiration of the exclusion. (At the time this publication was printed, this exclusion was set to expire for courses beginning after December 2001.)
4) Amounts excludable under a dependent care assistance program.

Nonqualified wages. See Form 8861 for a complete list of wages that do not qualify for the credit. Some of the most common wages that do not qualify include wages you pay or incur to an employee who:

1) Has worked for you for more than 2 years,
2) Is your relative or dependent,
3) You rehired, if he or she was not a long-term family assistance recipient when employed earlier, or
4) Does not either:
   a) Work for you for at least 180 days, or
   b) Complete at least 400 hours of service.

Amount of credit. The following table shows the rate you apply to the qualified wages you pay or incur during each year of employment. The table also shows the maximum credit you can claim each tax year for each qualified employee.

Table 3. Rate and Maximum Credit Each Tax Year for Each Long-Term Family Assistance Recipient

	Rate	Maximum Qualified Wages	Maximum Credit
Qualified first-year wages	35%	$10,000	$3,500
Qualified second-year wages ...	50%	10,000	5,000

Qualified first-year wages. Qualified first-year wages are qualified wages you pay or incur for work performed by a long-term family assistance recipient during the 1-year period beginning on the date the individual begins work for you.

Qualified second-year wages. Qualified second-year wages are qualified wages you pay or incur for work performed by a long-term family assistance recipient during the 1-year period beginning on the day after the last day of the first-year wage period.

Claiming the credit. Use ***Form 8861*** to claim this credit.

Effect on salary and wage deduction. In general, you must reduce the deduction on your income tax return for salaries and wages by the amount of your welfare-to-work credit.

Effect on empowerment zone and renewal community employment credits. Wages you use to claim the welfare-to-work credit cannot be used to figure the empowerment zone or renewal community employment credits. In addition, they reduce the maximum wage amount you can use to figure either of those credits.

Effect of work opportunity credit. You cannot claim both the welfare-to-work credit and the work opportunity credit for the same employee during the same tax year.

More information. For more information about the welfare-to-work credit, see Form 8861.

Indian Employment Credit

The Indian employment credit provides businesses with an incentive to hire certain individuals who live on or near an Indian reservation. Your business does not have to be in an empowerment zone, enterprise community, or renewal community to qualify for this credit. You can claim the credit if you pay or incur "qualified wages" to a "qualified employee."

At the time this publication was printed, this credit was set to expire for tax years beginning after 2003.

Qualified employee. A qualified employee, for any tax period, is any employee who meets all the following tests.

1) The employee is an enrolled member of an Indian tribe or the spouse of an enrolled member of an Indian tribe.
2) The employee performs substantially all of his or her services for you within an Indian reservation.
3) While performing those services, the employee has his or her main home on or near that reservation.

Also, more than 50% of the wages you pay or incur to the employee during the year must be for services performed in your trade or business.

Nonqualified employees. The following individuals are not qualified employees.

1) Any employee to whom you pay or incur wages (including wages for services outside an Indian reservation) at a rate that would cause you to pay the employee more than $30,000 if the rate applied for an entire year. (This wage limit may be adjusted for inflation for tax years beginning after 2000.)
2) Certain related taxpayers.
3) Certain dependents.
4) Any 5% owner.
5) Any individual who performs services involving certain gaming activities.
6) Any individual who performs services in a building housing certain gaming activities.

Qualified wages. Qualified wages are any wages you pay or incur for services performed by an employee while the employee is a qualified employee (defined earlier). Wages are generally defined as those wages subject to the Federal Unemployment Tax Act (FUTA) without regard to the FUTA dollar limit.

Also treat as qualified wages any qualified employee health insurance costs you pay or incur on behalf of a qualified employee. However, do not include any amount you pay or incur for health insurance under a salary reduction arrangement.

The total amount of qualified wages (including qualified employee health insurance costs) you can use to figure the credit cannot be more than $20,000 for each employee each tax year.

Effect of work opportunity credit. Qualified wages do not include any amount you pay or incur for work performed by a qualified employee during the 1-year period beginning on the date the individual begins work for you, if you use any part of these wages to claim the work opportunity credit.

Amount of credit. In most cases, the credit is 20% of the excess of your current year qualified wages and qualified employee health insurance costs over the sum of the corresponding amounts you paid or incurred during calendar year 1993.

Claiming the credit. Use ***Form 8845*** to claim this credit.

