THE ENTERPRISE ZONE CONCEPT AT THE FEDERAL LEVEL: ARE PROPOSED TAX INCENTIVES THE NEEDED INGREDIENT?

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"I will ask Congress to join me in creating enterprise zones in the most depressed areas of our cities . . . . Policies of opening up economic growth and opportunity can work and will work because they help people help themselves."[1]

I. INTRODUCTION

During the 1980's, the United States experienced great economic growth. Unfortunately, this prosperity by-passed many urban and rural areas. While many areas and their residents reaped the bene-

[1] Address by George Bush, President of the United States, to Joint Session of Congress, in Washington D.C. (June 15, 1989) ("Building a Better America, Message from the President of the United States.")

President Bush has endorsed the concept of enterprise zones and accompanying tax incentives in his own Enterprise Zone Initiative. See letter from George Bush, President of the United States, to Rep. Dan Rostenkowski, Chairman of the House Committee on Ways and Means (July 25, 1989).

fits of increased income, employment and investment, many others experienced economic decline. Personal income dropped, unemployment remained high, and investment in these areas was nonexistent. The private sector, as well as the government, has grappled with ideas and programs to reverse this trend and to help distribute more equitably the benefits of the nation's economic success. No solution, however, has been found to date. A strong federal enterprise zone system has not been tried and may be a possible solution.

This article examines the concept of enterprise zones in the United States. Part II explores this concept from an historical perspective: first, the conceptual origins of the enterprise zone system and how it made its way to the United States; second, the federal debate concerning enterprise zones that was carried on between 1981 and 1987; and finally, the states' involvement and experience with the enterprise zone concept.

Part III examines Title VII of the Housing and Community Development Act of 1987 (the "HCDA").[2] This legislation produced the first federal government involvement in the enterprise zone concept by creating the Federal Enterprise Zone Program.[3]

Part IV is devoted to the federal tax incentives that have been proposed to add strength to the federal enterprise zone program. While eight bills have been introduced in the 101st Congress,[4] this article addresses only one, H.R. 6,[5] which is considered the most ambitious. This section assesses the pros and cons of the tax incentives from an economic standpoint.

II. Enterprise Zones From An Historical Perspective

While a rudimentary concept of enterprise zones probably has been around for some time,[6] the concept as we know it today was

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[2] Pub. L. No. 100-242, 101 Stat. 1815. See 42 U.S.C.A. § 5301 (West 1983 & Supp. 1989), as amended by Pub. L. No. 100-242 § 1(a), which outlines the purpose of the HCDA.

[3] See 42 U.S.C.A. §§ 11501-11504 (West Supp. 1989), as enacted by Pub. L. No. 100-242, §§ 701-704, 101 Stat. 1957 (1988) and as amended by Pub. L. No. 100-628, § 1090(a)-(b), 102 Stat. 3283 (1988).

[4] The eight bills are H.R. 6, 101st Cong., 1st Sess. (1989); H.R. 69, 101st Cong., 1st Sess. (1989); H.R. 193, 101st Cong., 1st Sess. (1989); H.R. 1221, 101st Cong., 1st Sess. (1989); H.R. 2079, 101st Cong., 1st Sess. (1989); H.R. 2297, 101st Cong., 1st Sess. (1989); S. 35, 101st. Cong., 1st Sess. (1989); S. 58, 101st Cong., 1st. Sess. (1989).

[5] H.R. 6, 101st Cong., 1st Sess. (entitled "Enterprise Zone Improvements Act of 1989").

[6] See Peirce & Steinbach, Reindustrialization on a Small Scale—But Will the Small Busi-

formulated in the United States in the early 1980's.

A. Coming to America

While the British, and in particular Professor Peter Hall, are given credit for the "invention" of the modern day enterprise zone concept, the true credit might belong to the Far East. Professor Hall has acknowledged that the government-created enterprise areas of Hong Kong, where industry was allowed to operate free from controls and with little or no taxation, were the seeds for his further refinement of the concept.[7] In addition, at the end of World War II, special Export Processing Zones were established in India and Korea as they underwent decolonization.[8] These Export Processing Zones became the forerunners of the People's Republic of China's Special Economic Zones and Economic and Technological Development Zones. These zones, which came into existence in the 1970's, are areas in which enterprises enjoy lower tax rates and less government regulation than enterprises in other areas. While the purpose of these zones is to assist in modernization by attracting foreign capital and advanced technology to the People's Republic of China, the method used is certainly akin to our definition of enterprise zones.[9]

In the late 1970's, Peter Hall, a professor at England's Reading University, coined the term "enterprise zones" and created the first enterprise zone plan. By exposing certain depressed areas of inner Liverpool and inner Glasgow to all kinds of initiatives with minimal governmental interference or control, Professor Hall hoped to recreate the economic success that Hong Kong experienced in the 1950's and the 1960's.[10] This initial plan had four major components. First, the designated areas would be outside of

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ness Survive?, Nat'l L. J. Reports 105 (1981) for the proposition that there existed an "extensive array of bounties, tax incentives and legal monopolies" to encourage young enterprises in the American Colonies before the Revolutionary War.

[7] See P. Hall, Enterprise Zones in Theory and Practice: The British Experience, *in* The Enterprise Zone Concept: British Origins, American Adaptations 23, 24-25 (1981) (address to the National Urban Policy Roundtable, in Washington, D.C. (Jan. 14, 1981)).

[8] See Nishitateno, China's Special Economic Zones: Experimental Units for Economic Reform, 32 Int'l & Comp. L.Q. 175, 176 (1983).

[9] While the far eastern economic zones are beyond the scope of this article, see generally Nishitateno, supra note 8; Zheng, The Legal Structure of Economic and Technological Development Zones in the People's Republic of China, 5 Int'l Tax & Bus. Law. 70, 71 (1987).

[10] See Hall, supra note 7, at 24-25.

British foreign exchange and customs control, so that all goods could be imported, exported, and sold free of tax within the zone.[11] Second, while personal and corporate taxes, along with government regulation, would be reduced to a minimum in these areas, many social services would not be provided, and wage and price guidelines would not apply.[12] Next, the people choosing to live in these areas would have to recognize and accept the lower rates of taxation and the reduced benefits.[13] Finally, the areas would be administered as a Crown Colony or Protectorate.[14]

During this time, the campaign that led to the election of Margaret Thatcher as Prime Minister of the United Kingdom was taking place. Two members of her Conservative Party, Sir Keith Joseph and Sir Geoffrey Howe, adopted Professor Hall's concept and pushed for its inclusion in Thatcher's platform. In 1978, in a speech on the problems of blighted neighborhoods in London's depressed Docklands area, Howe publicly supported a modified version of Professor Hall's original plan.[15] Howe's plan, while different from Professor Hall's, had the same philosophy: that zones would be set aside where "free enterprise" would be allowed to flourish, in order to remedy the failures of past governmental planning. The Howe plan, which was a much scaled-down version of Hall's plan, was ultimately adopted by Parliament as the Local Government, Planning and Land Act of 1980 ("Land Act").[16]

The Land Act originally called for the designation of eleven zones in 1980, with an additional thirteen in 1982,[17] but even more zones have since come into operation. The primary purpose of the Land Act was to encourage capital-intensive industrial and commercial activity in the zones, while eschewing other goals such as

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[11] See S. Butler, Enterprise Zones: Greenlining the Inner Cities 97 (1981).

[12] Id.

[13] Id.

[14] Id.

[15] See Maloney, A Critical Analysis of the "Enterprise Zone" Concept and Its Application, 34 Tax Notes 261, 265 n.24 (Jan. 19, 1987) (address by Sir Geoffrey Howe, to Bow Group, in the Isle of the Dogs (June 26, 1978)). The Bow Group is an intellectual society associated with the British Conservative Party. The fact that a member of the British Conservative Party would publicly support a plan originated by a socialist academic is indicative of the strong bipartisan support for the enterprise zone concept in Britain.

[16] Local Government, Planning and Land Act of 1980, Ch. 65, Schedule 32, § 179 (1980), reprinted in 36 Hausbury's Statutes 828 (4th ed. 1987).

[17] Id.

promoting the mixed use of existing buildings or stimulating the housing market. The Land Act was designed to encourage medium to large businesses to expand into the zones, in the belief that increased industrial capacity would enhance economic conditions and create jobs for the zone's residents.[18]

The Land Act granted businesses that located in the zones a total exemption from the Development Land Tax and from the British equivalent of property taxes on business-related buildings.[19] It also gave businesses permission to write-off the entire cost of all buildings and equipment in one year.[20] In addition, many planning procedures, such as building codes and zoning restrictions, were simplified or eliminated and the procedures remaining were to be administered in a more timely fashion.[21]

Even though the United Kingdom's experience with enterprise zones has been mixed,[22] the concept, like the Pilgrims, survived the trip across the Atlantic Ocean and arrived in the United States.

B. The Federal Enterprise Zone Debate

In 1979, Stuart Butler, a leading advocate for enterprise zones, gave the United States its first introduction to the modern day concept of enterprise zones. In a report published by the Heritage Foundation, Butler analyzed the enterprise zone concept that had been created by Professor Hall and modified by Sir Geoffrey Howe.[23] This report brought the enterprise zone concept into the federal debate over the country's urban programs.

In 1980, Rep. Jack Kemp (R-N.Y.) introduced the first enter-

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[18] See Maloney, supra note 15, at 266.

[19] See Purton & Douglas, Enterprise Zones in the United Kingdom: A Successful Experiment?, 35 J. Plan. & Envtl. L. 412, 415-17 (1982). The Development Land Tax is equivalent to the United States' former capital gains tax. It was viewed as inhibiting the sale of real property. Furthermore, the property tax exemption did not apply to property used as residences.

[20] Id. at 415. This allowed these costs to be expensed rather than depreciated over time.

[21] Id. However, procedures and regulations that provide for basic health and safety standards remain intact.

[22] Id. See also Houlton & Mallon, Erroneous Zones, 104 New Statesman 6, 7 (1982); S. Butler, supra note 11; S. Butler, Free Zones in the Inner City, 27 Urb. Econ. Dev. 141, 152 (1984).

[23] S. Butler, Enterprise Zones: A Solution to Urban Crisis? (1979). See also Maloney, supra note 15, at 268 n.38.

prise zone bill.[24] In 1981, Kemp and Rep. Robert Garcia (D-N.Y.) introduced H.R. 3824, which became known as the Urban Jobs and Enterprise Zone Act.[25] On January 26, 1982, President Ronald Reagan in his State of the Union Address stated:

> . . . We're proposing enterprise zone legislation for an experimental effort to improve and develop our depressed urban areas in the 1980's and 1990's. This legislation will permit states and localities to apply to the federal government for designation as urban enterprise zones. A broad range of special economic incentives in the zones will help attract new business, new jobs, new opportunity to America's inner cities and rural towns. Some will say our mission is to save free enterprise. Well, I say we must free enterprise so that, together, we can save America.[26]

This speech marked the first significant commitment to enterprise zones by a U.S. administration.

In March, 1982, the Reagan Administration introduced the Enterprise Zone Tax Act of 1982[27] modeled after the Urban Jobs and Enterprise Zone Act of 1981. Realizing that prior efforts had not succeeded in stopping the economic deterioration that many cities and towns were experiencing, and that small businesses, government, and the private sector would have to work together to solve the problem, the 98th Congress introduced several more enterprise zone bills.[28] This overflow created considerable interest and discussion, much of which is reflected in an important congressional hearing on the subject.[29] Dan Rostenkowski,[30] Chairman of the

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[24] Congressman Kemp, now Secretary of Housing and Urban Development, originally introduced the enterprise zone concept in H.R. 7240, 96th Cong., 2d Sess. (1980), which was revised and reintroduced as H.R. 7563, 96th Cong., 2d Sess. (1980).

[25] H.R. 3824, 97th Cong., 1st Sess. (1981).

[26] State of the Union Address by Ronald Reagan, President of the United States, to Joint Session of Congress, in Washington, D.C. (Jan. 26, 1982), cited in Maloney, supra note 15, at 261.

[27] S. 2298, 97th Cong., 2d Sess., 128 Cong. Rec. 5803 (1982).

[28] For example, the following bills were introduced: H.R. 1955, 98th Cong., 1st Sess. (the Enterprise Zone Employment and Development Act of 1983); H.R. 1735, 98th Cong., 1st Sess. (the Community Assistance and Revitalization Act of 1983); and H.R. 2375, 98th Cong., 1st Sess. (the Enterprise Development and Industrial Revitalization Act of 1983).

[29] While the contents of these hearings are beyond the scope of this article, see generally Tax Incentives Targeted to Distressed Areas: Hearing before the Committee on Ways and Means, House of Representatives, 98th Cong., 1st Sess. (1983) [hereinafter "Tax Incentives Targeted"].

