

[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-142339-05]

RIN 1545-BE89

Targeted Populations Under Section 45D(e)(2)

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations relating to how an entity serving certain targeted populations under section 45D(e)(2) can meet the requirements to be a qualified active low-income community business. The regulations reflect changes to the law made by the American Jobs Creation Act of 2004. The regulations will affect certain taxpayers claiming the new markets tax credit. This document also provides a notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by December 23, 2008.

Outlines of topics to be discussed at the public hearing scheduled for Thursday, January 22, 2009 at 10:00 a.m. must be received by Friday, December 26, 2008.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-142339-05), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044.

Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-142339-05), Courier=s Desk, Internal

Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (IRS - REG-142339-05). The public hearing will be held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Julie Hanlon-Bolton, (202) 622-3040; concerning submission of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Funmi Awosika Taylor, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

**Background**

This document amends 26 CFR part 1 to provide rules relating to certain targeted populations under section 45D(e)(2). On May 24, 2005, the Community Development Financial Institutions (CDFI) Fund published an advance notice of proposed rulemaking (ANPRM) (70 FR 29658) to seek comments from the public with respect to how targeted populations may be treated as eligible low-income communities under section 45D(e)(2). In response to the ANPRM, comments were received making various suggestions relating to the Treasury Department's definition of the term "targeted populations" and proposing amendments to the requirements to be a qualified active low-income community business under §1.45D-1. On June 30, 2006, the IRS and Treasury Department released Notice 2006-60 (2006-29 IRB 82), which announced that §1.45D-1 would be amended to provide rules relating to how an entity meets the requirements to be a qualified active low-income community business when its activities

involve certain targeted populations under section 45D(e)(2). Taxpayers may rely on Notice 2006-60 until final regulations are issued. See §601.601(d)(2) (ii)(b). The IRS and Treasury Department have reviewed and considered all written and electronic comments in the process of preparing the proposed regulations. This preamble to the proposed regulations describes many of the more significant comments received by the IRS and Treasury Department in response to the notice.

### General Overview

Section 45D(a)(1) provides a new markets tax credit on certain credit allowance dates described in section 45D(a)(3) with respect to a qualified equity investment in a qualified community development entity (CDE) described in section 45D(c).

Section 45D(b)(1) provides that an equity investment in a CDE is a “qualified equity investment” if, among other requirements: (A) the investment is acquired by the taxpayer at its original issue (directly or through an underwriter) solely in exchange for cash; (B) substantially all of the cash is used by the CDE to make qualified low-income community investments; and (C) the investment is designated for purposes of section 45D by the CDE.

Under section 45D(b)(2), the maximum amount of equity investments issued by a CDE that may be designated by the CDE as qualified equity investments shall not exceed the portion of the new markets tax credit limitation set forth in section 45D(f)(1) that is allocated to the CDE by the Secretary under section 45D(f)(2).

Section 45D(c)(1) provides that an entity is a CDE if, among other requirements, the entity is certified by the Secretary as a CDE.

Section 45D(d)(1) provides that the term qualified low-income community investment means: (A) any capital or equity investment in, or loan to, any qualified active low-income community business (as defined in section 45D(d)(2)); (B) the purchase from another CDE of any loan made by the entity that is a qualified low-income community investment; (C) financial counseling and other services specified in regulations prescribed by the Secretary to businesses located in, and residents of, low-income communities; and (D) any equity investment in, or loan to, any CDE.

Under section 45D(d)(2), a qualified active low-income community business is any corporation (including a nonprofit corporation) or partnership if for such year, among other requirements, (i) at least 50 percent of the total gross income of the entity is derived from the active conduct of a qualified business within any low-income community, (ii) a substantial portion of the use of the tangible property of the entity (whether owned or leased) is within any low-income community, and (iii) a substantial portion of the services performed for the entity by its employees are performed in any low-income community.

Under section 45D(d)(3), with certain exceptions, a qualified business is any trade or business. The rental to others of real property is a qualified business only if, among other requirements, the real property is located in a low-income community.

Section 221 of the American Jobs Creation Act of 2004 (Public Law 108-357, 118 Stat. 1418) amended section 45D(e)(2) to provide that the Secretary shall prescribe regulations under which one or more targeted populations (within the meaning of section 103(20) of the Riegle Community Development and Regulatory Improvement

Act of 1994 (12 U.S.C. 4702(20))) may be treated as low-income communities. The regulations shall include procedures for determining which entities are qualified active low-income community businesses with respect to those populations.

The term targeted population, as defined in 12 U.S.C. 4702(20) and 12 C.F.R. 1805.201, means individuals, or an identifiable group of individuals, including an Indian tribe, who (A) are low-income persons; or (B) otherwise lack adequate access to loans or equity investments. Under 12 U.S.C. 4702(17) as interpreted by 12 C.F.R 1805.104, the term low-income means having an income, adjusted for family size, of not more than (A) for metropolitan areas, 80 percent of the area median family income; and (B) for non-metropolitan areas, the greater of (i) 80 percent of the area median family income; or (ii) 80 percent of the statewide nonmetropolitan area median family income.

