Questions and Answers on Renewal Community (RC) and Empowerment Zone (EZ) tax incentives

The first set of questions below pertains to Renewal Community and Empowerment Zone tax incentives. The second set of questions pertains to the Commercial Revitalization Deduction (CRD), an incentive available only in Renewal Communities.

1) What are Renewal Communities and Empowerment Zones?

Answer: Renewal Communities (RCs) and Empowerment Zones (EZs) are distressed urban and rural communities where qualifying businesses are eligible for billions of dollars in tax incentives. The Departments of Housing and Urban Development (HUD) and Agriculture (USDA) have designated RCs and EZs in three competitions since 1994. Currently, there are 40 HUD RCs, 28 of which are in urban areas and 12 in rural communities. There are 30 HUD EZs, all of which are in urban areas. There are 10 USDA EZs in rural communities only. A couple RCs have as few as approximately 100 businesses, while several RCs and EZs have more than 5,000 businesses. No RC or EZ has a population greater than 200,000.

2) What tax incentives are available to businesses that operate in Renewal Communities and Empowerment Zones and that hire residents of these areas?

Answer: Qualifying businesses in EZs are eligible for employment credits (up to $3,000 yearly per EZ resident employed). Qualifying EZ businesses are also eligible for low-cost loans through EZ facility bonds, increased Section 179 tax deductions, partial-exclusion of tax on capital gains upon the sale of certain assets, and other incentives. Qualifying businesses in RCs are also eligible for employment credits (up to $1,500 yearly per RC resident employed). Qualifying RC businesses are also eligible for a 0% tax on the capital gains of assets sold, provided the business holds the asset at least five years. Businesses in RCs that build or substantially rehabilitate commercial property may also be eligible for up to $10 million in Commercial Revitalization Deductions to rapidly increase their depreciation schedules. For detailed information on all RC/EZ tax incentives, including which tax forms to file to claim the incentives, read IRS Publication 954, *Tax Incentives for Distressed Communities*, available on the IRS website at www.irs.gov.

3) How does a businesses know if it is located in a Renewal Community or Empowerment Zone or if the employees live in these areas?

Answer: Each month, tens of thousands of business owners and their tax preparers use HUD's Internet-based Address Locator every month to determine if specific addresses are located in Renewal Communities or Empowerment Zones. HUD's Address Locator is available at www.hud.gov/crlocator.

4) What is the geography of an RC/EZ or EC?

Answer: Census tracts define RC/EZ and ECs. The Census Bureau defines these areas to collect data and make generalizations for an area. A census tract on average has about 4,000 residents but can have much more or no residents at all. They bear no relationship to Zip Codes, which are simply a number assigned to postal routes that change on demand.

5) How does HUD's Address Locator work?

Answer: HUD's Internet-based address locator allows any user to put in an address and find out if that address is in an RC or EZ. Usually, the tool takes the address, finds out approximately what street it is on and then asks which census tract includes that part of the street. These address locators are not a list of addresses. They are lists of census tracts. Remember that these locators only tell you the location of an address with respect to the RC or EZ. It is not a final eligibility determination for any given Federal, state or local program. Please contact a qualified professional or appropriate agency if you have program or tax incentive eligibility questions.

6) Why does the HUD locator make mistakes?

Answer: When a user asks if an address is in a federally designated area, it places the census tract-based designation layer on top of a layer of streets to get a yes or no answer. Although Census tracts generally follow street lines, 1990 tracts are not uniformly well defined. This means that in some areas, not all tract boundaries are created equally and thus it's not always possible to match them up to streets that are defined with current, precise geography. Furthermore as new streets are added, old streets are deleted and in some cases whole cities are resurveyed with a new longitude and latitude. Data providers no longer update streets that look to 1990 census geography. Thus, for addresses on the edge of your RC/EZ or EC, errors are inevitable. For more information see the locator disclaimer at www.hud.gov/crlocator.

7) How else can I verify an address?

Answer: In cases where the HUD address locator is giving contradictory information, the HUD locator has a help desk at (202) 245-1299 or email: egis@hud.gov where you can ask questions to resolve issues.

The US Census Bureau directs citizens to the Federal Financial Institutions Examination Council's (FFIEC) Web site to verify the location of an address in a 1990 census tract (http://www.ffiec.gov/geocode/default.htm). You must select year 2002 to get a return against a 1990 tract number. The FFIEC print out will tell you the census tract number, at which point you can cross check it against HUD and USDA's census tract list.