[30] Democrat from Illinois, who has represented the 8th District of Illinois since 1959.

House of Representatives' Committee on Ways and Means, opened the hearing with the following statement:

> I have been urged by Members of Congress, representatives of the Administration, mayors, governors and others, to conduct a hearing on enterprise zone proposals. As a Member of Congress representing an urban area characterized by persistent economic problems, I understand the need for the Federal government to assist in the redevelopment of distressed areas. The purpose of this hearing is to examine critically the question of whether or not tax provisions can be used to accomplish the redevelopment of particular geographic areas and, if so, whether any particular proposal is desirable in light of massive federal deficits.[31]

With the expected passage by the House and the Senate, the President's signature, and this endorsement, it appeared that federal enterprise zones would become a reality. However, while the idea lived, the legislation died.[32] While enterprise zone legislation did appear in the Deficit Reduction Act of 1984, it was scrapped before final passage. The Reagan administration continued to support the concept, obtaining a limited victory with the passage of Title VII of the HCDA, which provided for enterprise zones.[33] Nine years after its arrival in the United States, the enterprise zone concept finally became a federal project.

C. The Involvement of the States

While the federal government was lagging behind, many state governments adopted the enterprise zone idea. Within months of the concept's arrival from the United Kingdom, the first state bill incorporating enterprise zones was introduced in Illinois.[34] The bill however did not pass. The first operational enterprise zone in

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[31] Tax Incentives Targeted, supra note 29, at 1 (opening remarks of Dan Rostenkowski, Chairman of the House Committee on Ways and Means).

[32] See Finally! The Feds Pass Enterprise Zone Legislation, 21 Bus. Facilities 36 (1988). The article suggests that the failure of prior enterprise zone legislation, as well as the lack of tax incentives in the present legislation, can be explained by two factors. First, the politics of the budget deficit make it difficult to sell any program that is likely to result in a net drain on the federal treasury. Second, Ways and Means Committee Chairman Rostenkowski has steadfastly opposed tax incentives for federal enterprise zones, mainly because the Reagan Administration has supported them.

[33] See 42 U.S.C.A. §§ 11501-11504.

[34] See S. Butler, supra note 11, at 130.

the United States appeared in Norwalk, Connecticut, under Connecticut's 1982 Enterprise Zone legislation.[35] By May, 1989, thirty-seven states and the District of Columbia had enterprise zone programs on paper, thirty-one of which had actually designated specific areas as zones.[36] While many of the states that enacted enterprise zone legislation allowed the programs to become operational immediately, some had yet to designate areas, and others created provisions that would only become effective if and when federal enterprise zone legislation were to be enacted.[37]

Like the federal enterprise zone proposals, the state programs have differing details and goals. All, however, provide tax incentives to reduce the cost of running a business.[38] Common among the tax incentives used are: sales and use tax exemptions,[39] a wage credit for job creation,[40] an employer income tax credit,[41] a credit for hiring certain disadvantaged workers,[42] property tax reduction or abatement,[43] and investment credit for real improvements.[44]

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[35] See Conn. Gen. Stat. § 32-95 (1983).

[36] See Rosenbaum, Do Enterprise Zones Work?, I Editorial Research Reports 230, 231-32 (1989). Besides the District of Columbia, the following states have enacted enterprise zone programs: Alabama, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Georgia, Hawaii, Illinois, Indiana, Kansas, Kentucky, Louisiana, Maine, Maryland, Michigan, Minnesota, Mississippi, Missouri, Nevada, New Jersey, New York, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, Tennessee, Texas, Utah, Vermont, Virginia, West Virginia, and Wisconsin.

[37] See State-level Programs Continue to Spur New Investment, 21 Bus. Facilities 38 (1988). For example, Tennessee's Enterprise Zone Act was enacted in June, 1984, but no designation of areas has occurred. Rhode Island has had enterprise zone legislation on the books for many years, but its provisions can only become operational with the enactment of federal legislation, such as the HCDA.

[38] See U.S. Dep't of Hous. & Urb. Dev., State Enterprise Zone Update: Summaries of the State Enterprise Zone Programs (1988), which provides a state-by-state summary of status, eligibility criteria, number of zones, incentives used, and state contacts.

[39] Id. at 2. These tax incentives are employed by Arkansas, California, Colorado, Connecticut, Florida, Illinois, Kansas, Kentucky, Louisiana, Michigan, Minnesota, Mississippi, New Jersey, New York, Oklahoma, Texas, Virginia, and West Virginia.

[40] Id. This incentive is used by Alabama, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Indiana, Kansas, Louisiana, Maryland, Minnesota, Mississippi, Missouri, New Jersey, Rhode Island, South Carolina, and Vermont.

[41] Id. States using this incentive are California, Colorado, Connecticut, Delaware, Illinois, Indiana, Kansas, Louisiana, Maryland, Michigan, Minnesota, Mississippi, Missouri, New Jersey, Ohio, Rhode Island, and Virginia.

[42] Id. This credit is used by Alabama, Arizona, California, Connecticut, Delaware, Illinois, Kansas, Louisiana, Maryland, Missouri, New Jersey, New York, Ohio, Rhode Island, and Vermont.

[43] Id. Connecticut, Florida, Georgia, Illinois, Indiana, Maryland, Michigan, Minnesota,

Other incentives include availability of venture capital funds, tax increment financing, direct state loans, regulatory relief, and infrastructure improvement assistance.[45] In addition, some states have also created small business incubators.[46]

In Missouri, the primary goals of the enterprise zone program are the creation of jobs in economically depressed neighborhoods and stimulation of overall corporate growth in the state.[47] However, in Kentucky, the goals are business and industrial growth, and neighborhood revitalization.[48] In Illinois and Florida, the programs stress increased local participation in community projects.[49] Some states employ a competitive process to designate enterprise zones, while others award the enterprise zone designation upon meeting a formula of eligibility criteria.[50] Also, differences exist in the number and size of zones designated. Louisiana will allow up to one-quarter of the state's land area to receive enterprise zone designation, while Georgia has restricted its enterprise zone designation to areas within Atlanta.[51]

Actually, the diversity of detail and incentives among the various state and local programs, along with the somewhat inadequate procedures available for monitoring zone performance, has made it difficult to accurately assess the effectiveness of the state-level programs.[52] While some have failed, others have succeeded,[53] which suggests that the programs have been a move in the right direction. For example, in a state-by-state survey taken by *Business Facilities*, state-level enterprise zones were found to have accounted for the creation of 113,600 new jobs, 67,400 retained jobs, and a

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Missouri, Ohio, Oregon, Pennsylvania, and Rhode Island employ this incentive.

[44] Id. States using this incentive are Alabama, Colorado, Delaware, Florida, Illinois, Kansas, Minnesota, Missouri, New York, and Oklahoma.

[45] Id.

[46] Id.

[47] See Maloney, supra note 15, at 267-68.

[48] Id. at 268.

[49] Id.

[50] Id.

[51] Id.

[52] See U.S. Dep't of Hous. & Urb. Dev., Office of Program Analysis & Evaluation, State-Designated Enterprise Zones: Ten Case Studies iii (1986).

[53] See generally id. (reviewing case studies of state-designated enterprise areas in Bridgeport, CT (at 14-19); Chicago, IL (at 45-48); Dayton, OH (at 68-69); Louisville, KY (at 93-97); Macon (at 121-23) and St. Louis (at 130-34), MO; Michigan City, IN (at 161-64); Tampa, FL (at 180-82); Thief River Falls, MN (at 199-204); and York, PA (at 229-32)).

total capital investment of $8.8 billion.[54] A study conducted by the State of New York's Legislative Commission on Public-Private Cooperation concluded that even in the absence of federal legislation, state enterprise zones have been effective.[55] Furthermore, a 1983 report done by the Sabre Foundation found that "4,085 jobs had been saved, 4,601 jobs had been created, 8,477 jobs were planned by firms in the zones, and 3,108 jobs were to be created by firms in areas that were seeking state enterprise zone designation."[56] The report also revealed that "thirty percent of the new and saved jobs went to unemployed and disadvantaged workers."[57] Moreover, at a 1986 meeting of the American Association of Enterprise Zones, the Association concluded that the "incentives that have so far proven most effective in attracting new investment to the zones include property tax and sales tax abatements, followed by jobs tax credits."[58] Thus, enterprise zones appear to have worked for the states, and tax incentives have been the key to their success.

III. Federal Government Involvement

After years of debate, the federal government finally enacted enterprise zone legislation. On February 5, 1988, the 100th Congress enacted the HCDA.[59] The small portion of this legislation that deals with the development of enterprise zones[60] can be divided into four areas: designation, evaluation, interaction, and waiver or modification.

A. Designation of Enterprise Zones

In order to be classified as an enterprise zone under the HCDA, the area must:

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[54] Hatras, Enterprise Zones, Bus. Facilities (1987) (article separately reprinted with permission of the U.S. Dep't of Hous. & Urb. Dev.).

[55] See Maloney, supra note 15, at 268 & n.34 (citing Roy Goodman, Rebuilding our Cities: The Case for Enterprise Zones, Legislative Commission on Public-Private Cooperation, State of New York 4 (Albany, New York, 1985)).

[56] Maloney, supra note 15, at 268 & n.35 (citing Sabre Foundation, Enterprise Zone Activity in the States: Summary of Survey Findings (1983)).

[57] Id.

[58] See Maloney, supra note 15, at 268 & n.37 (citing American Association of Enterprise Zones, Enterprise Zone News 7-10 (1986)).

[59] See supra note 2.

[60] See 42 U.S.C.A. §§ 11501-11504 (West 1988).

1. be nominated by one or more local governments, and the state in which it is located, for designation as an enterprise zone (nominated area), and

2. be designated as an enterprise zone by the Secretary of Housing and Urban Development ("HUD") after consultation with the Secretaries of Agriculture, Commerce, Labor, and Treasury, the Director of the Office of Management and Budget, the Administrator of the Small Business Administration, and in the case of an area on an Indian reservation, the Secretary of the Interior.[61]

Furthermore, the Secretary of HUD may designate no more than one hundred nominated areas as federal enterprise zones.[62] Of these one hundred nominated areas, at least one-third must be:

1. within a local government jurisdiction or jurisdictions with a population of less than 50,000;

2. outside of a metropolitan statistical area; or

3. determined by the Secretary of HUD, after consultation with the Secretary of Commerce, to be rural areas.[63]

However, before the Secretary of HUD may designate an area as a federal enterprise zone, several conditions must occur.

1. Procedural Rules

Before an area can be designated as a federal enterprise zone, four conditions must be met. First, the local government and state in which the nominated area is located must have the authority:

1. to nominate such area for designation as an enterprise zone,

2. to make the necessary state and local commitments,[64] and

3. to provide assurances satisfactory to the Secretary of HUD that such commitments will be fulfilled.[65]

Second, the nomination must be submitted in the manner and form, and contain the requisite information, that the Secretary shall prescribe by regulation.[66] Third, the Secretary of HUD must determine that the information furnished is in fact reasonably accurate.[67] Fourth, the state and local governments must certify that

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[61] 42 U.S.C.A. § 11501(a)(1).
[62] 42 U.S.C.A. § 11501(a)(2)(A).
[63] 42 U.S.C.A. § 11501(a)(2)(B).
[64] See infra notes 72-74 and accompanying text.
[65] 42 U.S.C.A. § 11501(a)(4)(C)(i).
[66] 42 U.S.C.A. § 11501(a)(4)(C)(ii).
[67] 42 U.S.C.A. § 11501(a)(4)(C)(iii).

no portion of the area nominated is already included in an enterprise zone or in an area otherwise nominated to be an enterprise zone.[68]

Once designated as a federal enterprise zone, the area shall retain its designation during the period beginning on the date of designation and ending on the earliest of:

1. December 31 of the 24th calendar year following the calendar year in which such date occurs;

2. the termination date designated by the State and local governments as provided for in their nomination; or

3. the date the Secretary of HUD revokes such designation.[69]

The Secretary of HUD may revoke an area's federal enterprise zone designation only after following an extensive set of procedures.[70] First, the Secretary must consult with the Secretaries of Agriculture, Commerce, Labor, and Treasury, the Director of the Office of Management and Budget, the Administrator of the Small Business Administration, and in the case of an Indian reservation, the Secretary of the Interior.[71] The Secretary must then conduct a hearing on the record involving officials of the specified state or local government.[72] If it is determined that the local government or the state is not substantially complying with the state and local commitments, then the Secretary of HUD may revoke an area's federal enterprise zone designation.[73]

As previously mentioned, in order for a nominated area to be designated as a federal enterprise zone, the state and local governments must make certain commitments. They must agree in writing to comply with a specified course of action designed to help reduce some of the burdens borne by employers and employees in the specific area.[74] A course of action will not be approved unless it details methods to accomplish at least four of the following six goals:[75]

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[68] 42 U.S.C.A. § 11501(a)(4)(C)(iv). For Indian reservations, the reservation's governing body shall be deemed to be both the state and local governments. 42 U.S.C.A. § 11501(a)(5).