Section 101(a) of the Gulf Opportunity Zone Act of 2005 (Public Law 109-135, 119 Stat. 2577) added new section 1400M(1), which provides that the Gulf Opportunity Zone (GO Zone) is that portion of the Hurricane Katrina disaster area determined by the President to warrant individual or individual and public assistance from the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act (the Act) by reason of Hurricane Katrina.

Section 1400M(2) provides that the Hurricane Katrina disaster area is an area with respect to which a major disaster has been declared by the President before September 14, 2005, under section 401 of the Act by reason of Hurricane Katrina. After determination by the President that a disaster area warrants assistance pursuant to the Act, the Federal Emergency Management Agency (FEMA) makes damage

assessments. The categories for damage assessment in the wake of a hurricane are: flooded area, saturated area, limited damage, moderate damage, extensive damage, and catastrophic damage.

Under section 1400N(m)(1), a CDE shall be eligible for an allocation under section 45D(f)(2) of the increase in the new markets tax credit limitation described in section 1400N(m)(2) only if a significant mission of the CDE is the recovery and redevelopment of the GO Zone. Section 1400N(m)(2) provides that the new markets tax credit limitation otherwise determined under section 45D(f)(1) shall be increased by an amount equal to \$300,000,000 for 2005 and 2006 and \$400,000,000 for 2007, to be allocated among CDEs to make qualified low-income community investments within the GO Zone.

Notice 2006-60 provides rules relating to how an entity meets the requirements to be a qualified active low-income community business when its activities involve targeted populations. Targeted populations that will be treated as a low-income community are defined as individuals, or an identifiable group of individuals, including an Indian tribe, who are low-income persons or who are individuals who otherwise lack adequate access to loans or equity investments. The notice provides requirements for qualified active low-income community businesses that serve low-income targeted populations and for qualified active low-income community businesses that serve the GO Zone Targeted Population.

### **Summary of Comments and Explanation of Provisions**

The proposed amendments to §1.45D-1 incorporate the guidance provided by

Notice 2006-60 into the regulations. Unless otherwise stated, the existing rules of §1.45D-1 relating to qualified active low-income community businesses apply to businesses serving targeted populations. For example, the “reasonable expectations” safe harbor of §1.45D-1(d)(6)(i) applies to businesses serving targeted populations. That rule allows an entity to be treated as a qualified active low-income community business for the duration of the CDE’s investment if the CDE reasonably expects, at the time the CDE makes the investment in, or loan to, the entity that the entity will satisfy the requirements to be a qualified active low-income community business throughout the entire period of the investment or loan. Except as discussed later in this preamble, the rules in these proposed regulations are the same as those provided in Notice 2006-60.

Sections 3.03 and 3.04 of Notice 2006-60 and the proposed amendments to §1.45D-1 include a definition of Targeted Populations, determined by the Treasury Department, that further defines the terms “low-income persons” and “individuals who otherwise lack adequate access to loans or equity investments.”

Section 3.03(1) of Notice 2006-60 states that an individual shall be considered to be low-income if the individual’s family income, adjusted for family size, is not more than (A) for metropolitan areas, 80 percent of the area median family income; and (B) for non-metropolitan areas, the greater of (i) 80 percent of the area median family income; or (ii) 80 percent of the statewide nonmetropolitan area median family income. A commentator requested guidance on calculating the applicable income limitation and calculating the family income. In calculating the applicable income limitation, taxpayers

must rely on the annual estimates of median family income released by the Department of Housing and Urban Development (HUD) and may rely on those figures until 45 days after HUD releases a new list of income limits, or until HUD's effective date for the new list, whichever is later. For example, a taxpayer hires on January 1, 2007, a new employee who is a member of a four person family. The most recent HUD median family income estimates were released on March 19, 2007. In determining whether the employee is low-income on January 1, 2008, the taxpayer may rely on the 2007 HUD median family income estimates for a four person family until 45 days after HUD releases a new list of income limits, or until HUD's effective date for the new list, whichever is later. The income limits are computed and listed, according to family size, by HUD for every Metropolitan Statistical Area, Primary Metropolitan Statistical Area, and nonmetropolitan county of the United States and Puerto Rico. HUD also releases income limits for the possessions of Guam and the Virgin Islands.

One commentator suggested that it would be less burdensome for a qualified active low-income community businesses to document that an individual is low-income for purposes of section 45D(e)(2) if individuals who live in a low-income community as defined in section 45D(e)(1), (3), (4), or (5) were deemed to be low-income for purposes of section 45D(e)(2). However, section 45D(e)(2) directly cross references targeted populations as defined in 12 U.S.C. 4702(20). The term low-income is defined in 12 U.S.C. 4702(17) to mean having an income, adjusted for family size, of not more than: for metropolitan areas, 80 percent of the area median income; and for nonmetropolitan areas, the greater of 80 percent of the area median income or 80 percent of the



statewide nonmetropolitan area median income. Accordingly, the Treasury Department is not adopting the commentator's suggestion.