The US Census Bureau has placed archival information about 1990 census geography on the American Fact Finder. You can input an address and it will generate a map centered on the address with a 1990 census tract label. Here are the steps to do this:

1) Go to American Fact Finder on the web at http://factfinder.census.gov
2) Go to Data Sets (right side column)
3) Scroll down to the 1990 data (it does not matter which file you select)
4) Choose "Reference Maps"
5) Make sure the Legend is giving you 1990 boundaries
6) Scroll to bottom of the page
7) Type in an address and it will lead you to the 1990 Tract

Here's a direct link to the page:
http://factfinder.census.gov/servlet/ReferenceMapFramesetServlet?caller=dataset&tree_id=1110&bucket_id=40&_lang=en&_ts=97071095543

The RC and EZ directors can assist with visual or onsite verification. Contact information is available both on the locator and the HUD or USDA Community Renewal program websites, found at www.hud.gov/cr and www.ezec.gov, respectively. Alternatively, if you have a 1990 census tract map of your area, and can determine where your address falls, you may be able to do a visual verification for yourself.

8) Can I get a list of the census tracts that form the RCs and EZs?

Answer: The Community Renewal Website provides lists of census tracts that comprise each RC and EZ. To find these lists, take the RC/EZ/EC web tour at http://www.hud.gov/offices/cpd/economicdevelopment/programs/rc/tour/index.cfm, select a state and then select an RC or EZ from the subsequent page that appears. You will see a new web page for the designated RC or EZ and an option to view the census tracts for the designated area.

9) Can I get a list of Zip Codes in the RC or EZ?

Answer: Since RCs and EZs are built out of census tracts, the address locator contains a list of census tracts, not zip codes or addresses. HUD has compiled a list of all Zip Codes that include a portion of RC and EZ tracts but cannot guarantee accuracy. Be advised that this list only gives you zips that may fall within the RC or EZ because the area covered by this Zip Code list is substantially larger than the actual RC or EZ area. If your zip code is not on the list, there is still a chance it could fall in the RC or EZ because the US Post Office may add or change zip codes at any time. HUD understands that some wage credit consultants use zip codes to prescreen addresses before checking them against the address locator, but this practice may result in errors as zip codes change. HUD doesn't recommend using Zip Codes to identify locations in an RC or EZ.

10) How do I become an RC or EZ?

Answer: Congress has authorized three rounds of competitions thus far for RC, EZ and/or EC designations, in 1994, 1998 and 2001. If Congress authorizes another round, HUD will publish a notice inviting applications in the Federal Register. Information will also be available on the Community Renewal website at www.hud.gov/cr, list serve and at www.grants.gov. Please note that only local governments, tribal governments and states can apply for RC or EZ designation.

HUD's Office of Community Renewal occasionally has news of interest to audiences outside of our network of RC, EZ and EC contacts. We have compiled a list of these groups of tax professionals, wage credit consultants, local governments interested in seeking a designation, and private and non-profit partners. HUD will use this list to send announcements about changes in designated areas, notices inviting application, new publications or upcoming training. Click **here** to place your name on this list.

11) What documents does the IRS require businesses to keep for their records regarding residence in an RC or EZ?

Answer: IRS publication 954 cites the HUD RC/EZ Address Locator as the tool to use to determine if an address is in an RC or EZ. Please contact your tax preparer or the IRS for further clarification on what information to keep in your records. You can call the IRS at 800-829-4059 or visit its website at www.irs.gov.

12) What are the dates of designation for the RC/EZ/ECs?

Answer: The designation dates are listed in the table below. Please note that the designation date is the effective date of the designation, not the date of announcement.

Round	Type	Designation	Designation Date	End Date
N/A	Rural	Renewal Community	12/31/01	12/31/09
N/A	Urban	Renewal Community	12/31/01	12/31/09
1	Rural	Enterprise Community	12/21/94	12/31/04
1	Urban	Enterprise Community	12/21/94	12/31/04
1	Urban	Enhanced Enterprise Community	12/21/94	12/31/04
1	Rural	Empowerment Zone	12/21/94	12/31/09
1	Urban	Empowerment Zone	12/21/94	12/31/09
2	Rural	Enterprise Community	12/31/98	12/31/08
2	Rural	Empowerment Zone*	12/31/98	12/31/09
2	Urban	Empowerment Zone*	12/31/98	12/31/09
3	Rural	Empowerment Zone	01/01/02	12/31/09
3	Urban	Empowerment Zone	12/31/01	12/31/09
2	Urban	Enterprise Zone (DC Only)	01/01/98	12/31/05
1	Urban	DC Enterprise Community	12/21/94	12/31/04
1	Urban	Cleveland Empowerment Zone**	01/01/00	12/31/09
1	Urban	Los Angeles Empowerment Zone**	01/01/00	12/31/09

*Round II EZs did not receive the EZ employment credit until January 1, 2002.
**Cleveland and Los Angeles executed Supplemental Empowerment Zone EDI/108 grant agreements in 1995.