[69] 42 U.S.C.A. § 11501(d)(1).

[70] 42 U.S.C.A. § 11501(b)(2).

[71] Id.

[72] Id.

[73] Id.

[74] 42 U.S.C.A. § 11501(d)(1).

[75] Id.

1. a reduction of tax rates or fees which apply within the enterprise zone;

2. an increase in public services, or an increase in the efficiency of the delivery of public services, within the enterprise zone;

3. actions to simplify or remove paperwork requirements within the enterprise zone;

4. involvement in the enterprise zone program by public authorities or private entities, organizations, neighborhood associations, and community groups, particularly those within the nominated area, including a written commitment to provide jobs and job training for, and technical, financial, or other assistance to, employers, employees, and residents of the nominated area;

5. the giving of special preference to minority contractors; and

6. the donation, or sale at below fair market value, of surplus land in the enterprise zone to neighborhood organizations agreeing to operate a business on the land.[76]

The course of action may be implemented by the local government, the state, private nongovernmental entities, or a combination of the three.[77] In addition, the course of action may be funded, in whole or in part, with proceeds from any program administered by the Secretary of HUD or any program administered by the Secretary of Agriculture under Title V of the Housing Act of 1949.[78] If the state or local government has made efforts in the past to accomplish the above mentioned six goals, or has reduced the burdens borne by employers and employees in the nominated area by other methods, the Secretary of HUD is empowered to take these past efforts into consideration when evaluating the submitted course of action.[79]

With one exception, any course of action which is implemented may not include any action which is designed to assist 1) any establishment in relocating from one area to another area; or 2) any subcontractor whose purpose is to divest, or whose economic success is dependent upon divesting any other contractor or subcontractor of any contract customarily performed by such other con-

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[76] 42 U.S.C.A. § 11501(d)(2).

[77] Id.

[78] Id.

[79] 42 U.S.C.A. § 11501(d)(3).

tractor or subcontractor.[80] This limitation, however, will not be applied to a course of action which assists in the expansion of an existing business entity through the establishment of a new branch, affiliate, or subsidiary if the two following conditions are met. First, the Secretary of HUD must find that the establishment of the new branch, affiliate, or subsidiary will not result in an increase in unemployment in the area of original location or in any other area where the existing business entity conducts business operations.[81] Second, there should be no reason to believe that the new branch, affiliate, or subsidiary is being established with the intention of closing down the operations of the existing business entity in the area of its original location or in any other area where the existing business entity conducts business operations.[82]

2. *Area and Eligibility Requirements*

Even after an area has been nominated by the appropriate state or local government, and the commitment and course of action plan are in order, two additional requirements must be met before the Secretary of HUD may designate the area as a federal enterprise zone. The nominated area must pass area and eligibility requirements.[83]

a. *Area requirements*

In order for a nominated area to meet the area requirement, it must pass a three-part test. First, the area must be within the jurisdiction of the local government.[84] Second, the boundary of the area must be continuous.[85] Third, the area must either be entirely within an Indian reservation or have a population of not less than the following:

1. 4,000, if any portion of the area (other than a rural area) is located within a metropolitan statistical area with a population of 50,000 or more; or

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[80] 42 U.S.C.A. § 11501(d)(4)(A).
[81] 42 U.S.C.A. § 11501(d)(4)(B)(i).
[82] 42 U.S.C.A. § 11501(d)(4)(B)(ii).
[83] See 42 U.S.C.A. § 11501(c).
[84] 42 U.S.C.A. § 11501(c)(2)(A).
[85] 42 U.S.C.A. § 11501(c)(2)(B).

2. 1,000 in any other case.[86]

b. Eligibility requirements

After reviewing any supporting data the Secretary of HUD deems appropriate, the Secretary may accept certification from the state and local governments that a nominated area fits within a five-part eligibility standard. First, the area must be one of pervasive poverty, unemployment, and general distress.[87] Second, the area must be located wholly within the jurisdiction of a local government that is eligible for federal assistance under section 119 of the HCDA.[88] Third, the unemployment rate must not be less than one and one-half times the national unemployment rate for that period.[89] Fourth, the poverty rate must not be less than twenty percent.[90] Fifth, seventy percent or more of the households must have incomes below eighty percent of the median income of households in the area, or the population of the area must have decreased by twenty percent or more between 1970 and 1980.[91] A rural nominated area will meet the eligibility requirements if its state and local governments certify, and the Secretary of HUD accepts such certification, that the area meets the first two above-mentioned eligibility requirements and at least one of the remaining

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[86] 42 U.S.C.A. § 11501(c)(2)(C).

[87] 42 U.S.C.A. § 11501(c)(3)(A). An area of pervasive poverty, unemployment, or general distress is defined as:

> (1) *Pervasive poverty and unemployment.* The conditions of poverty must be reasonably distributed throughout the entire area. The poverty rate shall be described by citing nationally and locally available statistics on poverty. The unemployment situation shall be demonstrated through provision of information on job loss, plant closing, or other unemployment indicators which have affected the area.
>
> (2) *General distress.* The area must be an area of general distress. General distress shall be evidenced by describing conditions of distress existing within the area, other than those of poverty and unemployment, such as abandoned housing, infrastructure deficiencies, or other appropriate indicators of conditions of general distress.

24 C.F.R. § 596.101(c) (1989).

[88] 42 U.S.C.A. § 11501(c)(3)(B). Federal assistance is available to cities and urban counties that have demonstrated results in providing housing for persons of low and moderate income, and in providing equal opportunity housing and employment for low and moderate income persons and members of minority groups. See 42 U.S.C.A. § 5318(6)(1) (West Supp. 1989).

[89] 42 U.S.C.A. § 11501(c)(3)(C). As of August 1989, Reuters Business Report lists the unemployment rate at 5.2%.

[90] 42 U.S.C.A. § 11501(c)(3)(D).

[91] 42 U.S.C.A. § 11501(c)(3)(E).

three eligibility requirements.[92]

In designating the nominated areas, the Secretary of HUD must rank the areas with respect to the last three eligibility requirements.[93] In so doing, an area will be ranked within each of the last three eligibility categories on the basis of the amount by which the area exceeds the minimum criterion of the requirement. The area that exceeds this requirement by the greatest amount will be given the highest ranking.[94]

B. Evaluation and Reporting

Section 702 of Title VII of the HCDA establishes a method for reviewing the progress of the legislation.[95] By the end of the fourth calendar year after the year in which an area is designated an enterprise zone, the Secretary of HUD must submit a progress report to Congress.[96] In addition, the Secretary must submit a similar progress report at the close of each fourth calendar year after the submission of the first report.[97] All of these reports should describe the improvements resulting from the area's designation as an enterprise zone.[98]

C. Interaction

The legislation creating federal enterprise zones provides two rules concerning interaction with other federal programs. First, any area that meets all the requirements under section 701 of Title VII

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[92] 42 U.S.C.A. § 11501(c)(4). For example, a rural area would have to be an area of pervasive poverty, unemployment, and general distress, be located wholly within the jurisdiction of a local government that is eligible for federal assistance under § 119 of the Housing and Community Development Act of 1974, and have at least one of the following: (1) an unemployment rate 1.5 times the national rate, (2) a poverty rate of more than 20%, or (3) at least 70% of its households with incomes below 80% of the median income of local households (or a 20% decrease in population in the area between 1970 and 1980). See id.

[93] 42 U.S.C.A. § 11501(a)(3)(A).

[94] 42 U.S.C.A. § 11501(a)(3) is entitled "Areas designated *based solely on degree of poverty*" (emphasis added). Part (C) of that section explains that "such ranking is to be applied separately with respect to rural areas and to areas to be designated based solely on the degree of poverty." 42 U.S.C.A. § 11501(a)(3)(C).

[95] See Pub. L. No. 100-242, § 702, 101 Stat. 1961 (1988) (codified at 42 U.S.C.A. § 11502 (West 1988)).

[96] 42 U.S.C.A. § 11502.

[97] Id.

[98] Id.

of the HCDA and is thereby designated an enterprise zone, shall also be treated for purposes of federal law as a labor surplus area, thus entitling it to procurement set-asides by executive agencies.[99] In addition, the designation of an area as an enterprise zone shall not be deemed as an approval of a federal or federally-assisted program or project,[100] nor shall it entitle any person who is displaced from real property located in the enterprise zone to any rights or benefits under the Uniform Relocation Assistance and Real Property Acquisition Policy Act of 1970.[101]

D. Waiver or Modification

Section 704 of the Enterprise Zone Development legislation provides for some limited waiver and modification of the HCDA rules with regard to enterprise zones.[102] By way of written request, the state and local governments that designated and approved an area as an enterprise zone may request the Secretary of HUD to waive or modify all or some of the rules that pertain to the activities within the enterprise zone.[103] The rules must be ones that the Secretary has authority to promulgate, and the waiver or modification must further the employment, community development, or economic revitalization objectives of the enterprise zone.[104]

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[99] 42 U.S.C.A. § 11503(b) (West 1988) (as enacted by Pub. L. No. 100-242, § 703, 100 Stat. 1961 (1988)). A labor surplus area is defined as an area where the average unemployment rate for all civilian workers is 120% of the national average unemployment rate or higher, or 10% or higher. See 20 C.F.R. § 654.5(a) (1989). Furthermore, in order to strengthen the economic base of the nation, executive agencies can and shall emphasize procurement set-asides in labor surplus areas. See Executive Order No. 12,073, 3 C.F.R. 216 (1979).

[100] 42 U.S.C.A. § 11503(a)(1). A federal or federally-assisted program or project is defined in the Uniform Relocation Assistance and Real Property Acquisition Policy Act of 1970 as any program or project that receives a grant, loan, or contribution provided by the United States Government. See 42 U.S.C.A. § 4601(4) (West 1988).

[101] 42 U.S.C.A. § 11503. The Act entitles a displaced person to receive payments for:

1) actual reasonable expenses in moving himself, his family, business, farm operation, or other personal property;

2) direct loss of personal property as a result of moving or discontinuing a business or farm operation; and

3) actual reasonable expenses in searching for a replacement business or farm operation.

See Pub. L. No. 91-646 (1971).

[102] 42 U.S.C.A. § 11504 (West 1988) (as enacted by Pub. L. No. 100-242, § 704, 101 Stat. 1962 (1988)).

[103] 42 U.S.C.A. § 11504(a).

[104] Id.

Any request for a waiver or modification must specify the rule or rules to be waived or modified, the changes proposed, and a brief description of how the change will promote the employment, community, or revitalization objectives of the enterprise zone.[105] Before granting or denying the request, the Secretary of HUD must weigh the extent to which the proposed changes will further these goals, and balance this against other effects the rule change may have in the relevant geographic area.[106] If the Secretary finds that the employment and development benefits arising from the proposed change outweigh the public interest in retention of the rule, the request for waiver or modification shall be granted.[107] Otherwise, the request shall be denied and the Secretary shall inform the requesting governments of the reasons for such denial and, to the extent allowable, shall work with such governments to develop an alternative plan.[108] If a request for waiver or modification of a rule is granted, such waiver or modification cannot remain in effect beyond the date that the applicable area retains its enterprise zone designation.[109]

However, the Secretary of HUD is prohibited from waiving or modifying any rule adopted to carry out a statute or executive order that is designed to protect persons from discrimination on the basis of race, color, religion, sex, marital status, national origin, age, or handicap.[110] In addition, any waiver or modification requests that would directly violate a statutory health, safety, or medical requirement, or that are likely to pose a significant risk to the public health (including environmental health or safety), must be denied.[111]

E. Analysis

The biggest problem with the HCDA relates to its origin. The actual bill is a product of the Congressional Committee on Banking, Finance, and Urban Affairs, not the Committee on Ways and

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[105] 42 U.S.C.A. § 11504(c).
[106] 42 U.S.C.A. § 11504(d).
[107] Id.
[108] 42 U.S.C.A. § 11504(e).
[109] 42 U.S.C.A. § 11504(f).
[110] 42 U.S.C.A. § 11504(b).
[111] 42 U.S.C.A. § 11504(d).

Means.[112] Unfortunately, the Committee on Banking, Finance, and Urban Affairs is not capable of establishing the tax incentives (or sanctions) that is the critical component missing from this bill.

The Special Economic Zones of the People's Republic of China, the Hall-Howe modified enterprise zone of Britain, and the various enterprise zone programs of individual American states all have two key ingredients in their enterprise zone enactments. One is full or partial relief from governmental interference. The other is tax incentives.

While full relief from governmental interference is unrealistic in the United States, the HCDA does ease governmental interference by allowing the waiver of some rules. Thus, conducting business in an enterprise zone could be made easier by the Act.

