

Notice of Proposed Rulemaking and Notice of Public Hearing

Empowerment Zone Employment Credit

REG-209834-96

AGENCY: Internal Revenue Service (IRS), Treasury

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to the period employers may use in computing the empowerment zone employment credit under section 1396 of the Internal Revenue Code. These proposed regulations reflect and implement certain changes made by the Omnibus Budget Reconciliation Act of 1993 (OBRA '93). They affect employers of employees who live and work in an empowerment zone designated under the statute. These proposed regulations provide employers with the guidance necessary to claim the credit. This document also provides a notice of public hearing on these proposed regulations.

DATES: Written comments are due on March 17, 1997. Outlines of oral comments to be presented at the public hearing scheduled for 10:00 a.m. on Wednesday, May 7, 1997, must be received by Wednesday, April 16, 1997.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-209834-96), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, D.C. 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-209834-96), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/prod/tax_regs/comments.html. The public hearing will be held in room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Robert G. Wheeler, (202) 622-6060; concerning submissions and the

hearing, Michael Slaughter, (202) 622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) relating to the empowerment zone employment credit under section 1396. Sections 1391 through 1397D (relating to empowerment zones and enterprise communities) were added to the Internal Revenue Code by the Omnibus Budget Reconciliation Act of 1993 (OBRA'93). Section 1397D of the Code authorizes the Secretary of the Treasury to prescribe regulations that may be necessary or appropriate to carry out the purposes of section 1394 through 1397C.

The amount of the empowerment zone employment credit under section 1396 is equal to a specified percentage of qualified zone wages, which are certain wages paid or incurred by an employer for services performed by a qualified zone employee. Questions have arisen about the definition of a "qualified zone employee" in section 1396(d). In particular, questions have been raised about the appropriate period under section 1396(d)(1)(A) during which substantially all of the services performed by an employee for his or her employer must be performed within an empowerment zone in a trade or business of the employer.

In Notice 96-1, 1996-3 I.R.B. 30, the IRS announced its intention to publish a notice of proposed rulemaking that would clarify the relevant period for this purpose. Notice 96-1 described a rule under which employers would have a choice about what period to use, and invited comments on this and any other related issues for which guidance would be helpful to employers. No comments were received. These proposed regulations set forth the rule described in Notice 96-1.

Explanation of Provisions

Under the proposed regulations, an employer may use either each pay period or the entire calendar year as the relevant period in determining whether a particular employee performed substantially all of his or her services within an empowerment zone (the "location-of-services" requirement). For each taxable year the employer must use the same

method for all its employees, but the employer may change methods from one year to the next.

In addition to comments on the relevant period for applying the location-of-services requirement, Treasury and IRS request comments on other issues relating to the empowerment zone employment credit with respect to which guidance may be helpful to employers. In particular, comments are requested on whether the final regulations should include guidance on (1) the meaning of "substantially all" in the location-of-services requirement, or (2) a provision authorizing employers to rely on employee certifications to demonstrate compliance with the requirement that a qualified zone employee's principal place of abode be in an empowerment zone. In this regard, commentators may wish to consider analogous provisions in the final regulations under § 1.1394-1 on enterprise zone facility bonds (T.D. 8673, 61 FR 27258, May 31, 1996).

Some taxpayers and their representatives have asked whether there is any requirement that an employee's status as a qualified zone employee be certified by a third party in a fashion similar to the eligibility certifications required under the targeted jobs tax credit (prior to its expiration on December 31, 1994). There is no such requirement.

Proposed Effective Date

These proposed regulations are proposed to be effective December 21, 1994, the date on which the nine empowerment zones authorized by OBRA'93 were designated by the Secretaries of Housing and Urban Development and Agriculture.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy

of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (preferably a signed original and eight (8) copies) that are timely submitted to the IRS. All comments will be available for public inspection and copying.

A public hearing has been scheduled for Wednesday, May 7, 1997 in room 2615, Internal Revenue Building, 1111 Constitution Avenue NW, Washington, DC. Because of access restrictions, visitors will not be admitted beyond the building lobby more than 15 minutes before the hearing starts.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons that wish to present oral comments at the hearing must submit written comments and an outline of topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies by Wednesday, April 16, 1997).

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Robert G. Wheeler, Office of Associate Chief Counsel, Employee Benefits and Exempt Organizations. However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1 — INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.1396-1 also issued under 26 U.S.C. 1397D.

Par. 2. A new undesignated center heading and § 1.1396-1 are added to read as follows:

Empowerment Zone Employment Credit

§ 1.1396-1 Qualified zone employees.

(a) *In general.* A qualified zone employee of an employer is an employee who satisfies the location-of-services requirement and the abode requirement with respect to the same empowerment zone and is not otherwise excluded by section 1396(d).

(1) *Location-of-services requirement.* The location-of-services requirement is satisfied if substantially all of the services performed by the employee for the employer are performed in the empowerment zone in a trade or business of the employer.