13) Can a business benefiting from RC tax credits transfer those credits to another business entity, i.e., a flow-through entity?

Answer: No. There is no provision in the Internal Revenue Code that allows one entity to transfer an unused RC employment credit to another entity.

14) With respect to the employment credit, can an employer count the time an employee is on a tour boat in, for example, Lake Champlain that starts and stops its tours in the RC?

Answer: To qualify for the credit, substantially all of the services performed by the employee for the employer must be performed within the RC. Any services that are performed outside of the RC's geographic boundaries would not count under this test.

15) Can real estate professionals qualify as Renewal Community businesses?

Answer: Yes, provided the property owned by the real estate professional is not residential rental property and at least 50% of the gross rental income from the lessees is from RC businesses. Note that property is residential rental property only if at least 80% of the gross rental income from the property is from dwelling units.

16) Can a bank, located in an RC with more than 35% of it's employees being in the RC and doing more than 50% of its business in the RC, meet the definition of an RC business? This question arises since the provision stating that less than 5% of the aggregate adjusted bases of the property of the business must be attributable to "non qualified financial property" is unclear. What type of business is this provision referring to?

Answer: No, unless less than 5% of the bank's average aggregate unadjusted bases are attributable to nonqualified financial property. Nonqualified financial property includes debt and other similar property (other than accounts or notes receivable from sales or services). There is no explanation in the Congressional Committee Reports as to the types of businesses targeted by this provision.

17) A company is located in an Empowerment Zone and leases employees from a third party employer that is located outside the EZ. The company pays the third party employer a fee that includes gross wages, payroll taxes and administrative fees. These leased employees are residents of the EZ and work 100% of their available time at the company. Who can take advantage of the EZ Employment Credit - the company or the third party employer?

Answer: Only the employer for Federal employment tax purposes is eligible for the credit. See IRS Publication 15-A for more information on the treatment of leased employees for employment tax purposes.

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

Answer: No. Wages must be paid to a qualified zone employee to qualify for the credit. To be a "qualified zone employee," the employee must live in the same EZ or RC in which substantially all of the services are performed for the employer. (See Internal Revenue Code section 1396(d)(1)).

19) To qualify as an EZ or RC business, based on the percentage requirements, can investments and employees be in multiple designated RCs or EZs?

Answer: Yes, except that the tests for RCs and EZs must be figured separately (i.e., you can aggregate RCs with other RCs, but not with EZs, and vice versa). (See Internal Revenue Code sections 1397C and 1400G).

20) In what manner can national or international conglomerates participate in this program if they have a plant or plants located in the RC?

Answer: To qualify as an RC business, a large business can set up a separate legal entity (e.g., a subsidiary or partnership). Activities of legally separate (even if related) parties are

not aggregated for purposes of determining whether an entity qualifies as an Enterprise Zone (or RC) business. (See Public Law 103-66, House Committee Report).

21) With respect to EZ or RC Employment Credits, is the 90-day period calculated based on the calendar, or on days worked?

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

22) Do you count family members as employees in determining if the business is considered a Renewal Community Business? For example, if a business located in the RC has ten employees, four of whom are family members who live in the RC, how many employees need to live in the RC in order to be considered an RC Business? Would it be 35% of 10 employees or 35% of 6 employees?

Answer: Employees who are also family members count for purposes of the 35% test. So, in the example, you would base the test on 10 employees.

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

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

23) Are tips considered Qualified Wages in order to determine the RC Employment Credit?

Answer: No. Wages are defined in IRC section 1397 by reference to Internal Revenue Code (IRC) section 51, which in turn defines them by reference to IRC section 3306(b). Because tips are counted as wages under IRC section 3306(s), not IRC section 3306(b), tips do not count as wages for figuring the RC employment credit.

24) The 0% capital gains benefit is available to "Renewal Community businesses". What happens if, during the 5-year period that the asset must be held, the status of the business changes? For example, a business buys a building 1/1/2002 and meets the RC Business definition during 2002, 2003, 2004, but doesn't meet the definition in 2005 and 2006. The business sells the property in 2007 after holding it five years. Does the business still get the 0% capital gains tax rate on the profits?