However, while the HCDA goes a long way towards authorizing federal enterprise zones, it fails to provide the tax incentives necessary to encourage business and investment in the zones. Without tax incentives, Title VII of the HCDA is nothing more than a skeleton, because such incentives are needed to encourage businesses to locate and invest in the zones, thus fulfilling the goals of the enterprise zone concept.

Moreover, the legislative history of the bill shows that the Committee on Banking, Finance, and Urban Affairs was well aware that tax incentives were missing:

> This proposed Enterprise Zone legislation is one part of the larger administration proposal which falls [within] the jurisdiction of the Committee on Ways and Means. Since the basic structure of the federal Enterprise Zone proposal requires major tax legislation, approval by this Committee of the proposal contained in this bill would not create the Enterprise Zone Program that the Administration has been recommending for the past few years.[113]

Thus, it is now time for the "incentive makers" - the Committee on Ways and Means - to implement the second key ingredient, tax incentives, in order to invigorate the federal enterprise zone concept.

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[112] See H.R. Rep. No. 122(I), 100th Cong., 1st Sess. 4, reprinted in 5 U.S. Code Cong. & Admin. News 3317.

[113] See H.R. Rep. No. 122(I), 100th Cong., 1st Sess. 100, reprinted in 5 U.S. Code Cong. & Admin. News 3317, 3416.

IV. Proposed Federal Tax Incentives

Realizing that the enabling legislation for the designation of federal enterprise zones[114] lacked the necessary elements for success, Rep. Charles Rangel (D-N.Y.) introduced H.R. 6[115] to the United States House of Representatives. This bill, which would be entitled the "Enterprise Zones Improvements Act of 1989," proposes amending the Internal Revenue Code (the "Code") in seven ways. Its basic goal is to provide incentives for investment in federal enterprise zones.

A. Credit for Employers and Employees

The first tax incentive proposed by the Enterprise Zones Improvements Act of 1989 (the "Act") involves granting tax credits to both employers who locate businesses in enterprise zone areas and to those area residents who are employed within a zone.[116]

1. The Employers

H.R. 6 would add a new section 30 to the Code entitled "Credit For Enterprise Zone Employment" which would give an employer a credit against federal income tax.[117] The credit would be equal to ten percent of the qualified increased employment expenditures of the taxpayer, plus the "economically disadvantaged amount" of the taxpayer for the taxable year.[118]

a. Economically disadvantaged amount

In order to determine an employer's "economically disadvantaged amount," the sum of the applicable percentage of qualified wages paid to each "qualified economically disadvantaged individual" must be ascertained.[119] Thus, the terms "applicable percentage," "qualified wages," "qualified employee," and "qualified economically disadvantaged individual" must be adequately defined.

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[114] Title VII of the HCDA. See supra notes 2-3 and accompanying text.
[115] H.R. 6, 101st Cong., 1st Sess. (1989). See supra note 5.
[116] See H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30).
[117] Id.
[118] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(a)).
[119] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(d)).

i. Applicable percentage

To arrive at the applicable percentage with respect to any qualified economically disadvantaged individual, the period of time that qualified wages are paid to that individual becomes important. If the qualified wages are paid for services performed during the first three years after the individual's starting date (the day on which the qualified economically disadvantaged individual begins work for the employer within a federally designated enterprise zone),[120] then the applicable percentage is fifty percent.[121] For each additional year after the first three years, the applicable percentage is adjusted downward by ten percentage points. Once the applicable percentage reaches ten percent, it does not change through the twentieth year of the individual's service. Beginning in the individual's twenty-first year of service, the applicable percentage drops to zero.[122]

Once a qualified economically disadvantaged individual has completed three years of service, his service time can be extended under two circumstances. The first is any period of time in which the individual is unemployed. The second is any period of time during which the individual is employed by a taxpayer in an enterprise zone designated under a state law enacted after January 1, 1981, but only if such designation occurs prior to designation of the enterprise zone under section 701 of the Act.[123]

ii. Qualified wages

For purposes of the Act, the term "qualified wages" has the same meaning as "wages" in section 3306(b) of the Code,[124] but

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[120] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(d)(3)(A)).

[121] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(d)(2)).

[122] Id.

[123] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(d)(3)(B)).

[124] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(e)(1)). Section 3306(b) defines "wages" as:

> (b) WAGES.—For purposes of this chapter, the term "wages" means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash; except that such term shall not include—
>
> (1) that part of the remuneration which, after remuneration (other than remuneration referred to in the succeeding paragraphs of this subsection) equal to $7,000 with respect to employment has been paid to an individual by an employer during any calendar year, is paid to such individual by such employer during such calendar year. If an employer (hereinafter referred to as successor

with three modifications. First, any reference to dollar limitations

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employer) during any calendar year acquires substantially all the property used in a trade or business of another employer (hereinafter referred to as a predecessor), or used in a separate unit of a trade or business of a predecessor, and immediately after the acquisition employs in his trade or business an individual who immediately prior to the acquisition was employed in the trade or business of such predecessor, then, for the purpose of determining whether the successor employer has paid remuneration (other than remuneration referred to in the succeeding paragraphs of this subsection) with respect to employment equal to $7,000 to such individual during such calendar year, any remuneration (other than remuneration referred to in the succeeding paragraphs of this subsection) with respect to employment paid (or considered under this paragraph as having been paid) to such individual by such predecessor during such calendar year and prior to such acquisition shall be considered as having been paid by such successor employer;

(2) the amount of any payment (including any amount paid by an employer for insurance or annuities, or into a fund, to provide for any such payment) made to, or on behalf of, an employee or any of his dependents under a plan or system established by an employer which makes provision for his employees generally (or for his employees generally and their dependents) or for a class or classes of his employees (or for a class or classes of his employees and their dependents), on account of—

(A) sickness or accident disability (but, in the case of payments made to an employee or any of his dependents, this subparagraph shall exclude from the term "wages" only payments which are received under a workmen's compensation law), or

(B) medical or hospitalization expenses in connection with sickness or accident disability, or

(C) death;

(3) [Repealed in 1983];

(4) any payment on account of sickness or accident disability, or medical or hospitalization expenses in connection with sickness or accident disability, made by an employer to, or on behalf of, an employee after the expiration of six calendar months following the last calendar month in which the employee worked for such employer;

(5) any payment made to, or on behalf of, an employee or his beneficiary—

(A) from or to a trust described in section 401(a) which is exempt from tax under section 501(a) at the time of such payment unless such payment is made to an employee of the trust as remuneration for services rendered as such employee and not as a beneficiary of the trust, or

(B) under or to an annuity plan which, at the time of such payment, is a plan described in section 403(a),

(C) under a simplified employee pension (as defined in section 408(k)(1)), other than any contributions described in section 408(k)(6),

(D) under or to an annuity contract described in section 403(b), other than a payment for the purchase of such contract which is made by reason of a salary reduction agreement (whether evidenced by a written instrument or otherwise),

(E) under or to an exempt governmental deferred compensation plan (as defined in section 3121(v)(3)),

(F) to supplement pension benefits under a plan or trust described in any of the foregoing provisions of this paragraph to take into account some portion or all of the increase in the cost of living (as determined by the Secretary of Labor) since retirement but only if such supplemental payments are under a plan which is treated as a welfare plan under section 3(2)(B)(ii) of the Employee Retirement Income Security Act of 1974; or

(G) under a cafeteria plan (within the meaning of section 125),

(6) the payment by an employer (without deduction from remuneration of the employee)—

(A) of the tax imposed upon an employee under section 3101, or

(B) of any payment required from an employee under a State unemployment compensation law, with respect to remuneration paid to an employee for domestic service in a private home of the employer or for agricultural labor;

(7) remuneration paid in any medium other than cash to an employee for service not in the course of the employer's trade or business;

(8) [Repealed in 1983];

(9) remuneration paid to or on behalf of an employee if (and to the extent that) at the time of the payment of such remuneration it is reasonable to believe that a corresponding deduction is allowable under section 217;

(10) any payment or series of payments by an employer to an employee or any of his dependents which is paid—

(A) upon or after the termination of an employee's employment relationship because of (i) death, or (ii) retirement for disability, and

(B) under a plan established by the employer which makes provision for his employees generally or a class or classes of his employees (or for such employees or classes of employees and their dependents), other than any such payment or series of payments which would have been paid if the employee's employment relationship had not been so terminated;

(11) remuneration for agricultural labor paid in any medium other than cash;

(12) any contribution, payment, or service, provided by an employer which may be excluded from the gross income of an employee, his spouse, or his dependents, under the provisions of section 120 (relating to amounts received under qualified group legal services plans);

(13) any payment made, or benefit furnished, to or for the benefit of an employee if at the time of such payment or such furnishing it is reasonable to believe that the employee will be able to exclude such payment or benefit from income under section 127 or 129;

(14) the value of any meals or lodging furnished by or on behalf of the employer if at the time of such furnishing it is reasonable to believe that the employee will be able to exclude such items from income under section 119;

(15) any payment made by an employer to a survivor or the estate of a former employee after the calendar year in which such employee died; or

(16) any benefit provided to or on behalf of an employee if at the time such benefit is provided it is reasonable to believe that the employee will be able to exclude such benefit from income under section 74(c), 117 or 132.

Nothing in the regulations prescribed for purposes of chapter 24 (relating to income tax withholding) which provides an exclusion from "wages" as used in such chapter shall be construed to require a similar exclusion from "wages" in the regulations prescribed for purposes of this chapter.

Except as otherwise provided in regulations prescribed by the Secretary, any

in section 3306(b) should be disregarded.[125] Second, any federally-funded payments the employer receives, or is entitled to receive, for on-the-job training of a qualified economically disadvantaged individual are not included in the computation of qualified wages.[126] Finally, the Act would authorize the Secretary to create special rules similar to section 51(h) of the Code, which addresses agricultural and railway labor wages.[127]

iii. Qualified employee

An individual is a qualified employee if at least ninety percent of his or her services are directly related to the employer's enterprise zone business[128] and at least fifty percent of the individual's services are performed in an enterprise zone.[129] However, any individ-

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third party which makes a payment included in wages solely by reason of the parenthetical matter contained in subparagraph (A) of paragraph (2) shall be treated for purposes of this chapter and chapter 22 as the employer with respect to such wages.

I.R.C. § 3306(b).

[125] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(e)(1)).

[126] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(e)(2)).

[127] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(e)(3)). See § 51(h)(1)-(2) which addresses "Special Rules for Agricultural Labor and Railway Labor" and provides:

(1) UNEMPLOYMENT INSURANCE WAGES.—

(A) AGRICULTURAL LABOR.—If the services performed by any employee for an employer during more than one-half of any pay period (within the meaning of section 3306(d)) taken into account with respect to any year constitute agricultural labor (within the meaning of section 3306(k)), the term "unemployment insurance wages" means, with respect to the remuneration paid by the employer to such employee for such year, an amount equal to so much of such remuneration as constitutes "wages" within the meaning of section 3121(a), except that the contribution and benefit base for each calendar year shall be deemed to be $6,000.

(B) RAILWAY LABOR.—If more than one-half of remuneration paid by an employer to an employee during any year is remuneration for service described in section 3306(c)(9), the term "unemployment insurance wages" means, with respect to such employee for such year, an amount equal to so much of the remuneration paid to such employee during such year which would be subject to contributions under section 8(a) of the Railroad Unemployment Insurance Act (45 U.S.C. 358(a)) if the maximum amount subject to such contributions were $500 per month.

(2) WAGES.—In any case to which subparagraph (A) or (B) of paragraph (1) applies, the term "wages" means unemployment insurance wages (determined without regard to any dollar limitation).

I.R.C. § 51(h)(1)-(2).

[128] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(f)(1)(A)).

[129] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(f)(1)(B)).

ual with respect to whom the employer takes any credit determined under section 51(a) of the Code for the taxable year cannot be recognized as a qualified employee for that taxable year.[130]

iv. Qualified economically disadvantaged individual

In order for an individual to qualify as a qualified economically disadvantaged individual, a three-part test must be met. First, the individual must be a qualified employee.[131] Second, the individual must be hired by an employer during the period that an enterprise zone designation is in effect for the area in which the services are performed.[132] Third, the individual must be able to be certified as either a general assistance recipient,[133] an eligible work incentive employee,[134] or an economically disadvantaged individual.[135] While

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[130] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(f)(2)). Section 51(a) allows an employer a targeted jobs credit equal to 40% of any qualified first year wages paid during the taxable year. I.R.C. § 51(a).

[131] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(g)(1)(A)). See supra notes 128-30 and accompanying text.

[132] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(g)(1)(B)).