Effect on salary and wage deduction. In general, you must reduce the deductions on your income tax return for salaries and wages and health insurance costs by the amount of your Indian employment credit.

Early termination of employee. Generally, if you terminate a qualified employee sooner than 1 year after the date of initial employment, you cannot claim a credit for that employee for the tax year the employment is terminated. Also, you may have to recapture credits allowed in earlier years.

These rules do not apply in the following situations.

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

More information. For more information about the Indian employment credit, see Form 8845.

Depreciation of Property Used on Indian Reservations

Depreciation is a loss in the value of property over the time the property is being used. You can get back your cost of certain property by taking deductions for depreciation. This includes the cost of certain buildings and equipment you use in your business.

Special depreciation rules apply to qualified property that you place in service on an Indian reservation after 1993 and before 2004. These special rules allow you to use shorter recovery periods to figure your depreciation deduction for qualified property. As a result, your deduction is larger. Your business does not have to use the property in an empowerment zone, enterprise community, or renewal community to use these special rules.

Qualified property. Property eligible for the shorter recovery periods is 3-, 5-, 7-, 10-, 15-, and 20-year property and nonresidential real property. You must use this property predominantly in the active conduct of a trade or business within an Indian reservation. Real property you rent to others that is located on an Indian reservation is also eligible for the shorter recovery periods.

The following property is ***not*** qualified property.

1) Property used or located outside an Indian reservation on a regular basis, other than qualified infrastructure property.
2) Property acquired directly or indirectly from certain related persons.
3) Property placed in service for purposes of conducting or housing certain gaming activities.
4) Any property you must depreciate under the Alternative Depreciation System (ADS).

Qualified infrastructure property. Item (1) above does not apply to qualified infrastructure property located outside the reservation that is used to connect with qualified infrastructure property within the reservation.

Qualified infrastructure property is property that meets all the following requirements.

1) It is qualified property, as defined earlier (except that it is outside the reservation).
2) It benefits the tribal infrastructure.
3) It is available to the general public.
4) It is placed in service in connection with the active conduct of a trade or business within a reservation.

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

Recovery periods. The following table shows the shorter recovery periods you can use to depreciate qualified property.

Table 4. Recovery Periods for Qualified Property

Property Class	Recovery Period
3-year	2 years
5-year	3 years
7-year	4 years
10-year	6 years
15-year	9 years
20-year	12 years
Nonresidential real property	22 years

More information. For more information about depreciation, including the special rules that apply to property used on Indian reservations, see Publication 946.

Exclusion of Capital Gains From DC Zone Assets

If you hold a District of Columbia Enterprise Zone (DC Zone) asset more than 5 years, you will not have to include any “qualified capital gain” from its sale or exchange in your gross income. This exclusion applies to an interest in, or property of, certain businesses operating in the District of Columbia.

DC Zone Asset

A DC Zone asset is any of the following.

- DC Zone business stock.
- DC Zone partnership interest.
- DC Zone business property.

In determining whether any property is a DC Zone asset, continue to treat the DC Zone as an empowerment zone for years after 2003.

DC Zone business stock. DC Zone business stock is any stock in a U.S. corporation that is originally issued after 1997, if all the following requirements are met.

1) You acquired the stock before January 1, 2004, at its original issue solely in exchange for cash. (This requirement is also met if you acquired the stock before, on, or after January 1, 2004, from another person in whose hands it was DC Zone business stock.)
2) The corporation was a DC Zone business (or was being organized as a DC Zone business) at the time the stock was issued.
3) The corporation qualified as a DC Zone business during substantially all of your holding period for the stock. (This requirement is also met if the corpo-

ration ceased to qualify as a DC Zone business after the 5-year period beginning on the date you acquired the stock. However, your qualified capital gain cannot be more than what it would have been if you had sold the stock on the date the corporation ceased to qualify.)

Redemptions of business stock. Stock will not qualify as DC Zone business stock if the issuing corporation makes certain redemptions of its stock within 2 years before or 2 years after the date the stock was issued. For details, see sections 1400B(b)(2)(B) and 1202(c)(3) of the Internal Revenue Code.

DC Zone partnership interest. A DC Zone partnership interest is any capital or profits interest in a U.S. partnership that is originally issued after 1997, if all the following requirements are met.