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

What about a scenario where the business meets the criteria for an RC business in 2002 and '03, doesn't meet it in '04, but regains the status for '05 and '06, and sell in '07 while it still meets the criteria. Does the business get the 0% capital gains tax rate on the profits?

Answer: To qualify for the capital gain exclusion, substantially all of the use of the property during substantially all of the taxpayer's holding period must have been in an RC business. Because "substantially all" is not defined in the Code for this purpose, it is unclear if qualifying as an RC business in 4 of 5 years would be considered "substantially all" of the taxpayer's holding period.

25) Based on the 1990 Census Tract data, one major employer's address is located in the RC. The firm has several adjacent buildings connected by pedestrian walkways that are physically located outside the RC, simply by the demarcation lines of the census tract. If all the connected buildings have one central address, however, that is located in the RC, can all the buildings be considered to be inside the RC?

Answer: Under Internal Revenue Code section 1397C(f), if a business uses real property located both within and outside an RC, and the amount of the real property located within the RC is "substantial" when compared to amount of the real property located outside the RC and contiguous to the real property within the RC, the contiguous property is treated as being within the RC. However, this rule applies only for purposes of defining a "Renewal Community business." For any other purpose, the taxpayer can get an answer by submitting a private letter-ruling request to the IRS.

26) If the tax year for a business were other than the calendar year, when would the business claim the RC/EZ wage credits? For example, if the business's fiscal year runs from October 1, 2001 through September 30, 2002, should it claim all credits earned during this period when it files its 2002 tax return or should it claim the October - December 2001 credits in its 2001 tax return and then claim the January - September 2002 credits in its 2002 tax return?

Answer: The credit is based on the qualified wages paid or incurred during the <u>calendar year</u> that <u>ends during</u> the taxpayer's <u>fiscal year</u>.

EXAMPLE: For a taxpayer with a fiscal year ending on September 30, the credit for <u>calendar year</u> 2003 wages is claimed on Form 8844 for the <u>fiscal year</u> that begins October 1, 2003 and ends on September 30, 2004. That's because December 31, 2003 falls within the fiscal year ending September 30, 2004.

Therefore, for wages paid or incurred from January 1 - December 31, 2003 (RC/EZ employment credit only), the credit would be claimed on the return for the fiscal year that begins on October 1, 2003, and ends on September 30, 2004. For the wages paid or incurred from January 1 - December 31, 2004, the credit would be claimed on the return for the fiscal year that begins on October 1, 2004, and ends on September 30, 2005. Therefore, even though the taxpayer's <u>deduction</u> is for fiscal year wages, the <u>credit</u> is for calendar year wages.

NOTE: This rule applies <u>only</u> to the RC and EZ employment credit. The work opportunity tax credit, welfare-to-work credit, and Indian employment credit all use <u>fiscal year</u> wages.

27) In an Empowerment Zone of less than or equal to 100,000 people, is the total allocation of EZ facility bonds $130 million?

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

28) Can a building construction site in an RC qualify for RC employment credits?

Answer: The RC employment credit is available for any employee that performs substantially all of its services during the period in the RC and also lives in the RC. The IRS has interpreted the language "the period" to include pay periods. So if an employee is working at a construction site for substantially all of specified pay periods, the wages paid during those pay periods would be qualified wages eligible for the 15% credit up to $10,000 per year in wages. The employee must live the in the RC that same time period.

29) To qualify for the zero-percent capital gains rate, what percentage of a business's gross income must come from the active conduct of business within the RC, is it 50% or 80%?

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

30) Are the employers and employees that use the Renewal Community and Empowerment Zone tax incentives required to be residents of the United States?

Answer: For purposes of figuring the RC and EZ credits and deductions, neither the owner nor the employees are required to be U.S. citizens.

31) With regard to the RC or EZ employment credits, what does "substantially all" mean in regards to services performed? How does a company determine if an employee meets this test?

Answer: Although there is no published guidance on this question that specifically relates to the renewal community employment credit, the IRS recently ruled that "substantially all" means "80% or more" as it relates to identical statutory language regarding services performed by New York Liberty Zone business employees for purposes of the work opportunity credit. So, in the absence of any other guidance, it would not be unreasonable to apply that same percentage for purposes of the RC employment credit.

32) Could a tax-exempt organization take advantage of the RC or EZ employment credits?