[133] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(g)(1)(c)(iii)). See I.R.C. § 51(d)(6) which provides:

> (6) GENERAL ASSISTANCE RECIPIENTS.—
>
> (A) IN GENERAL.— The term "general assistance recipient" means any individual who is certified by the designated local agency as receiving assistance under a qualified general assistance program for any period of not less than 30 days ending within the preemployment period.
>
> (B) QUALIFIED GENERAL ASSISTANCE PROGRAM.—The term "qualified general assistance program" means any program of a State or a political subdivision of a State—
>
> (i) which provides general assistance or similar assistance which—
>
> (I) is based on need, and
>
> (II) consists of money payments or voucher or scrip, and
>
> (ii) which is designated by the Secretary (after consultation with the Secretary of Health and Human Services) as meeting the requirements of clause (i).

I.R.C. § 51(d)(6).

[134] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(g)(1)(c)(ii)). See § 51(d)(9) which provides:

> (9) ELIGIBLE WORK INCENTIVE EMPLOYEES.—The term "eligible work incentive employee" means an individual who has been certified by the designated local agency as—
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> (A) being eligible for financial assistance under part A of title IV of the Social Security Act and as having continually received such financial assistance during the 90-day period which immediately precedes the date on which such individual is hired by the employer, or
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> (B) having been placed in employment under a work incentive program established under section 432(b)(1) or 445 of the Social Security Act.

a general assistance recipient and an eligible work incentive employee are already defined in the Code,[136] the new section would provide its own definition for an economically disadvantaged individual.[137]

Under the new section, an economically disadvantaged individual is any individual certified by the designated local agency as being a member of a family that had a combined family income equal to or less than the sum of:

> (i) the highest amount which would ordinarily be paid to a family of the same size without any income or resources in the form of payments for aid to families with dependent children under the State plan approved under part A of title IV of the Social Security Act for the State in which such individual resides, plus,
>
> (ii) the highest cash value of the food stamps to which a family of the same size without any income or resources would be paid aid to families with dependent children under such State plan in the amount determined under clause (i).[138]

The family's combined income would include the cash value of any food stamps received and such determination would be made for a six-month period preceding the month in which the determination occurs.[139] However, the income received during that six-month period must be equal to or less than the annual income referred to above.[140] In addition, any determination shall be valid only for a forty-five day period beginning on the date of such determination.[141] If the family in question consists of only one individual, a special rule would exist. In this case, the "highest amount which would ordinarily be paid" to such family under the state's plan approved under Part A of Title IV of the Social Security Act shall be an amount determined by the designated local agency on the basis of a reasonable relationship to the amounts payable under such plan to families consisting of two or more persons.[142]

I.R.C. § 51(d)(9).

[135] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(g)(1)(c)(i)).

[136] See I.R.C. § 51(d)(6), (d)(9).

[137] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(g)(2)).

[138] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(g)(2)(A)).

[139] Id.

[140] Id.

[141] Id.

[142] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(g)(2)(B)).

v. Example A

To illustrate the economically disadvantaged credit amount, consider the following example. Employer A is attempting to compute his economically disadvantaged credit amount for the year 19X3. Employer A has a small business which is located in a federally designated enterprise zone and he employs four full-time workers: W, X, Y, and Z. All four workers are qualified employees who are certified as economically disadvantaged individuals. Their qualified wages and service time after the starting date are as follows:

Employee	Qualified Wages	Service Time (Years)
W	$10,000	5
X	8,000	3
Y	14,500	6
Z	17,000	9

Since W's qualified wages are being paid to him in the fifth year after his starting date, the applicable percentage to be used for him is thirty percent.[143] For X the applicable percentage is fifty percent, and for Y and Z the applicable percentages are twenty and ten percent, respectively. Employer A's economically disadvantaged credit amount would thus be computed in the following manner:

Employee	Wages	Applicable %	Credit
W	$10,000	30	$ 3,000
X	8,000	50	4,000
Y	14,500	20	2,900
Z	17,000	10	1,700
		Total	$11,600

For the year 19X3, Employer A has an economically disadvantaged credit amount of $11,600.

b. Qualified increased employment expenditures

To determine the enterprise zone credit for an employer, ten percent of the employer's qualified increased employment expenditure can be added to the employer's economically disadvantaged

[143] The applicable percentage rates are found in H.R. 6, 101st Cong., 1st Sess. § 201(a). See supra text accompanying notes 120-22.

credit amount.[144] An employer's qualified increased employment expenditure is defined as "the excess of (A) the qualified wages paid or incurred by the employer during the taxable year to qualified employees with respect to all enterprise zones, over (B) the base period wages of the employer with respect to all such zones."[145] While the definitions of qualified wages and qualified employees are consistent with the concept of the economically disadvantaged credit amount,[146] a distinction does exist. Since the qualified increased employment expenditures do not demand that qualified wages be paid to a qualified economically disadvantaged individual, qualified wages paid to employees who meet the qualified employees test, but fail the economically disadvantaged individual test, are eligible.[147]

However, in determining the qualified wages for purposes of the qualified increased employment expenditure, two limitations must be applied. First, if the wages are taken into account in determining the economically disadvantaged credit amount, they cannot be taken into account in determining the qualified increased employment expenditures.[148] Second, the amount of any qualified wages taken into account in determining the qualified increased employment expenditure "for any taxable year with respect to any qualified employee may not exceed 2.5 times the dollar limitation in effect under section 3306(b)(1) for the calendar year with or within which such taxable year ends."[149]

With respect to any enterprise zone, the term "base period wages" has a special definition. It is defined as:

> The amount of wages paid to employees during the 12-month period preceding the date on which the enterprise zone was designated as such under section 701 of the Enterprise Zone Act, or the date on which the enterprise zone is designated under State law, enacted after January 1, 1981, if earlier, which would have been qualified wages paid to qualified employees if such designation had

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[144] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(a)).

[145] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(c)(1)).

[146] Id. See supra notes 124-30 and accompanying text.

[147] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(c)).

[148] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(c)(2)(B)).

[149] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(c)(2)(A)). See supra note 124 for the I.R.C. § 3306(b)(1) dollar limitation.

been in effect for such period.[150]

c. Example B

To illustrate the qualified increased employment expenditure, consider the facts in Example A plus the following additional facts. In addition to employees W, X, Y, and Z, employer A has two other employees, U and V. Neither U nor V can qualify as an economically disadvantaged individual, so no economically disadvantaged credit can be taken for them. Both are qualified employees, however, and their wages are qualified wages. U's qualified wages for the year 19X3 are $21,000, while V's are $18,500. For purposes of illustration, the amount of wages paid to employees by employer A during the 12-month period preceding the date on which the applicable zone was designated an enterprise zone was $8,500. To determine the qualified wages paid for purposes of the qualified increased employment expenditure, two limitations must be applied.

First, qualified wages used to compute the economically disadvantaged credit amount must be ignored. Therefore, the $49,500 of qualified wages paid to employees W, X, Y, and Z is excluded. This leaves U's $21,000 and V's $18,500 as the only potential qualified wages for use in computing employer A's qualified increased employment expenditure.

However, the second limitation can serve to reduce both U's and V's qualified wage amount for purposes of this test. This limitation only allows 2.5 times the section 3306(b)(1) dollar amount to be taken into account for each qualified employee. Since the section 3306(b)(1) dollar amount is $7,000, the limitation is $17,500. Therefore, $3,500 of U's $21,000 wages and $1,000 of V's $18,500 will be disregarded for purposes of this test. Therefore, the qualified wages paid by employer A during the taxable year to qualified employees will be $35,000 ($17,500 for U and $17,500 for V). Because the base period wage amount is $8,500, employer A's qualified increased employment expenditures for 19X3 will be $26,500 ($35,000 minus $8,500).

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[150] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(c)(3)(A)).

d. The credit for enterprise zone employment—limitations and unused credits

Incorporating Examples A and B, employer A's enterprise zone employment credit for 19X3 would be the sum of ten percent of his qualified increased employment expenditures plus his economically disadvantaged credit amount.[151] This credit amount would be $2,650 (10 percent of $26,500 of qualified increased employment expenditures) plus $11,600 (the economically disadvantaged credit amount), for a total of $14,250.

The enterprise zone employment credit is subject to an important limitation, however. The limitation requires that the credit allowed for the taxable year shall not be greater than the regular tax for the taxable year, reduced by the sum of allowable credits under subpart A and sections 27, 28, and 29 of the Code, minus the taxable year's tentative minimum tax.[152] If an amount of enterprise zone employment credit remains after applying the limitation, the remaining credit becomes an unused enterprise zone employment credit and the taxable year becomes an unused credit year.[153] The unused enterprise zone employment credit shall be allowed as an enterprise zone employment credit carryback to each of the three taxable years preceding the unused credit year, and as an enterprise zone employment credit carryover to each of the fifteen taxable years following the unused credit year.[154] The carryback/carryover of unused enterprise zone employment credit shall be carried to the earliest of the eighteen taxable years to which the credit may be carried, and then to each of the other seventeen taxable years.[155] The unused enterprise zone employment credit that is carried back or carried over may be added to any existing enterprise zone employment credit for that taxable year or may solely comprise the enterprise zone employment credit for such year.[156] However, the unused credit added in any preceding or succeeding taxable year may not exceed the regular enterprise zone employ-

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[151] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(a)).

[152] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(b)(1)).

[153] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(b)(2)).

[154] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(b)(2)(A)). This is similar to the carryback and carryovers of net operating losses provided for in I.R.C. § 172(b).

[155] Id.

[156] Id.

ment credit for such taxable year minus the sum of the enterprise zone employment credit for such taxable year plus the amounts which are added to the allowable amount for such taxable year which are attributable to taxable years preceding the unused credit year.[157]

e. Example C

By using the situation described in Examples A and B, the limitation and carryovers of enterprise zone employment credits can be illustrated.

If employer A's regular tax for 19X3 minus allowable credits is $15,000 and his tentative minimum tax for the same year is $11,500, then his allowable enterprise zone employment credit for 19X3 cannot exceed $3,500 (the excess of $15,000 over $11,500). Because employer A's tentative enterprise zone employment credit for 19X3 was $14,250[158] and he will only be able to use $3,500 in 19X3, 19X3 becomes an unused credit year and he will have $10,750 of unused enterprise zone employment credit ($14,250 minus $3,500). The $10,750 of unused enterprise zone employment credit may be carried back 3 years and then carried over 15 years. The order in which it must be applied is: initially to the third year preceding 19X3, then to the second year preceding 19X3, followed by the year preceding 19X3, then to the first year succeeding 19X3, and so on until the unused enterprise zone employment credit is exhausted, or the eighteen-year period expires. In any of these years, the unused enterprise zone employment credit can be added to the enterprise zone employment credit for that year, subject to limitations.

For example, assume employer A attempts to carry the $10,750 of unused enterprise zone employment credit to the third year preceding 19X3, or taxable year 19X0. In 19X0, employer A's regular tax minus allowable credits was $25,000 and his tentative minimum tax was $15,000. In addition, he had a $3,000 enterprise zone employment credit for 19X0 and $1,000 of unused enterprise zone employment credit carried over to 19X0 from a year preceding both 19X0 and 19X3. In attempting to add the $10,750 of unused

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[157] Id.