1) You acquired the partnership interest from the partnership before January 1, 2004, in exchange for cash. (This requirement is also met if you acquired the partnership interest before, on, or after January 1, 2004, from another person in whose hands it was a DC Zone partnership interest.)
2) The partnership was a DC Zone business (or was being organized as a DC Zone business) at the time the partnership interest was acquired.
3) The partnership qualified as a DC Zone business during substantially all of your holding period for the partnership interest. (This requirement is also met if the partnership ceased to qualify as a DC Zone business after the 5-year period beginning on the date you acquired the partnership interest. However, your qualified capital gain cannot be more than what it would have been if you had sold the partnership interest on the date the partnership ceased to qualify.)

Redemptions of partnership interest. A partnership interest will not qualify as a DC Zone partnership interest if the partnership makes certain acquisitions of its partnership interests within 2 years before or 2 years after the date the partnership interest was issued. For details, see sections 1400B(b)(3), 1400B(b)(2)(B), and 1202(c)(3) of the Internal Revenue Code.

DC Zone business property. DC Zone business property is tangible property acquired after 1997 that meets all the following requirements.

1) You acquired the property before January 1, 2004. (This requirement is also met if you acquired the property before, on, or after January 1, 2004, from another person in whose hands it was DC Zone business property.)
2) You did not acquire the property from a related person or member of a controlled group of which you are a member.
3) Your basis in the property is not determined either by its adjusted basis in the hands of the person from whom you acquired it or under the stepped-up basis rules for property acquired from a decedent.
4) You were the first person to use the property in the DC Zone. (This requirement is also met if you acquired the property from another person in whose hands it was DC Zone business property.)
5) Substantially all of the use of the property was in your DC Zone business during substantially all of your holding period for that property. (This requirement is also met if you stopped using the property in your DC Zone business, or your business ceased to qualify as a DC Zone business, after the 5-year period beginning on the date you acquired the property. However, your qualified capital gain cannot be more than what it would have been if you had sold the property on the date you stopped using the property in your DC Zone business or on the date your business ceased to qualify.)

Special rule for substantially improved buildings. Buildings (and land on which they are located) will be treated as having met requirements (1) and (4) if you substantially improve the buildings before January 1, 2004. You substantially improve a building if, during any 24-month period beginning after 1997, your additions to the basis of the property are more than the greater of the following amounts.

1) 100% of the adjusted basis of the property at the beginning of the 24-month period.
2) $5,000.

DC Zone business. A DC Zone business for this capital gains exclusion is an enterprise zone business as defined earlier under *Increased Section 179 Deduction* in the discussion of empowerment zones, with the following exceptions.

- The 35% employee residence requirement listed in item (6) does not apply.
- The 50% of gross income requirement listed in item (2) is increased to 80%.
- No area other than the DC Zone can be treated as an empowerment zone or enterprise community.

For this purpose, the DC Zone is treated as including all census tracts in the District of Columbia with a poverty rate of 10% or more as determined by the 1990 census.

Qualified Capital Gain

Qualified capital gain is any gain recognized on the sale or exchange of a DC Zone asset that is a capital asset or property used in a trade or business as defined in section 1231(b) of the Internal Revenue Code (generally real property or depreciable personal property). But it does not include any of the following gains.

- Gain attributable to periods before 1998 or after December 31, 2008.
- Section 1245 gain. See chapter 3 in Publication 544, *Sales and Other Dispositions of Assets.*

- Section 1250 gain figured as if section 1250 applied to ***all*** depreciation rather than the additional depreciation. See chapter 3 in Publication 544.
- Gain attributable to real property or an intangible asset that is not an integral part of a DC Zone business.
- Gain attributable, directly or indirectly, in whole or in part, to a transaction with a related person. For the definition of a related person, see chapter 2 in Publication 544.

Other rules. Rules similar to certain rules in section 1202 of the Internal Revenue Code apply to interests in pass-through entities, certain tax-free transfers, contributions to capital after the original stock issuance date, and short positions.

How To Get Tax Help

You can get help with unresolved tax issues, order free publications and forms, ask tax questions, and get more information from the IRS in several ways. By selecting the method that is best for you, you will have quick and easy access to tax help.

Contacting your Taxpayer Advocate. If you have attempted to deal with an IRS problem unsuccessfully, you should contact your Taxpayer Advocate.

The Taxpayer Advocate represents your interests and concerns within the IRS by protecting your rights and resolving problems that have not been fixed through normal channels. While Taxpayer Advocates cannot change the tax law or make a technical tax decision, they can clear up problems that resulted from previous contacts and ensure that your case is given a complete and impartial review.