Answer: "Tax-exempt organizations (other than farmers' cooperatives) are not eligible to claim the RC employment credit."

33) What if a sister of the employer works at a company that wishes to use the RC or EZ employment credits – if she is married and files her taxes separately from the employer, will she qualify under the employment credit rules?

Answer: No. Under IRC section 152(a)(3), wages paid to brothers, sisters, stepbrothers, and stepsisters of the taxpayer are not qualifying wages for purposes of the empowerment zone employment credit or the renewal community employment credit. Other subsections of section 152 prohibit the credit for any wages paid to sons, daughters, stepsons, stepdaughters, a father or mother (or an ancestor of either), a stepfather or stepmother, aunts, uncles, nieces, nephews, and various in-laws.

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

Answer: Schedule D or Form 4797 is used (i.e., the same form that would normally used in the absence of a rollover). The instructions for reporting the rollover of gain on the sale of EZ assets for Schedule D filers are in IRS Publication 550.

35) The RC/EZ wage credits indicate the employee must live in the EZ/RC. How, then, would an RC or EZ use these credits when providing employment for a homeless individual?

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

36) The rules on the Work Opportunity Tax Credit (WOTC) mention many groups from which prospective employees must come (ex-felons, veterans, recipient of TANF funds, etc.) but don't mention homeless. Would an employer qualify for WOTC simply because an employee is homeless, or must the homeless person also meet one of the other conditions?

Answer: An employer cannot claim the WOTC for wages paid to a homeless individual just because he or she is homeless. The individual MUST be a member of a targeted group for the employer to qualify for the WOTC.

37) If an employer pays unemployment tax, are they qualified to claim the credits on an employee that files a Form 1099?

Answer: No. An employee doesn't receive a 1099. 1099's are to report amounts paid to contractors, not employees. If all people performing services for the company are getting 1099s, then the company isn't even an employer. The wages must be subject to Federal Unemployment Tax (FUTA), not have FUTA voluntarily paid on them. Wages subject to FUTA are wages to employees, and are also subject to FICA. The amounts paid must be wages paid to employees and be subject to (legally, not voluntarily) both FICA and FUTA.

The definition uses FUTA only because that is generally the standard used to determine whether wages are subject to other things, including FICA.

38) I see that "certain cooperatives" may qualify to use RC and EZ employment credits? What cooperatives would these be? Are telephone and electrical cooperatives included?

Answer: No. The cooperative must be a cooperative described in section 521, farmer's cooperatives.

39) What documentation is required if employer wants to claim the RC wage credit? If the business have employee records showing residence during employment is this sufficient?

Answer: There's no pre screening for the RC wage credit. The taxpayer files would need a signed statement by the employee attesting to residence, which is usually found in the employment application. At some point, the taxpayer would have to determine if the residence is in the zone, but the IRS would only check this during an audit. Most use the HUD address locator available from our website at www.hud.gov/cr. There are also consulting firms who verify addresses.

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

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

41) If an employee begins work toward the end of the year, say Nov. 1, 2005, can an employer claim the RC employment credit on that person for wages earned in 2005 if by tax time the employee has worked the requisite 90 days?

Answer: The 90-day requirement does not need to be met by the end of the calendar year in which the person was hired. It only needs to be met before a credit is claimed on an original or amended return for that employee.

42) If a person buys a restaurant, can he or she qualify the employees under the WOTC as a new employee, even if the employee was already working at the restaurant prior to the new owner purchasing the restaurant?

Answer: No. Under Internal Revenue Code section 51(k)(1) and Regulations section 1.51-1(h), the 1-year period for a successor employer begins on the date the employee first began work for the previous employer and any qualified first-year wages paid by the successor

employer are reduced by the qualified first-year wages paid by the previous employer. The same rule applies for purposes of the welfare-to-work credit.

The definition of ***successor*** employer is an employer that acquires substantially all of the property used in a trade or business (or a separate unit thereof) of another employer (the ***previous*** employer) and immediately after the acquisition the successor employs in his trade or business an individual who was employed immediately prior to the acquisition in the trade or business of the previous employer.

The remaining questions and answers pertain to the Renewal Community Commercial Revitalization Deduction (CRD):

1) Are CRD allocations made only after projects are placed into service so that actual costs are used, or are allocations based on estimated costs?

Answer: The statute does not require allocations to be based on either actual or estimated costs. All allocations must be made pursuant to a qualified allocation plan approved by the governmental unit of which the agency is a part. The governmental unit may approve the plan only after a public hearing has been held following reasonable public notice.