Some commentators suggested stricter requirements for targeted populations by increasing the 120-percent-income restriction in section 3.03(3) of Notice 2006-60 to 150 percent of municipal median income and requiring that taxpayers meet all three of the qualified active low-income community business tests set forth in sections 3.03(2)(a) and 3.04(3)(a) instead of one of the three. The commentators also suggested providing stricter requirements for the definitions of low-income persons, low-income communities, and qualified active low-income community businesses. The commentators expressed concern that Notice 2006-60 permits investments beyond low-income communities. Neither Notice 2006-60 nor the proposed regulations change the existing rules governing low-income communities. Rather, they provide guidance on how an entity serving certain targeted populations under section 45D(e)(2) can be a qualified active low-income community business. The IRS and Treasury Department believe that Notice 2006-60 and the proposed regulations appropriately implement Congressional intent to expand new market tax credit investments to low-income individuals and individuals that otherwise lack adequate access to loans or equity investments by treating targeted populations as a low-income community. Congress enacted the targeted populations provisions under section 45D(e)(2) to expand new markets tax credit investment dollars to other underserved areas. Consequently, the proposed regulations do not adopt the commentators' suggestions.

Some commentators believe that the rules in Notice 2006-60 should be

broadened in scope to allow entities engaged in essential governmental functions, such as health care services to the community, to be deemed to be a qualified active low-income community business serving targeted populations. The IRS and Treasury Department do not believe that it is appropriate to provide targeted benefits to particular industries. Accordingly, the proposed regulations do not adopt this comment.

Other commentators believe that a non-profit business that is not individually owned should be able to satisfy the ownership test if at least 25 percent of the business's board is comprised of individuals who are low-income or represent a low-income targeted population. Another commentator suggested removing the 120-percent-income restriction. Concerning the rules for the GO Zone Targeted Population, one commentator suggested using parishes rather than census tracts and suggested removing or substantially reducing the percentage test for the gross income requirement. The proposed regulations do not adopt these suggestions because the IRS and Treasury Department believe that the guidance provided in Notice 2006-60 generally ensures that the businesses receiving qualified low-income community investments serve targeted populations for low-income and GO Zone populations. Finally, some commentators suggested providing geographic rules for targeted populations. Targeted populations is not a geographic concept; it is designed to provide a new markets tax credit to investors of qualified active low-income community businesses that serve targeted populations. Therefore, this comment was not adopted.

Section 3.03(2) of Notice 2006-60 provides qualified active low-income community business requirements for low-income targeted populations. Several

commentators suggested that businesses that qualify and participate in other Federal programs targeted specifically to low-income individuals and families may use such participation as a proxy for meeting the targeted populations requirements. The IRS and Treasury Department have not analyzed other Federal programs to determine whether they meet the statutory requirements under section 45D(e), and it is not certain that programs currently meeting the requirements would continue to do so in the future. Moreover, the IRS and Treasury Department do not believe it is appropriate to exempt certain businesses from meeting the regulatory requirements to be a qualified active low-income community business based upon participation in other Federal programs, including those designed to aid low-income individuals and families, because these Federal programs cannot be substituted for the statutory requirements under section 45D(e). Therefore, the proposed regulations do not adopt this comment.

One commentator requested that the gross income requirement of section 3.03(2)(a)(i) of Notice 2006-60 be amended to include income from the provision of services to businesses that serve targeted populations. The comment focuses on wholesalers that sell goods to retailers that resell to low-income persons. The IRS and Treasury Department believe that such a rule would cover too broad a range of transactions and would conflict with the goal of ensuring that qualified low-income community investment dollars go directly to businesses that serve targeted populations. Accordingly, the proposed regulations do not adopt this comment.

Several commentators suggested that additional restrictions should be added to the employee requirement under sections 3.03(2)(a)(ii) and 3.04(3)(a)(ii) of Notice 2006-

60. One commentator proposed that the employee should be a member of a targeted group as defined by the work opportunity tax credit under section 51. Another commentator suggested that a business should be able to satisfy the employee test only if the business pays a wage that would increase the income of the low-income individual being hired. Still another commentator suggested that the employee requirement be satisfied only if each \$25,000 in tax credit allocation results in at least one new job. Although the proposed regulations do not incorporate these suggestions at this time, the IRS and Treasury Department request comments regarding whether additional restrictions should be added to the employee requirement.

One commentator asked that the guidance provided in section 3.03(2)(b) of Notice 2006-60 on the determination of whether an employee is a low-income person be amended to provide that the determination should be made on the later of the date the employee was hired or the date the qualified low-income community investment is made. The IRS and Treasury Department believe that adopting this comment would create undue complexity. In addition, the IRS and Treasury Department do not want to provide a rule that may encourage employers to keep their employees low-income to be eligible as a qualified active low-income community business. Therefore, the proposed regulations retain the rule in Notice 2006-60 that the determination of whether an employee is a low-income person is made at the time of hire.