[158] See supra note 151 and accompanying text.

enterprise zone employment credit from 19X3 to 19X0's enterprise zone employment credit, employer A is faced with the second limitation. He must first determine his enterprise zone employment credit limitation for 19X0. Because his regular tax, minus credits for 19X0, exceeds his tentative minimum tax for 19X0 by $10,000 ($25,000 minus $15,000), $10,000 is employer A's enterprise zone employment credit limitation for 19X0. All $3,000 of employer A's enterprise zone employment credit for 19X0 will be allowed, as well as all $1,000 of unused enterprise zone employment credit carried forward to 19X0. Therefore, this $4,000 of enterprise zone employment credit ($3,000 plus $1,000) must be subtracted from the 19X0 limitation of $10,000 to arrive at the portion of the 19X3's unused enterprise zone employment credit that will be allowed to be added on in 19X0. The amount added on to the 19X0 amount from 19X3 cannot exceed this $6,000 difference ($10,000 minus $4,000). Thus, only $6,000 of the 19X3 unused enterprise zone employment credit can be carried back to 19X0 and added to the 19X0 enterprise zone employment credit amount of $4,000, thereby exhausting the $10,000 limitation for enterprise zone employment credits allowed for 19X0. The remaining $4,750 ($10,750 minus $6,000) of 19X3 unused enterprise zone employment credit will now be applied to the second year preceding 19X3, or 19X1, subject to similar limitations.

f. Special rules applicable to the enterprise zone employment credit

i. Phase-out of credit

In determining the enterprise zone employment credit, special rules apply when the area continues, or ceases, to be a federally-designated enterprise zone. The special rules operate by reducing the potential amount of enterprise zone employment credit available to the employer. Two important reductions will occur on the earlier of 1) the taxable year which is twenty-one years after the date on which the area was designated an enterprise zone under section 701 of the Act, or 2) the taxable year which is four years before the date (if any), on which such area ceases to be an enterprise zone under section 701(b)(1)(B) of the Act.[159] First, instead

[159] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(i)(1)).

of allowing 10 percent of the qualified increased employment expenditures as part of the enterprise zone employment credit, the employer only will be allowed 7.5 percent.[160] Second, the employer only will be allowed 75 percent of the economically disadvantaged credit amount.[161]

After this initial reduction, further reductions come into play. In the first succeeding taxable year, the allowable percentages fall to five and fifty percent, respectively.[162] In the second succeeding taxable year, they are reduced to 2.5 and 25 percent, respectively.[163] Thereafter, the percentages become zero.[164]

If the area's enterprise zone designation is revoked under section 701(b)(2) of the Act, however, a special reduction rule applies.[165] In this case, the area continues to be treated as an enterprise zone for the three taxable years succeeding the year of revocation, and the employer can compute his enterprise zone employment credit under the regular method. However, the employer only will be allowed seventy-five percent of the total amount as his enterprise zone employment credit in the first succeeding year, fifty percent in the second succeeding year, and twenty-five percent in the third succeeding year.[166]

ii. Early termination of certain employees

If any qualified economically disadvantaged individual,[167] for whom qualified wages[168] are taken into account in computing the enterprise zone employment credit, has his employment terminated within a 270-day period beginning on the date such individual begins work for the employer/taxpayer, a special reduction in tax benefits will occur. The employer's tax for the taxable year in which such termination occurs shall be increased by an amount

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[160] Id.
[161] Id.
[162] Id.
[163] Id.
[164] Id.
[165] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(i)(2)).
[166] Id.
[167] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(g)). See supra notes 131-42 and accompanying text.
[168] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(e)). See supra notes 124-27 and accompanying text.

equal to the enterprise zone employment credit allowed for such year and all prior years which is attributable to qualified wages paid or incurred with respect to such employee.[169]

As with other parts of this proposed section, exceptions would exist. The early termination penalty would not apply if:

a. the termination of employment is due to the employee voluntarily leaving his employer;

b. the termination of employment is determined, under applicable state unemployment compensation law, to be due to the misconduct of such individual;

c. the termination of employment is due to the fact that the employee becomes disabled from performing his employment services, unless such disability is removed before the 270-day period and the employer fails to offer reemployment to such individual; or

d. the termination of employment is due to a substantial reduction in the trade or business operations of the employer.[170]

In addition, the employment relationship between the employee and employer shall not be treated as terminated:

a. by a transaction to which section 381(a) of the Code applies, if the employee continues to be employed by the acquiring corporation, or

b. by reason of a mere change in the form of conducting the trade or business of the taxpayer, if the employee continues to be employed in such trade or business and the employer retains a substantial interest in such trade or business.[171]

The section would also direct the Secretary to prescribe regulations necessary to prevent abuse by denying the enterprise zone employment credit to employers who relocate their businesses in an enterprise zone while displacing former employees, or who conduct their businesses in such a way as to take advantage of the enterprise zone employment credit without furthering the purposes of the section.[172]

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[169] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(j)(1)).

[170] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(j)(2)(A)).

[171] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(j)(2)(B)). An I.R.C § 381(a) transaction occurs when one corporation acquires the assets of another corporation.

[172] H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(h)).

g. The effect of new section 30 on other Code sections

i. Section 280C

Section 280C of the Code, which provides for the disallowance of certain expenses for which credits are allowable, would be amended by adding a subsection (d).[173] New subsection 280C(d) of the Code would be entitled "Rule for Section 30 Credits"[174] and would state the following:

> No deduction shall be allowed for that portion of the wages or salaries paid or incurred for the taxable year which is equal to the amount of the credit allowable under section 30 (relating to the employment credit for enterprise zone businesses). This subsection shall be applied under a rule similar to the rule under the last sentence of subsection (a).[175]

This amendment would prevent the employer from taking a deduction in arriving at taxable income for the portion of the same wages that were used to compute his enterprise zone employment credit.

ii. Sections 381 and 383

Because of the carryovers of tax incentives and their proper role within the field of mergers, acquisitions, and corporate taxation, amendments to sections 381 and 383 of the Code[176] would also be necessary. A new paragraph would be added to section 381(c) to provide some direction to corporations which, having acquired another corporation with enterprise zone employment credit carryovers, might try to take advantage of those credits. New section 381(c)(26) would read as follows:

> Credit Under Section 30.- The acquiring corporation shall take into account (to the extent proper to carry out the purposes of this section and section 30, and under such regulations as may be prescribed by the Secretary) the items required to be taken into account for purposes of section 30 in respect to the distributor or

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[173] See H.R. 6, 101st Cong., 1st Sess. § 201(b).

[174] Id.

[175] Id.

[176] I.R.C. §§ 381, 383. Section 381 of the Code is entitled "Carryovers in certain corporate acquisitions," and § 383 of the Code is entitled "Special limitations on certain excess credits, etc." Id.

transferor corporation.[177]

While it is not clearly stated, the language "to the extent proper to carry out the purposes" makes it clear that a review of the new corporation's business and its location will be a prerequisite to the use of the enterprise zone employment credits acquired in any takeover, merger, and acquisition.

Section 383(a)(2) would also be amended to include unused enterprise zone employment credits awarded under section 30 as excess credits.[178] This change would work as another limitation on the use of these credits if the ownership of the business changes.[179]

iii. Sections 6511 and 6411[180]

In providing limitation periods for credits and refunds, the Code creates a special limitation period with respect to certain credit carrybacks.[181] By amending section 6511(d)(4)(C), enterprise zone employment credits awarded under section 30(b) would be included in that special group.[182] Section 6411 would also be amended to allow an enterprise zone carryback and refund adjustment procedure.[183]

2. The Employees

In addition to providing tax incentives for employers who locate their businesses in enterprise zones, the Act would grant tax benefits for their employees.

a. Credit for enterprise zone employees

Under a new section 30A, qualified employees would be entitled to a credit of five percent of their qualified wages.[184] For purposes of this credit, the term "qualified employee" has the same meaning

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[177] H.R. 6, 101st Cong., 1st Sess. § 201(c)(1)(A).

[178] H.R. 6, 101st Cong., 1st Sess. § 201(c)(1)(B).

[179] Section 383(a) of the Code limits the use of excess credit if a change of ownership occurs. For a discussion of this, see I.R.C. § 383(a) and its accompanying regulations.

[180] I.R.C. §§ 6411, 6511. Section 6511 of the Code describes "Limitations on credits or refunds," while § 6411 provides for "Tentative carryback and refund adjustments." Id.

[181] See I.R.C. § 6511(a).

[182] See H.R. 6, 101st Cong., 1st Sess. § 201(c)(2)(A).

[183] H.R. 6, 101st Cong., 1st Sess. § 201(c)(2)(B)-(C).

[184] H.R. 6, 101st Cong., 1st Sess. § 202(a) (proposing I.R.C. § 30A(b)).

as it has with respect to enterprise zone employment credits,[185] but with two exceptions. First, an employer taking a section 51(a) credit with respect to the employee for the taxable year does not disqualify the individual from being a qualified employee.[186] Second, the individual may not be an employee of the federal government, a state, or subdivision of a state.[187]

To determine whether a qualified employee's wages may be deemed qualified wages, reference is given to section 3306(b) of the Code.[188] With the exception of any compensation received from federal, state, or local governments, an employee's qualified wages would be any section 3306(b) wages attributable to services performed for an employer with respect to whom the employee is a qualified employee.[189] The maximum amount of the employee's wages that can designated qualified wages for any taxable year is $10,500.[190]

An individual's allowable credit for any taxable year may not exceed the excess of the individual's regular tax for the taxable year reduced by the sum of allowable credits, over the individual's tentative minimum tax for the taxable year.[191] Any amount which is not allowed as a credit for any taxable year cannot be carried forward or back.

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[185] See H.R. 6, 101st Cong., 1st Sess. § 201(a) (proposing I.R.C. § 30(f)), which provides:

(f) QUALIFIED EMPLOYEE DEFINED.-

(1) In General.—For purposes of this section, the term "qualified employee" means an individual—

(A) at least 90 percent of whose services for the employer during the taxable year are direcly related to the conduct of the employer's trade or business located in an enterprise zone, and

(B) who performs at least 50 percent of his services for the employer during the taxable year in an enterprise zone.

(2) Exception for individuals with respect to whom credit is determined under section 51(a).—The term "qualified employee" shall not include an individual with respect to whom any credit for the employer is determined under section 51(a) for the taxable year (relating to targeted jobs credit).

Id.

[186] H.R. 6, 101st Cong., 1st Sess. § 202(a) (proposing I.R.C. § 30A(b)(1)(A)).

[187] H.R. 6, 101st Cong., 1st Sess. § 202(a) (proposing I.R.C. § 30A(b)(1)(B)).

[188] H.R. 6, 101st Cong., 1st Sess. § 121(a) (proposing I.R.C. § 30A(b)(2)(A)). For the text of I.R.C. § 3306(b), see supra note 124.

[189] H.R. 6, 101st Cong., 1st Sess. § 121(a) (proposing I.R.C. § 30A(b)(2)(B)).

[190] H.R. 6, 101st Cong., 1st Sess. § 202(a) (proposing I.R.C. § 30A(b)(2)(A)). See also I.R.C. § 3306(b) (1.5 times $7000 limitation equals $10,500).

[191] Id.

b. Example D

To illustrate the enterprise zone employee's credit, a qualified employee with wages of $17,500 will be allowed a potential tax credit of $525. Since, in a taxable year, the maximum wages that can rise to the level of qualified wages is $10,500, the maximum credit is 5 percent of $10,500, or $525. If the employee's regular tax minus allowable credits for the taxable year is $2,000, and his tentative minimum tax for the taxable year is $1,800, then the employee will only be allowed an employee enterprise zone credit of $200 ($2,000 minus $1,800) for the taxable year. The remaining $325 ($525 minus $200) of potential employee enterprise zone credit will be disallowed and lost forever.

c. Phase-out of the credit

As with the enterprise zone employment credit, the employee enterprise zone credit has a phase-out portion. The five percent applicable rate which is applied to a qualified employee's qualified wages will be reduced to zero in four stages.[192] The applicable rate will be 3.75 percent for the taxable year which occurs the earlier of "(A) 21 years after the date on which the area was designated an enterprise zone under section 701 of the Enterprise Zone Act, or (B) the date four years before the date the zone designation is to expire."[193] In the next succeeding taxable year, the applicable rate will be 2.5 percent with a drop in rate to 1.25 percent the following year. After the second succeeding year, the applicable rate drops to and remains zero.[194]

3. Comments

While the introduction of tax credits for both the employer and employee appears to provide incentives for enterprise zone development, improvement remains possible. In particular, the employee enterprise zone credit could be refined. First, the maximum benefit per employee per tax year is $525, due to the limitations on credit and the lack of a carryover/carryback provision. Since one goal of the Act is to benefit the employees, the $525 yearly limit on

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[192] H.R. 6, 101st Cong., 1st Sess. § 202(a) (proposing I.R.C. § 30A(c)).
[193] H.R. 6, 101st Cong., 1st Sess. § 202(a) (proposing I.R.C. § 30A(c)(1)).
[194] H.R. 6, 101st Cong., 1st Sess. § 202(a) (proposing I.R.C. § 30A(c)).

tax savings should be expanded to further this goal. Second, despite an employee's economically disadvantaged status, the credit is available to *any* individual who is a qualified employee. It is possible, therefore, for a wealthy commuter to receive the same tax credit as a poor employee who also lives in the enterprise zone area. Thus, the employee enterprise zone credit should be amended to provide the "resident" employee a larger credit and the commuter employee no credit at all.

Furthermore, the enterprise zone credit should be amended to clarify the uncertainty in the allowance of the credit to employers that are pass-through entities.[195] The credit fails to address the proper treatment for employers that are S corporations or partnerships, particularly with regard to how the limitation and the carryover/carryback provision will affect the individual shareholder or partner. Furthermore, the credit fails to consider the potential for abuse where the employer that is a pass-through entity hires two married shareholders or two partners in the entity. The following example illustrates this problem.

4. Example E

Jim and Mary, a married couple, organize an S corporation and open a business in an enterprise zone. Jim and Mary each own fifty percent of the corporation and are the only two employees. Both Jim and Mary devote all of their work to the corporation and its activities in the enterprise zone, for which they each receive a salary of $15,000. For the employer, the corporation, the qualified wages are $30,000. This will potentially allow the corporation a $3,000 employment enterprise zone credit which will pass down to the shareholders, Jim and Mary, equally. In addition, both Jim and Mary will be entitled to an enterprise zone credit for employees of $525. Therefore, on Jim's and Mary's personal tax return they will receive a tax credit and savings of $4,050. It seems unlikely that the bill intended to give married couples this extra tax credit.