2) If the commercial revitalization agency for the state allocates, for example, $8M of an available $12M to one project, does the entire $8M count against the total available allocation of $12M for that year, regardless of the deduction method used by the business (50% in 1st year or 10% over 10 years)? Also, would the amount of allocation for the RC the next year be impacted by the amount and deduction method (i.e. 50%, 10%) used by the business in the RC the previous year?

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

3) The CRD states that a company can exercise one of two options for taking accelerated deductions, (1) a 50% write off, or (2) a 100% write off of "all of its investment over a 10 year period". Is the stipulation under (2) limited to the $10.0 million per project cap, or if a company had an expense of, for example, $38 million, could it write off (depreciate) this entire amount over a 10-year period?

Answer: No. Under either method, the company cannot take accelerated deductions in excess of the expenditure amount allocated to the building by the CRA (or $10 million, if less). The remaining expenditures must be capitalized and depreciated under the applicable MACRS recovery period (generally 39 years).

4) If an RC is not able to award the total of $12 million in any given year, is there a carry forward provision to the next year?

Answer: No.

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

Answer: Yes. The deduction is allowed ratably over a 120-month period.

6) Can a business take the CRD together with Historic Tax Credits?

Answer: Under section 1400I (CRD), qualified revitalization expenditures do not include any expenditure that the taxpayer may take into account in computing any credit allowable under the Internal Revenue Code unless the taxpayer elects to take the expenditure into account only for purposes of section 1400I. See section 1400I(b)(2)(B)(ii). Accordingly,

the same expenditures cannot be used for the CRD and for the rehabilitation credit under section 47 (which includes the credit for certified historic structures).

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

Answer: The CRD applies to any nonresidential real property. Nonresidential real property is any real property other than (a) residential rental property or (b) property with a class life of less than 27.5 years. Residential rental property is a building or structure for which at least 80% of the gross rental income is rental income from dwelling units. Therefore, if less than 80% of a building's gross rental income were rental income from dwelling units, the building would qualify for the CRD.

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

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

9) What forms are required to claim the Commercial Revitalization Deduction?

Answer:

- If the 50% deduction is claimed, it will be claimed under "other deductions" or "other expenses" on the taxpayer's income tax return or business schedule (e.g., Schedule C).
- If amortization over a 120-month period is claimed, the deduction is claimed on line 42 of Form 4562 (for the first tax year) and also on the "other deductions" or "other expenses" line of the taxpayer's income tax return or business schedule.
- For partners and S corporation shareholders, the deduction will be included in the net income or loss claimed in Part II of Schedule E (Form 1040).
- Form 8582 must also be used to claim the special $25,000 allowance if the CRD is from a passive rental real estate activity. The $25,000 allowance for the CRD applies to all taxpayers regardless of their AGI.

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

Answer: Yes.

11) Does the tax code require RC states to adopt the CRD (and other RC incentives) for state tax purposes -- so that when a business determines their federal taxable basis with use of RC deductions - that taxable basis is carried over to the state tax return? (This doesn't pertain to the state process for allocating credits - rather a state's recognition of federal tax incentives for the state's taxable basis.)

Answer: No. No provision of the Internal Revenue Code requires any state to follow Federal income tax law for state purposes.

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

Answer: No provision in the Internal Revenue Code allows a reallocation of unused CRD allocations. Therefore, the allocation would be lost forever.

13) What should the CRA give to businesses that receive a CRD allocation? Is there a required form or letter from the CRA to substantiate the allocation?

Answer: No specific form is available or under development to inform the taxpayer of an allocation. A letter or other notice signed by an authorized CRA official reporting the date and dollar amount of the allocation, the address of the building, and the name and address of the owner of the building would be a valid allocation as of the date it is mailed to the building owner.

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

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

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

15) A developer is looking to build a new $7 million hotel in the RC. One-half of the building will be in the RC with the remainder outside the RC. Would this business qualify for the commercial revitalization credit or a pro-rata portion or not at all?

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

16) Since 2005, HUD has expanded the boundaries of approximately 20 Renewal Communities. Is it possible for businesses in the expanded areas to claim any unused Commercial Revitalization Deduction allocations from 2003-2005? Yes, it is possible for businesses in the expanded Renewal Community areas to apply for these unused allocations. Renewal Community leaders, business owners, and their tax preparers should review Internal Revenue Bulletin 2006-9, dated February 27, 2006, for instructions on how business can apply for these unused allocations.