Sections 3.03(3)(a)(iii) and 3.04(4)(a)(iii) of Notice 2006-60 provide that the 120-percent-income restriction and the 200-percent-income restriction, respectively, do not apply to an entity located within a population census tract with a population of less than

2,000 if such tract is located in a metropolitan area and more than 75 percent of the tract is zoned for commercial or industrial use. A commentator suggested that to determine whether 75 percent of a population census tract is zoned for commercial or industrial use, the area of the population census tract should be used. In addition, the tract should be considered zoned for commercial or industrial use if commercial or industrial use is a permissible zoning use. The IRS and Treasury Department agree that these suggestions will help clarify the rule. Accordingly, the proposed regulations adopt the commentator's suggestions.

Sections 3.03(3)(b), 3.04(3)(b), and 3.04(4)(b) of Notice 2006-60 provide tests to determine whether an entity is located in a particular census tract. One commentator suggested that the percentages used for the use of tangible property test and services performed test be increased from 40 percent to 60 percent. The proposed regulations do not adopt this comment because the proposed percentages are consistent with the qualified active low-income community business requirements under §1.45D-1(d)(4)(i).

Section 3.03(4) of Notice 2006-60 provides that the rental to others of real property for low-income targeted populations that otherwise satisfies the requirements to be a qualified business will be treated as located in a low-income community if at least 50 percent of the entity's total gross income is derived from rentals to individuals who are low-income persons and/or to a qualified active low-income community business that meets the requirements for low-income targeted populations. Section 3.04(5) provides a similar rule for rental of real property for the GO Zone Targeted Population. One commentator suggested that "50 percent" be lowered to "20 percent"

to mirror the definition of non-residential real property for purposes of depreciation under section 168. The IRS and Treasury Department believe that, for purposes of determining whether a business engaged in the rental of real property is located in a low-income community, it is more appropriate to adopt rules consistent with the rules governing whether an entity is a qualified active low-income community business for targeted populations. Therefore, the proposed regulations do not adopt the commentator's suggestion.

The Treasury Department has determined that an individual is considered to otherwise lack adequate access to loans or equity investments only if the individual was displaced from his or her principal residence as a result of Hurricane Katrina and/or the individual lost his or her principal source of employment as a result of Hurricane Katrina. In order to meet this definition, the individual's principal residence or principal source of employment, as applicable, must have been located in a population census tract within the GO Zone that contains one or more areas designated by FEMA as flooded, having sustained extensive damage, or having sustained catastrophic damage as a result of Hurricane Katrina. One commentator asked how taxpayers would know which population census tracts have received the relevant FEMA designations. The CDFI Fund has made this information available on its website at [www.cdfifund.gov](http://www.cdfifund.gov).

Commentators requested that the GO Zone Targeted Population be expanded to all census tracts within the GO Zone, rather than limited to only those areas designated by FEMA as flooded, having sustained extensive damage, or having sustained catastrophic damage as a result of Hurricane Katrina. The IRS and Treasury

Department believe that for purposes of the increase in the limitation under section 1400N(m)(2), the new markets tax credit should only be used in the areas that were most devastated by Hurricane Katrina or are otherwise qualified as low-income communities. The IRS and Treasury Department believe that the areas that were most devastated by Hurricane Katrina are in greater need of assistance, due to lack of adequate access to loans or equity investments, than other areas within the GO Zone.

Commentators requested that the proposed regulations not limit use of the rules governing the GO Zone Targeted Population to investments made by CDEs with allocations from the increase under section 1400N(m)(2). The IRS and Treasury Department do not believe that it is appropriate to expand the ability to use the rules governing the GO Zone Targeted Population beyond investments made by CDEs with GO Zone allocations, because it would remove much needed assistance from other low-income communities within the GO Zone.

Section 1.45D-1(d)(4)(iv)(A) provides that for purposes of §1.45D-1(d)(4)(i), an entity will be treated as engaged in the active conduct of a trade or business if, at the time the CDE makes a capital or equity investment in, or loan to, the entity, the CDE reasonably expects that the entity will generate revenues (or, in the case of a nonprofit corporation, engage in an activity that furthers its purpose as a nonprofit corporation) within 3 years after the date the investment or loan is made. This “active conduct of a trade or business” safe harbor applies only for purposes of determining whether an entity is engaged in the active conduct of a trade or business and does not apply for purposes of determining whether an entity is otherwise a qualified active low-income