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[195] While hardly simple, the enterprise zone credit for employers that are C corporations is at least clear and free from possible abuse.

B. Credit for Investment in Tangible Property in Enterprise Zones

The second tax incentive proposed by H.R. 6 is a general business credit for an investment in new enterprise zone construction property.[196] By amending section 48(a)(1) of the Code,[197] the Act would create a new category of section 38 property to include "(H) new enterprise zone construction property (within the meaning of subsection (t)) which is not otherwise section 38 property."[198]

1. Amount of the Credit

Section 46(a) of the Code, which computes the amount of investment tax credit, would be amended to include "(4) in the case of new enterprise zone construction property, the enterprise zone percentage."[199]

A new category entitled "enterprise zone percentage" would be created by amending section 46(b) of the Code.[200] The enterprise zone percentage would be divided into two parts. The first part would allow the enterprise zone percentage to be ten percent, while the second part would create a phase-out of the credit as the area ceases to be an enterprise zone.[201] The 10 percent would be reduced to 7.5 percent after 21 years.[202] For the following taxable year, the allowable percentage would drop to 5 percent, the next taxable year to 2.5 percent, and then to zero for all subsequent taxable years.[203]

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[196] H.R. 6, 101st Cong., 1st Sess. § 211.

[197] I.R.C. § 48(a)(1) defines § 38 property. Section 38 deals with the general business credit on certain property and gives limitations and special rules. See I.R.C. § 38.

[198] H.R. 6, 101st Cong., 1st Sess. § 211(a).

[199] H.R. 6, 101st Cong., 1st Sess. § 211(b)(1). Currently, § 46(a) provides:

> (a) AMOUNT OF INVESTMENT CREDIT.-For purposes of section 38, the amount of the investment credit determined under this section for any taxable year shall be an amount equal to the sum of the following percentages of the qualified investment (as determined under subsections (c) and (d)):
>
> (1) the regular percentage,
>
> (2) in the case of energy property, the energy percentage, and
>
> (3) in the case of that portion of the basis of any property which is attributable to qualified rehabilitation expenditures, the rehabilitation percentage.

I.R.C. § 46(a).

[200] H.R. 6, 101st Cong., 1st Sess. § 211(b)(2) (proposing I.R.C. § 46(b)(5)).

[201] Id.

[202] Id.

[203] Id.

Section 48(o) of the Code would also be amended to include a definition for the new enterprise zone credit.[204] The new section 48(o)(4) of the Code would define the enterprise zone credit as "that portion of the credit allowed by section 38 of the Code which is attributable to the enterprise zone percentage."[205]

2. *New Enterprise Zone Construction Property*

In order to qualify as new enterprise zone construction property, a four-part test must be met. First, the property must be section 1250 property.[206] Second, the property must be located in an enterprise zone.[207] Third, the property must be "used by the taxpayer predominantly in the active conduct of a trade or business in an enterprise zone."[208] Ownership of rental real property in an enterprise zone would be treated as actively conducting a trade or business.[209] Finally, the taxpayer must have either constructed, reconstructed, rehabilitated, renovated, expanded, or erected the property during the period the area is designated an enterprise zone.[210] Alternatively, the taxpayer could satisfy the fourth part of this test by acquiring the property during the time the area is designated as an enterprise zone, "if the original use of the property commences with the taxpayer and commences during" the period the area is designated an enterprise zone.[211] In addition, new enterprise zone construction property used for lodging will be added to the list of properties exempt from the section 48(a)(3) rule regarding non-applicability of section 38.[212]

New enterprise zone construction property would not include property acquired, either directly or indirectly, by the taxpayer

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[204] See H.R. 6, 101st Cong., 1st Sess. § 211(b)(3) (proposing I.R.C. § 48(o)(4)). Section 48(o) provides definitions of credits. See I.R.C. § 48(o).

[205] Id.

[206] H.R. 6, 101st Cong., 1st Sess. § 211(c) (proposing I.R.C. § 48(t)(1)). Section 1250 property is defined in § 1250(c) of the Code as "any real property (other than section 1245 property, as defined in section 1245(a)(3)) which is or has been property of a character subject to the allowance for depreciation provided in section 167." I.R.C. § 1250.

[207] H.R. 6, 101st Cong., 1st Sess. § 211(c) (proposing I.R.C. § 48(t)(1)(A)).

[208] H.R. 6, 101st Cong., 1st Sess. § 211(c) (proposing I.R.C. § 48(t)(1)(B)).

[209] H.R. 6, 101st Cong., 1st Sess. § 211(c) (proposing I.R.C. § 48(t)(3)).

[210] H.R. 6, 101st Cong., 1st Sess. § 211(c) (proposing I.R.C. § 48(t)(1)(C)(i)).

[211] H.R. 6, 101st Cong., 1st Sess. § 211(c) (proposing I.R.C. § 48(t)(1)(C)(ii)).

[212] H.R. 6, 101st Cong., 1st Sess. § 211(d) (proposing I.R.C. § 48(a)(3)).

from any person who is "related" to the taxpayer.[213] A list of these prohibited relationships is found in sections 267(b) and 707(b)(1) of the Code.[214] In applying sections 267(b) and 707(b)(1), ten percent would be substituted for fifty percent in determining relationship status.[215] If the acquisition of property by a partnership results from the termination of another partnership under section 708(b)(1)(B), "the determination of whether the acquiring partnership is related to the other partnership would be made immediately before the event resulting in the termination."[216] Another prohibited relationship exists if the taxpayer and the other person are engaged in a trade or business under common control within

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[213] H.R. 6, 101st Cong., 1st Sess. § 211(c) (proposing I.R.C. § 48(t)(2)(A)(i)).

[214] H.R. 6, 101st Cong., 1st Sess. § 211(c) (proposing I.R.C. § 48(t)(2)(A)(ii)(I)).
Section 267(b) defines "relationships" as follows:

> (b) RELATIONSHIPS.—The persons referred to in subsection (a) are:
> (1) Members of a family, as defined in subsection (c)(4);
> (2) An individual and a corporation more than 50 percent in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;
> (3) Two corporations which are members of the same controlled group (as defined in subsection (f));
> (4) A grantor and a fiduciary of any trust;
> (5) A fiduciary of a trust and a fiduciary of another trust, if the same person is a grantor of both trusts;
> (6) A fiduciary of a trust and a beneficiary of such trust;
> (7) A fiduciary of a trust and a beneficiary of another trust, if the same person is a grantor of both trusts;
> (8) A fiduciary of a trust and a corporation more than 50 percent in value of the outstanding stock of which is owned, directly or indirectly, by or for the trust or by or for a person who is a grantor of the trust;
> (9) A person and an organization to which section 501 (relating to certain educational and charitable organizations which are exempt from tax) applies and which is controlled directly or indirectly by such person or (if such person is an individual) by members of the family of such individual;
> (10) A corporation and a partnership if the same persons own—
> (A) more than 50 percent in value of the outstanding stock of the corporation, and
> (B) more than 50 percent of the capital interest, or the profits interest, in the partnership;
> (11) An S corporation and another S corporation if the same persons own more than 50 percent in value of the outstanding stock of each corporation; or
> (12) An S corporation and a C corporation, if the same persons own more than 50 percent in value of the outstanding stock of each corporation.

I.R.C. § 267(b). This definition is also used by I.R.C. § 707(b)(1).

[215] H.R. 6, 101st Cong., 1st Sess. § 211(c) (proposing I.R.C. § 48(t)(2)(A)(ii)).

[216] Id. Section 708(b)(1)(B) termination would occur if within a 12-month period there is a sale or exchange of 50% or more of the total interest in partnership capital and profits.

the meaning of subsections 52(a) and (b).[217]

3. *Recapture of the Credit*

If the taxpayer disposes of property subject to an enterprise zone credit, a portion of the credit must be recaptured and the taxpayer's tax liability would increase.[218] The increase in tax would equal the aggregate decrease in enterprise zone credits allowed under section 38:

> [F]or all prior taxable years which would have resulted solely from reducing the expenditures taken into account with respect to the disposed property by an amount which bears the same ratio to such expenditures as the number of taxable years that the property was held by the taxpayer bears to the applicable recovery period for earnings and profits under section 312(k).[219]

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[217] H.R. 6, 101st Cong., 1st Sess. § 211(c) (proposing I.R.C. § 48(t)(2)(A)(ii)(II)). Sections 52(a) and (b) provide:

> (a) CONTROLLED GROUP OF CORPORATIONS.—For purposes of this subpart, all employees of all corporations which are members of the same controlled group of corporations shall be treated as employed by a single employer. In any such case, the credit (if any) determined under section 51(a) with respect to each such member shall be its proportionate share of the wages giving rise to such credit. For purposes of this subsection, the term "controlled group of corporations" has the meaning given to such term by section 1563(a), except that—
>
> (1) "more than 50 percent" shall be substituted for "at least 80 percent" each place it appears in section 1563(a)(1), and
>
> (2) the determination shall be made without regard to subsections (a)(4) and (e)(3)(C) of section 1563.
>
> (b) EMPLOYEES OF PARTNERSHIPS, PROPRIETORSHIPS, ETC., WHICH ARE UNDER COMMON CONTROL.—For purposes of this subpart, under regulations prescribed by the Secretary—
>
> (1) All employees of trades or businesses (whether or not incorporated) which are under common control shall be treated as employed by a single employer, and
>
> (2) the credit (if any) determined under section 51(a) with respect to each trade or business shall be its proportionate share of the wages giving rise to such credit.
>
> The regulations prescribed under this subsection shall be based on principles similar to the principles which apply in the case of subsection (a).

I.R.C. § 52(a)-(b).

[218] H.R. 6, 101st Cong., 1st Sess. § 211(e) (proposing I.R.C. § 47(a)(10)).

[219] H.R. 6, 101st Cong., 1st Sess. § 211(e) (proposing I.R.C. § 47(a)(10)(B)). Section 312(k) requires earnings and profits to be computed, with limited exceptions, using the straight-line method of depreciation.

4. Example F

To help understand the enterprise zone credit, consider the following example. Taxpayer A constructs a new building in 19X1. The cost of construction is $250,000 and the building is located in an area that is designated an enterprise zone under section 701 of the Enterprise Zone Act. In addition, the building is used by taxpayer A predominantly in her business of renting residential real estate. In 19X1, taxpayer A will receive a credit for new enterprise zone construction property of $25,000 (10 percent of $250,000). If taxpayer A disposes of the building ten years later, she must recapture a portion of the credit taken in 19X1 and increase her tax for the taxable year of disposition. The increase in tax for the taxable year in which the disposition occurs will be $15,900.[220]

C. Nonrecognition of Qualified Enterprise Zone Capital Gain

Section 221 of H.R. 6 would create the third tax incentive for enterprise zone investment. By amending Part III of Subchapter O of the Code, a new section 1043 would be created.[221] The new section would provide for a potential nonrecognition of gain if three conditions were met. First, the taxpayer must have sold property that, but for this section, would have created a recognized gain from the sale.[222] Second, the taxpayer must acquire qualified replacement property within one year from the date of the sale.[223] Third, the taxpayer must elect the application of new section 1043 with respect to the sale.[224] If all three conditions are met, the non-

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[220] In order to arrive at the $15,900 recapture figure:
A. $250,000 (expenditure) x 10% (credit percentage) = $25,000 amount of credit
B. Recapture after 10 years
250,000 x (years held)/(§ 312(k) depreciation)
250,000 x 10/27.5
250,000 x .364 = $91,000
C. $250,000 - 91,000 = $159,000
D. $159,000 x 10% = $15,900

[221] H.R. 6, 101st Cong., 1st Sess. § 221(a) (proposing I.R.C. § 1043 in general). This new section would be entitled "NONRECOGNITION OF CAPITAL GAIN WHERE ACQUISITION OF ENTERPRISE ZONE BUSINESS PROPERTY." Subchapter O of the Code deals with the "Gain or loss on disposition of property."

[222] H.R. 6, 101st Cong., 1st Sess. § 221(a) (proposing I.R.C. § 1043(a)(1)).

[223] H.R. 6, 101st Cong., 1st Sess. § 221(a) (proposing I.R.C. § 1043(a)(2)).