To contact your Taxpayer Advocate:

- Call the Taxpayer Advocate at **1–877–777–4778.**
- Call the IRS at **1–800–829–1040.**
- Call, write, or fax the Taxpayer Advocate office in your area.
- Call **1–800–829–4059** if you are a TTY/TDD user.

For more information, see Publication 1546, *The Taxpayer Advocate Service of the IRS.*

Free tax services. To find out what services are available, get Publication 910, *Guide to Free Tax Services.* It contains a list of free tax publications and an index of tax topics. It also describes other free tax information services, including tax education and assistance programs and a list of TeleTax topics.

Personal computer. With your personal computer and modem, you can access the IRS on the Internet at **www.irs.gov**. While visiting our web site, you can select:

- *Frequently Asked Tax Questions* (located under *Taxpayer Help & Ed)* to find answers to questions you may have.
- *Forms & Pubs* to download forms and publications or search for forms and publications by topic or keyword.
- *Fill-in Forms* (located under *Forms & Pubs)* to enter information while the form is displayed and then print the completed form.
- *Tax Info For You* to view Internal Revenue Bulletins published in the last few years.
- *Tax Regs in English* to search regulations and the Internal Revenue Code (under *United States Code (USC)).*
- *Digital Dispatch* and *IRS Local News Net* (both located under *Tax Info For Business)* to receive our electronic newsletters on hot tax issues and news.
- *Small Business Corner* (located under *Tax Info For Business)* to get information on starting and operating a small business.

You can also reach us with your computer using File Transfer Protocol at **ftp.irs.gov**.

TaxFax Service. Using the phone attached to your fax machine, you can receive forms and instructions by calling **703–368–9694.** Follow the directions from the prompts. When you order forms, enter the catalog number for the form you need. The items you request will be faxed to you.

Phone. Many services are available by phone.

- *Ordering forms, instructions, and publications.* Call **1–800–829–3676** to order current and prior year forms, instructions, and publications.
- *Asking tax questions.* Call the IRS with your tax questions at **1–800–829–1040.**
- *TTY/TDD equipment.* If you have access to TTY/TDD equipment, call **1–800–829–4059** to ask tax questions or to order forms and publications.
- *TeleTax topics.* Call **1–800–829–4477** to listen to pre-recorded messages covering various tax topics.

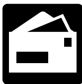
Evaluating the quality of our telephone services. To ensure that IRS representatives give accurate, courteous, and professional answers, we evaluate the quality of our telephone services in several ways.

- A second IRS representative sometimes monitors live telephone calls. That person only evaluates the IRS assistor and does not keep a record of any taxpayer's name or tax identification number.
- We sometimes record telephone calls to evaluate IRS assistors objectively. We hold these recordings no longer than one week and use them only to measure the quality of assistance.

- We value our customers' opinions. Throughout this year, we will be surveying our customers for their opinions on our service.

Walk-in. You can walk in to many post offices, libraries, and IRS offices to pick up certain forms, instructions, and publications. Also, some libraries and IRS offices have:

- An extensive collection of products available to print from a CD-ROM or photocopy from reproducible proofs.
- The Internal Revenue Code, regulations, Internal Revenue Bulletins, and Cumulative Bulletins available for research purposes.



Mail. You can send your order for forms, instructions, and publications to the Distribution Center nearest to you and receive a response within 10 workdays after your request is received. Find the address that applies to your part of the country.

- **Western part of U.S.:**
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- **Central part of U.S.:**
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  P.O. Box 8903
  Bloomington, IL 61702–8903
- **Eastern part of U.S. and foreign addresses:**
  Eastern Area Distribution Center
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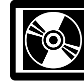
  Richmond, VA 23261–5074



CD-ROM. You can order IRS Publication 1796, *Federal Tax Products on CD-ROM,* and obtain:

- Current tax forms, instructions, and publications.
- Prior-year tax forms, instructions, and publications.
- Popular tax forms which may be filled in electronically, printed out for submission, and saved for recordkeeping.
- Internal Revenue Bulletins.

The CD-ROM can be purchased from National Technical Information Service (NTIS) by calling **1–877–233–6767** or on the Internet at **www.irs.gov/cdorders.** The first release is available in mid-December and the final release is available in late January.

IRS Publication 3207, *Small Business Resource Guide,* is an interactive CD-ROM that contains information important to small businesses. It is available in mid-February. You can get one free copy by calling **1–800–829–3676** or visiting the IRS web site at **www.irs.gov/prod/bus_info/sm_bus/smbus-cd.html.**

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