community business. Further, the “active conduct of a trade or business” safe harbor does not conflict with the gross-income requirement of §1.45D-1(d)(4)(i)(A) because that paragraph provides that the entity is deemed to meet the gross-income requirement if the entity meets the requirements of either §1.45D-1(d)(4)(i)(B) or (C) if “50 percent” is applied instead of “40 percent.” Therefore, an entity that has no gross receipts and relies on the “active conduct of a trade or business” safe harbor of §1.45D-1(d)(4)(iv)(A) can meet the requirements to be a qualified active low-income community business by satisfying either the use of tangible property requirement of §1.45D-1(d)(4)(i)(B) or the services performed requirement of §1.45D-1(d)(4)(i)(C) at 50 percent instead of 40 percent. Several commentators requested that, in order to accommodate start-up entities, the proposed regulations provide a rule wherein a business could qualify as a qualified active low-income community business serving targeted populations if the CDE reasonably expects that the entity will generate revenues within three years after the date the investment or loan is made. If a business serving targeted populations chose to apply the gross income requirement rather than the employee requirement or the owner requirement, the commentators’ suggestion could potentially allow a business to be a qualified active low-income community business for three years without having to meet any requirement. This result is clearly inappropriate. Therefore, the proposed regulations do not adopt the commentators’ suggestion. In addition, the proposed regulations clarify the language in §1.45D-1(d)(4)(iv)(A) to address any confusion as to the application of the “active conduct of a trade or business” safe harbor.

Several commentators submitted comments that address subjects not within the



scope of these proposed regulations. For example, comments were received addressing CDFI Fund allocation application procedures, such as minimum submission requirements, weighted scoring criteria, approval procedures, “high distress” criteria, underwriting criteria, and amendments to existing allocation agreements. These comments have been forwarded to the CDFI Fund for consideration.

### **Proposed Effective/Applicability Date**

The rules contained in these regulations are proposed to apply to taxable years ending on or after the date of publication of the Treasury decision adopting these rules as final regulation in the **Federal Register**. In the meantime, taxpayers may rely on Notice 2006-60 (2006-29 IRB 82) for designations made by the Secretary after October 22, 2004.

### **Request for Comments**

The IRS and Treasury Department invite taxpayers to submit comments on issues relating to how an entity meets the requirements to be a qualified active low-income community business when its activities involve certain targeted populations under section 45D(e)(2). In particular, the IRS and Treasury Department encourage taxpayers to submit comments on the following issues:

1. What measure of income should be used to determine an individual's income for purposes of the definition of low-income persons in §1.45D-1(d)(9)(i)(A)? For example, should the measure of income for this purpose be the same as the measure of income used by the U.S. Census Bureau, the measure of income on the IRS Form 1040, or the measure of income in 24 CFR Part 5, which is used for certain HUD

programs and other Federal programs? The IRS and Treasury Department are considering using the measure of income used by the U.S. Census Bureau to ensure a consistent comparison between the individual's family income and the applicable area median family income.

2. Should the gross income requirements in §1.45D-1(d)(9)(i)(B)(1)(i) and (ii)(C)(1)(i) be modified to include the fair market value of goods and services provided to low-income persons at reduced fees? For example, should a business that provides its services to low-income persons for half of what it charges its other customers be able to include the fair market value of the services provided to low-income persons in its calculation of gross income for purposes of the requirement in §1.45D-1(d)(9)(i)(B)(1)(i)?

3. Should additional restrictions be added to the employee requirements in §1.45D-1(d)(9)(i)(B)(1)(ii) and (ii)(C)(1)(ii)? For example, as one commentator suggested, should a requirement be added that the employee be a member of a targeted group as defined by the work opportunity tax credit? As another commentator suggested, should the employee test be satisfied only if the business pays a wage that would increase the income of the low-income individual being hired?

### **Special Analyses**

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification

is based upon the fact that the regulations provide a positive impact because, consistent with legislative intent, they allow a tax credit to be claimed in situations where it was previously unavailable without the Secretary providing for such situations in regulations. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. 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 their 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 (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. Comments are requested on all aspects of the proposed regulations. In addition, the IRS and Treasury Department specifically request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for Friday, January 22, 2009 at 10 a.m. in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts.

For information about having your name placed on the building access list to attend the hearing, see the “FOR FURTHER INFORMATION CONTACT” section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons who wish to present oral comments at the hearing must submit electronic or written comments and an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) by December 26, 2008. 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 Lauren Ross Taylor, formerly with the Office of the Associate Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

### **List of Subjects in 26 CFR Part 1**

Income taxes, Reporting and recordkeeping requirements.

### **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 in part as follows:

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

Section 1.45D-1 also issued under 26 U.S.C. 45D(e)(2) \* \* \*

Par. 2. Section 1.45D-1 is amended by:

1. Revising paragraph (a) to revise the entry for paragraph (h) and add new entries for (d)(9), (d)(9)(i), (d)(9)(i)(A), (d)(9)(i)(B), (d)(9)(i)(B)(1), (d)(9)(i)(B)(2), (d)(9)(i)(B)(3), (d)(9)(i)(C), (d)(9)(i)(C)(1), (d)(9)(i)(C)(2), (d)(9)(i)(D), (d)(9)(ii), (d)(9)(ii)(A), (d)(9)(ii)(B), (d)(9)(ii)(C), (d)(9)(ii)(C)(1), (d)(9)(ii)(C)(2), (d)(9)(ii)(C)(2)(i), (d)(9)(ii)(C)(2)(ii), (d)(9)(ii)(D), (d)(9)(ii)(D)(1), (d)(9)(ii)(D)(2), (d)(9)(ii)(E), and (h)(3).