(2) *Abode requirement.* The abode requirement is satisfied if the employee's principal place of abode while performing those services is in the empowerment zone.

(b) *Period for applying location-of-services requirement.* In applying the location-of-services requirement, an employer may use either the pay period method described in paragraph (b)(1) of this section or the calendar year method described in paragraph (b)(2) of this section. For each taxable year of an employer, the employer must either use the pay period method with respect to all of its employees or use the calendar year method with respect to all of its employees. The employer may change the method applied to all of its employees from one taxable year to the next.

(1) *Pay period method—(i) Relevant period.* Under the pay period method, the relevant period for applying the location-of-services requirement is each pay period in which an employee provides services to the employer. If an employer has one pay period for certain employees and a different pay period for other employees (e.g., a weekly pay period for hourly wage employees and a bi-weekly pay period for salaried employees), the pay period actually applicable to a particular employee is the relevant pay period for that employee under this method.

(ii) *Application of method.* Under this method, an employee does not satisfy the location-of-services requirement during a pay period unless substantially all of the services performed by the employee for the employer during that pay period are performed within the empowerment zone in a trade or business of the employer.

(2) *Calendar year method—(i) Relevant period.* Under the calendar year

method, the relevant period for an employee is the entire calendar year with respect to which the credit is being claimed. However, for any employee who is employed by the employer for less than the entire calendar year, the relevant period is the portion of that calendar year during which the employee is employed by the employer.

(ii) *Application of method.* Under this method, an employee does not satisfy the location-of-services requirement during any part of a calendar year unless substantially all of the services performed by the employee for the employer during that calendar year (or, if the employee is employed by the employer for less than the entire calendar year, the portion of that calendar year during which the employee is employed by the employer) are performed within the empowerment zone in a trade or business of the employer.

(3) *Examples.* This paragraph (b) may be illustrated by the following examples. In each example, the employees satisfy the abode requirement at all relevant times and all services performed by the employees for their employer are performed in a trade or business of the employer. The employees are not precluded from being qualified zone employees by section 1396(d)(2) (certain employees ineligible). No portion of the employees' wages is precluded from being qualified zone wages by section 1396(c)(2) (only first \$15,000 of wages taken into account) or section 1396(c)(3) (coordination with targeted jobs credit and work opportunity credit). The examples are as follows:

Example 1. (i) Employer X has a weekly pay period for all its employees. Employee A works for X throughout 1997. During each of the first 20 weekly pay periods in 1997, substantially all of A's work for X is performed within the empowerment zone in which A resides. A also works in the zone at various times during the rest of the year, but there is no other pay period in which substantially all of A's work for X is performed within the empowerment zone.

(ii) Employer X uses the pay period method. For each of the first 20 pay periods of 1997, A is a qualified zone employee, all of A's wages from X are qualified zone wages, and X may claim the empowerment zone employment credit with respect to those wages. X cannot claim the credit with respect to any of A's wages for the rest of 1997.

Example 2. (i) Employer Y has a weekly pay period for its factory workers and a bi-weekly pay period for its office workers. Employee B works for Y in various factories and Employee C works for Y in various offices.

(ii) Employer Y uses the pay period method. Y must use B's weekly pay periods to determine the periods (if any) in which B is a qualified zone employee. Y may claim the empowerment zone employment credit with respect to B's wages only

for the weekly pay periods for which B is a qualified zone employee, because those are B's only wages that are qualified zone wages. Y must use C's bi-weekly pay periods to determine the periods (if any) in which C is a qualified zone employee. Y may claim the credit with respect to C's wages only for the bi-weekly pay periods for which C is a qualified zone employee, because those are C's only wages that are qualified zone wages.

Example 3. (i) Employees D and E work for Employer Z throughout 1997. Although some of D's work for Z in 1997 is performed outside the empowerment zone in which D resides, substantially all of it is performed within the empowerment zone. E's work for Z is performed within the empowerment zone in which E resides for several weeks of 1997 but outside the zone for the rest of the year so that, viewed on an annual basis, E's work is not substantially all performed within the empowerment zone.

(ii) Employer Z uses the calendar year method. D is a qualified zone employee for the entire year, all of D's 1997 wages from Z are qualified zone wages, and Z may claim the empowerment zone employment credit with respect to all of those wages, including the portion attributable to work outside the zone. Under the calendar year method, E is not a qualified zone employee for any part of 1997, none of E's 1997 wages are qualified zone wages, and Z cannot claim any empowerment zone employment credit with respect to E's wages for 1997. Z cannot use the calendar year method for D and the pay period method for E because Z must use the same method for all employees. For 1998, however, Z can switch to the pay period method for E if Z also switches to the pay period method for D and all Z's other employees.

(c) *Effective date.* This section applies with respect to wages paid or incurred on or after December 21, 1994.

Margaret Milner Richardson,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on December 13, 1996, 8:45 a.m., and published in the issue of the Federal Register for December 16, 1996, 61 F.R. 66000)