2. Revising paragraph (d)(4)(i).

3. Adding the language “See paragraph (d)(9) of this section for rules relating to targeted populations.” to the end of paragraph (d)(4)(i)(A).

4. Adding the language “See paragraph (d)(9) of this section for rules relating to targeted populations.” to the end of paragraph (d)(4)(i)(B)(1).

5. Adding the language “See paragraph (d)(9) of this section for rules relating to targeted populations.” to the end of paragraph (d)(4)(i)(C).

6. Adding a new sentence at the end of paragraph (d)(4)(iv)(A).

7. Adding new paragraph (d)(9).

8. Revising the heading for paragraph (h) and adding new paragraph (h)(3).

The additions and revisions read as follows:

1.45D-1 New markets tax credit.

(a) \* \* \*

(d) \* \* \*

(9) Targeted populations.

- (i) Low-income persons.
  - (A) Definition.
  - (B) Qualified active low-income community business requirements for low-income targeted populations.
    - (1) In general.
    - (2) Employee.
    - (3) Owner.
  - (C) 120-percent-income restriction.
    - (1) In general.
    - (2) Population census tract location.
  - (D) Rental of real property for low-income targeted populations.
- (ii) Individuals who otherwise lack adequate access to loans or equity investments.
  - (A) In general.
  - (B) GO Zone Targeted Population.
  - (C) Qualified active low-income community business requirements for the GO Zone Targeted Population.
    - (1) In general.
    - (2) Location.
  - (i) In general.
  - (ii) Determination.
  - (D) 200-percent-income restriction.
    - (1) In general.
    - (2) Population census tract location.
  - (E) Rental of real property for the GO Zone Targeted Population.

\* \* \* \* \*

- (h) Effective/applicability dates
- (3) Targeted populations.

\* \* \* \* \*

(d) \* \* \*

(4) \* \* \*

(i) In general. The term qualified active low-income community business means, with respect to any taxable year, a corporation (including a nonprofit corporation) or a partnership engaged in the active conduct of a qualified business (as defined in paragraph (d)(5) of this section), if the requirements of (d)(4)(i)(A), (B), (C), (D), and (E) of this section are met (or in the case of an entity serving targeted populations, if the requirements of paragraphs (d)(4)(i)(D), (E), and (d)(9)(i) or (ii) of this section are met).

Solely for purposes of this section, a nonprofit corporation will be deemed to be engaged in the active conduct of a trade or business if it is engaged in an activity that furthers its purpose as a nonprofit corporation.

\* \* \* \* \*

(iv) Active conduct of a trade or business--(A) \* \* \* This paragraph (d)(4)(iv) applies only for purposes of determining whether an entity is engaged in the active conduct of a trade or business and does not apply for purposes of determining whether the gross-income requirement under paragraph (d)(4)(i)(A), (d)(9)(i)(B)(1)(i), or (d)(9)(ii)(C)(1)(i) of this section is satisfied.

\* \* \* \* \*

(9) Targeted populations. As determined by the Treasury Department, for purposes of section 45D(e)(2), targeted populations that will be treated as a low-income community are individuals, or an identifiable group of individuals, including an Indian tribe, who are low-income persons as defined in paragraph (d)(9)(i) of this section or who are individuals who otherwise lack adequate access to loans or equity investments as defined in paragraph (d)(9)(ii) of this section.

(i) Low-income persons--(A) Definition. For purposes of section 45D(e)(2), an individual shall be considered to be low-income if the individual's family income, adjusted for family size, is not more than--

(1) For metropolitan areas, 80 percent of the area median family income; and

(2) For non-metropolitan areas, the greater of 80 percent of the area median family income, or 80 percent of the statewide non-metropolitan area median family

income.

(B) Qualified active low-income community business requirements for low-income targeted populations--(1) In general. An entity will not be treated as a qualified active low-income community business for low-income targeted populations unless--

(i) At least 50 percent of the entity's total gross income for any taxable year is derived from sales, rentals, services, or other transactions with individuals who are low-income persons for purposes of section 45D(e)(2) and this paragraph (d)(9),

(ii) At least 40 percent of the entity's employees are individuals who are low-income persons for purposes of section 45D(e)(2) and this paragraph (d)(9), or

(iii) At least 50 percent of the entity is owned by individuals who are low-income persons for purposes of section 45D(e)(2) and this paragraph (d)(9).

(2) Employee. The determination of whether an employee is a low-income person must be made at the time the employee is hired. If the employee is a low-income person at the time of hire, that employee is considered a low-income person for purposes of section 45D(e)(2) and this paragraph (d)(9) throughout the time of employment, without regard to any increase in the employee's income after the time of hire.

(3) Owner. The determination of whether an owner is a low-income person must be made at the time the qualified low-income community investment is made. If an owner is a low-income person at the time the qualified low-income community investment is made, that owner is considered a low-income person for purposes of section 45D(e)(2) and this paragraph (d)(9) throughout the time the ownership interest



is held by that owner.

(C) ~~120-percent-income restriction~~--(1) ~~In general~~--(i) In no case will an entity be treated as a qualified active low-income community business under paragraph (d)(9)(i) of this section if the entity is located in a population census tract for which the median family income exceeds 120 percent of--

(A) In the case of a tract not located within a metropolitan area, the statewide median family income, or

(B) In the case of a tract located within a metropolitan area, the greater of statewide median family income or metropolitan area median family income (120-percent-income restriction).

(ii) The 120-percent-income restriction shall not apply to an entity located within a population census tract with a population of less than 2,000 if such tract is not located in a metropolitan area.

(iii) The 120-percent-income restriction shall not apply to an entity located within a population census tract with a population of less than 2,000 if such tract is located in a metropolitan area and more than 75 percent of the tract is zoned for commercial or industrial use. For this purpose, the 75 percent calculation should be made using the area of the population census tract. For purposes of this paragraph (d)(9)(i)(C)(1)(iii), property for which commercial or industrial use is a permissible zoning use will be treated as zoned for commercial or industrial use.

(2) Population census tract location--(i) For purposes of the 120-percent-income restriction, an entity will be considered to be located in a population census tract for

which the median family income exceeds 120 percent of the applicable median family income under paragraph (d)(9)(i)(C)(1)(i)(A) or (B) of this section (non-qualifying population census tract) if--

(A) At least 50 percent of the total gross income of the entity is derived from the active conduct of a qualified business (as defined in paragraph (d)(5) of this section) within one or more non-qualifying population census tracts (non-qualifying gross income amount);

(B) At least 40 percent of the use of the tangible property of the entity (whether owned or leased) is within one or more non-qualifying population census tracts (non-qualifying tangible property usage); and

(C) At least 40 percent of the services performed for the entity by its employees are performed in one or more non-qualifying population census tracts (non-qualifying services performance).

(ii) The entity is considered to have the non-qualifying gross income amount if the entity has non-qualifying tangible property usage or non-qualifying services performance of at least 50 percent instead of 40 percent.

(iii) If the entity has no employees, the entity is considered to have the non-qualifying gross income amount as well as non-qualifying services performance if at least 85 percent of the use of the tangible property of the entity (whether owned or leased) is within one or more non-qualifying population census tracts.

(D) Rental of real property for low-income targeted populations. The rental to others of real property for low-income targeted populations that otherwise satisfies the

requirements to be a qualified business under paragraph (d)(5) of this section will be treated as located in a low-income community for purposes of paragraph (d)(5)(ii) of this section if at least 50 percent of the entity's total gross income is derived from rentals to individuals who are low-income persons for purposes of section 45D(e)(2) and this paragraph (d)(9) and/or to a qualified active low-income community business that meets the requirements for low-income targeted populations under paragraphs (d)(9)(i)(B)(1)(i) or (ii) and (d)(9)(i)(B)(2) of this section.

(ii) Individuals who otherwise lack adequate access to loans or equity investments--(A) In general. Paragraph (d)(9)(ii) of this section may be applied only with regard to qualified low-income community investments made under the increase in the new markets tax credit limitation pursuant to section 1400N(m)(2). Therefore, only CDEs with a significant mission of recovery and redevelopment of the Gulf Opportunity Zone (GO Zone) that receive an allocation from the increase described in section 1400N(m)(2) may make qualified low-income community investments from that allocation pursuant to the rules in paragraph (d)(9)(ii) of this section.

(B) GO Zone Targeted Population. As determined by the Treasury Department, for purposes of targeted populations under section 45D(e)(2), an individual is considered to otherwise lack adequate access to loans or equity investments only if the individual was displaced from his or her principal residence as a result of Hurricane Katrina and/or the individual lost his or her principal source of employment as a result of Hurricane Katrina (GO Zone Targeted Population). In order to meet this definition, the individual's principal residence or principal source of employment, as applicable, must

have been located in a population census tract within the GO Zone that contains one or more areas designated by the Federal Emergency Management Agency (FEMA) as flooded, having sustained extensive damage, or having sustained catastrophic damage as a result of Hurricane Katrina.

(C) Qualified active low-income community business requirements for the GO Zone Targeted Population--(1) In general. An entity will not be treated as a qualified active low-income community business for the GO Zone Targeted Population unless--

(i) At least 50 percent of the entity's total gross income for any taxable year is derived from sales, rentals, services, or other transactions with the GO Zone Targeted Population, low-income persons as defined in paragraph (d)(9)(i) of this section, or some combination thereof;

(ii) At least 40 percent of the entity's employees consist of the GO Zone Targeted Population, low-income persons as defined in paragraph (d)(9)(i) of this section, or some combination thereof; or

(iii) At least 50 percent of the entity is owned by the GO Zone Targeted Population, low-income persons as defined in paragraph (d)(9)(i) of this section, or some combination thereof.

(2) Location--(i) In general. In order to be a qualified active low-income community business under paragraph (d)(9)(ii)(C) of this section, the entity must be located in a population census tract within the GO Zone that contains one or more areas designated by FEMA as flooded, having sustained extensive damage, or having sustained catastrophic damage as a result of Hurricane Katrina (qualifying population

census tract).

(ii) Determination--(A) For purposes of the preceding paragraph, an entity will be considered to be located in a qualifying population census tract if--

(I) At least 50 percent of the total gross income of the entity is derived from the active conduct of a qualified business (as defined in paragraph (d)(5) of this section) within one or more qualifying population census tracts (gross income requirement);

(II) At least 40 percent of the use of the tangible property of the entity (whether owned or leased) is within one or more qualifying population census tracts (use of tangible property requirement); and

(III) At least 40 percent of the services performed for the entity by its employees are performed in one or more qualifying population census tracts (services performed requirement).

(B) The entity is deemed to satisfy the gross income requirement if the entity satisfies the use of tangible property requirement or the services performed requirement on the basis of at least 50 percent instead of 40 percent.

(C) If the entity has no employees, the entity is deemed to satisfy the services performed requirement as well as the gross income requirement if at least 85 percent of the use of the tangible property of the entity (whether owned or leased) is within one or more qualifying population census tracts.

(D) 200-percent-income restriction--(1) In general--(i) In no case will an entity be treated as a qualified active low-income community business under paragraph (d)(9)(ii) of this section if the entity is located in a population census tract for which the

median family income exceeds 200 percent of--

(A) In the case of a tract not located within a metropolitan area, the statewide median family income, or

(B) In the case of a tract located within a metropolitan area, the greater of statewide median family income or metropolitan area median family income (200-percent-income restriction).

(ii) The 200-percent-income restriction shall not apply to an entity located within a population census tract with a population of less than 2,000 if such tract is not located in a metropolitan area.

(iii) The 200-percent-income restriction shall not apply to an entity located within a population census tract with a population of less than 2,000 if such tract is located in a metropolitan area and more than 75 percent of the tract is zoned for commercial or industrial use. For this purpose, the 75 percent calculation should be made using the area of the population census tract. For purposes of this paragraph (d)(9)(ii)(D)(1)(iii), property for which commercial or industrial use is a permissible zoning use will be treated as zoned for commercial or industrial use.

(2) Population census tract location--(i) For purposes of the 200-percent-income restriction, an entity will be considered to be located in a population census tract for which the median family income exceeds 200 percent of the applicable median family income under paragraph (d)(9)(ii)(D)(1)(i)(A) or (B) of this section (non-qualifying population census tract) if--

(A) At least 50 percent of the total gross income of the entity is derived from the

active conduct of a qualified business (as defined in paragraph (d)(5) of this section) within one or more non-qualifying population census tracts (non-qualifying gross income amount);

(B) At least 40 percent of the use of the tangible property of the entity (whether owned or leased) is within one or more non-qualifying population census tracts (non-qualifying tangible property usage); and

(C) At least 40 percent of the services performed for the entity by its employees are performed in one or more non-qualifying population census tracts (non-qualifying services performance).

(ii) The entity is considered to have the non-qualifying gross income amount if the entity has non-qualifying tangible property usage or non-qualifying services performance of at least 50 percent instead of 40 percent.

(iii) If the entity has no employees, the entity is considered to have the non-qualifying gross income amount as well as non-qualifying services performance if at least 85 percent of the use of the tangible property of the entity (whether owned or leased) is within one or more non-qualifying population census tracts.

(E) Rental of real property for the GO Zone Targeted Population. The rental to others of real property for the GO Zone Targeted Population that otherwise satisfies the requirements to be a qualified business under paragraph (d)(5) of this section will be treated as located in a low-income community for purposes of paragraph (d)(5)(ii) of this section if at least 50 percent of the entity's total gross income is derived from rentals to the GO Zone Targeted Population, low-income persons as defined in paragraph (d)(9)(i)

of this section and/or to a qualified active low-income community business that meets the requirements for the GO Zone Targeted Population under paragraphs (d)(9)(ii)(C)(1)(i) or (ii) of this section.

\* \* \* \* \*



(h) Effective/applicability dates \* \* \*

\* \* \* \* \*

(3) Targeted populations. The rules in paragraph (d)(9) of this section apply to taxable years ending on or after the date of publication of the Treasury decision adopting these rules as final regulation in the **Federal Register**.

/s/ Linda E. Stiff

Deputy Commissioner for Services and Enforcement.