[224] H.R. 6, 101st Cong., 1st Sess. § 221(a) (proposing I.R.C. § 1043(a)(3)).

recognition of gain would extend to the degree that the amount realized from the sale equals the taxpayer's cost of the replacement property.[225] To the degree that the amount realized from the sale exceeds the taxpayer's cost of replacement property, new section 1043 would only partially apply and the taxpayer would recognize the excess as gain.[226]

1. Qualified Replacement Property

In order to take advantage of this nonrecognition provision, the taxpayer must acquire qualified replacement property which consists of three types of property. The first type is "any tangible personal property used predominantly in an enterprise zone in the active conduct of a trade or business within such enterprise zone."[227] The second type is "any real property located in an enterprise zone used predominantly in the active conduct of a trade or business within such enterprise zone."[228] The ownership of real property for rental in an enterprise zone would be treated as the active conduct of a trade or business.[229] Finally, the third type of qualified replacement property is any interest in a corporation, partnership, or other entity, that for the three most recent taxable years was a qualified business.[230]

In order to rise to the status of a qualified business, a three-part test must be met. First, the entity must have been "actively engaged in the conduct of a trade or business within an enterprise zone during each of the three most recent taxable years" ending before the date of sale of the interest in the entity.[231] Next, eighty percent of the entity's gross receipts for the taxable year must be attributable to the active conduct of a trade or business within an enterprise zone.[232] Finally, substantially all of the entity's tangible assets must be located within an enterprise zone.[233]

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[225] H.R. 6, 101st Cong., 1st Sess. § 221(a) (proposing I.R.C. § 1043(a)).
[226] Id.
[227] H.R. 6, 101st Cong., 1st Sess. § 221(a) (proposing I.R.C. § 1043(b)(1)(A)).
[228] H.R. 6, 101st Cong., 1st Sess. § 221(a) (proposing I.R.C. § 1043(b)(1)(B)).
[229] H.R. 6, 101st Cong., 1st Sess. § 221(a) (proposing I.R.C. § 1043(c)).
[230] H.R. 6, 101st Cong., 1st Sess. § 221(a) (proposing I.R.C. § 1043(b)(1)(C)).
[231] H.R. 6, 101st Cong., 1st Sess. § 221(a) (proposing I.R.C. § 1043(b)(2)(A)).
[232] H.R. 6, 101st Cong., 1st Sess. § 221(a) (proposing I.R.C. § 1043(b)(2)(B)).
[233] H.R. 6, 101st Cong., 1st Sess. § 221(a) (proposing I.R.C. § 1043(b)(2)(C)).

2. Special Rules

a. Exchange treated as a sale

The new section 1043 would allow certain exchanges of property to be covered by the nonrecognition provision. If the property the taxpayer acquires in the exchange is qualified replacement property, then the section would treat the exchange as a sale of the first property and the purchase of qualified replacement property.[234]

b. Non-applicability of the nonrecognition provision

New section 1043 would not apply to any gain on the sale or exchange of property, and the subsequent acquisition of qualified replacement property, to the extent gain is treated as ordinary income under any provision of the Code, including the recapture provisions of sections 1245 and 1250.[235]

c. Reduction in basis

If the taxpayer elects the nonrecognition provision of new section 1043, and the purchase or acquisition of qualified replacement property results in the nonrecognition of gain, the basis of the qualified replacement property "must be reduced by an amount equal to the amount of gain not so recognized on the sale of such other property."[236] If the purchase of more than one qualified replacement property is taken into account in determining the nonrecognition of gain on the sale of property, then the reduction of basis would be applied to each qualified replacement property in the order in which such properties were purchased.[237]

3. Example G

If taxpayer A sells property that has a fair market value of $30,000 and a basis of $12,000, he would have a potential capital gain and income of $18,000. If within a one-year period from the date of sale taxpayer A purchases qualified replacement property for $25,000, he may elect to take advantage of new section 1043

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[234] H.R. 6, 101st Cong., 1st Sess. § 221(a) (proposing I.R.C. § 1043(c)(1)).
[235] H.R. 6, 101st Cong., 1st Sess. § 221(a) (proposing I.R.C. § 1043(c)(2)).
[236] H.R. 6, 101st Cong., 1st Sess. § 221(a) (proposing I.R.C. § 1043(d)).
[237] Id.

and postpone a portion of the $18,000 potential gain. Because the amount of gain that must be recognized in this situation is limited to the extent that the amount realized from the sale of property ($30,000) exceeds the cost of the qualified replacement property ($25,000), taxpayer A must recognize only $5,000. The remaining $13,000 of gain on the sale would not presently be recognized. However, taxpayer A must reduce the basis in his qualified replacement property by the amount of gain he elected not to recognize pursuant to new section 1043. Therefore, the basis of taxpayer A's qualified replacement property will be $12,000, instead of $25,000.

If taxpayer B sells property that had a fair market value of $30,000 and a basis of $12,000, she would also have a potential gain of $18,000. However, further assume that $7,000 of her gain is attributed to recapture of depreciation under section 1245 or section 1250. Then, taxpayer B purchases qualified replacement property within one year of the sale for $32,000. Because the amount realized on the sale ($30,000) is less than the cost of the qualified replacement property ($32,000), it would appear that all of taxpayer B's $18,000 gain will escape recognition. However, the section 1043 nonrecognition provision would not apply to any gain that would be classified as ordinary income. Because $7,000 of the $18,000 gain is attributed to recapture and is therefore ordinary income, that $7,000 of gain must be recognized. At the election of taxpayer B, the recognition of the remaining $11,000 of gain can be deferred. Upon such an election, however, the basis on taxpayer B's qualified replacement property must be reduced by the $11,000 of deferred gain, leaving a basis of $21,000.

D. Deduction for Purchase of Enterprise Stock

The fourth tax incentive provided by H. R. 6 would be a tax deduction for the purchase of enterprise stock. A new section 197 would create a deduction for the amount paid for the purchase of original enterprise stock issued by a qualified issuer.[238]

1. Definitions

In order to qualify as enterprise stock, the stock may only be

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[238] H.R. 6, 101st Cong., 1st Sess. § 231(a) (proposing I.R.C. § 197(a)).

common stock issued by a qualified issuer. In addition, the proceeds of this common stock may be used only in the conduct of a qualified business.[239]

Other than qualifying as a C corporation, the issuer of common stock must meet four requirements in order to be classified as a qualified issuer. First, at the time of issuance of the common stock the C corporation must be involved in conducting a qualified business.[240] Second, the C corporation cannot have a net worth exceeding $2 million before or immediately after the issuance of the common stock.[241] Third, at the time of issuance of the common stock the C corporation cannot have issued any outstanding regulated securities during a five-year testing period.[242] Finally, during the five-year testing period, the C corporation must have derived more than fifty percent of its gross receipts from sources other than royalties, rents, dividends, interest, annuities, and sales and exchanges of stock or securities.[243] In determining the testing period, the issuer must count back to the fifth taxable year before the date the stock was issued. The testing period will begin on the first day of that year and end on the date the stock is actually issued.[244]

2. *Amount of Deduction and Stock Basis*

While, under the proposals, the maximum amount allowed as a deduction for any taxable year cannot exceed $100,000, there are several special rules.[245] First, the taxpayer and all persons related to the taxpayer would be treated as one person, and the $100,000 deduction would be allocated among the taxpayer and such related persons in proportion to their respective purchases of stock during the taxable year.[246] For purposes of this deduction, a person is "related" to another person if both are treated as a single employer under section 52(a) and (b),[247] or, in the case of individuals, if they

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[239] H.R. 6, 101st Cong., 1st Sess. § 231(a) (proposing I.R.C. § 197(e)(1)).
[240] H.R. 6, 101st Cong., 1st Sess. § 231(a) (proposing I.R.C. § 197(e)(2)(A)(i)).
[241] H.R. 6, 101st Cong., 1st Sess. § 231(a) (proposing I.R.C. § 197(e)(2)(A)(ii)).
[242] H.R. 6, 101st Cong., 1st Sess. § 231(a) (proposing I.R.C. § 197(e)(2)(A)(iii)).
[243] H.R. 6, 101st Cong., 1st Sess. § 231(a) (proposing I.R.C. § 197(e)(2)(A)(iv)).
[244] H.R. 6, 101st Cong., 1st Sess. § 231(a) (proposing I.R.C. § 197(e)(2)(C)).
[245] H.R. 6, 101st Cong., 1st Sess. § 231(a) (proposing I.R.C. § 197(b)(1)).
[246] H.R. 6, 101st Cong., 1st Sess. § 231(a) (proposing I.R.C. § 197(b)(2)).
[247] See supra note 217 for I.R.C. § 52(a)-(b).

are husband and wife.[248] Thus, a husband and wife who individually would be entitled to the $100,000 stock purchase deduction in the same taxable year would be prohibited from taking the total $200,000 deduction. Instead, they would be entitled to a total deduction of $100,000 allocated between them.

If the amount of stock purchased by any person exceeds the $100,000 limitation, the $100,000 deduction allowed must be "allocated pro rata among the stock purchased in accordance with the purchase price per share."[249] However, any amount paid after the taxable year for enterprise stock would be treated as if paid during the taxable year, if the amount is paid in the time prescribed by law for filing that year's tax return, and the taxpayer was under a binding contract to purchase the enterprise stock.[250]

There also would be a limitation on the allowable deduction for the purchase of enterprise stock if the following three conditions exist. First, the enterprise stock must be issued in exchange for property other than money.[251] Second, the basis of the stock in the hands of the taxpayer must be determined by reference to the basis of the exchanged property.[252] Third, the adjusted basis for determining the gain of the exchanged property immediately before the exchange must exceed the fair market value of the exchanged property immediately before the exchange.[253] If these three conditions exist, then the deduction allowed by new section 197 and the adjusted basis of the stock must be adjusted by the amount by which the adjusted basis of the exchanged property exceeds the fair market value of the exchanged property immediately before the exchange.[254]

Furthermore, in determining the basis of the enterprise stock in the hands of the purchasing taxpayer, the basis must "be reduced by the amount of deduction allowed with respect to the purchase of such stock."[255]

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[248] H.R. 6, 101st Cong., 1st Sess. § 231(a) (proposing I.R.C. § 197(e)(4)).
[249] H.R. 6, 101st Cong., 1st Sess. § 231(a) (proposing I.R.C. § 197(b)(3)).
[250] H.R. 6, 101st Cong., 1st Sess. § 231(a) (proposing I.R.C. § 197(f)(1)).
[251] H.R. 6, 101st Cong., 1st Sess. § 231(a) (proposing I.R.C. § 197(f)(2)(A)).
[252] H.R. 6, 101st Cong., 1st Sess. § 231(a) (proposing I.R.C. § 197(f)(2)(B)).
[253] H.R. 6, 101st Cong., 1st Sess. § 231(a) (proposing I.R.C. § 197(f)(2)(C)).
[254] H.R. 6, 101st Cong., 1st Sess. § 231(a) (proposing I.R.C. § 197(f)(2)).
[255] H.R. 6, 101st Cong., 1st Sess. § 231(a) (proposing I.R.C. § 197(g)).

3. Disposition of Stock and Subsequent Non-Qualified Issuers

If a taxpayer disposes of his enterprise stock or a corporate issuer subsequently becomes unqualified, special tax consequences will apply. If a taxpayer who has taken a deduction for the purchase of enterprise stock disposes of such stock, a portion of the gain from the disposition must be treated as ordinary income instead of capital gain.[256] To determine the amount of gain which must be treated as ordinary income, the taxpayer must compare two numbers. The first number is the excess of the amount realized (in the case of a sale or exchange), or the fair market value of the stock (in the case of any other disposition), over the adjusted basis of the stock. The second number is the actual amount of the deduction allowed for the purchase of the enterprise stock. Whichever number is smaller shall be the amount of gain that must be treated as ordinary income on the disposition of enterprise stock, notwithstanding any other provision of the Code.[257]

In addition, any taxpayer who disposes of enterprise stock within three years after the stock was purchased will have an additional tax imposed.[258] This increase in tax, called the enterprise stock recapture amount, will be an amount equal to the amount of interest accruing, using the applicable section 6621 interest rate, during the period beginning on the date the stock was purchased and ending on the date the stock was disposed of by the taxpayer.[259] This rate will apply to the aggregate decrease in the taxpayer's assessment resulting from the deduction from the purchase of the disposed enterprise stock.[260]

a. Example H

To illustrate, take a taxpayer in the 28 percent tax bracket who purchases $100,000 of enterprise stock on December 31, 1989, and takes a $100,000 deduction from her 1989 tax return with respect to such purchase. Her basis in the enterprise stock will be zero and she will have a $28,000 tax savings for 1989. If she sells 50 percent of her enterprise stock for $125,000, she would have a gain of

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[256] H.R. 6, 101st Cong., 1st Sess. § 231(a) (proposing I.R.C. § 197(c)(1)).
[257] Id.
[258] H.R. 6, 101st Cong., 1st Sess. § 231(a) (proposing I.R.C. § 197(c)(2)).
[259] H.R. 6, 101st Cong., 1st Sess. § 231(a) (proposing I.R.C. § 197(c)(2)(B)(i)).
[260] H.R. 6, 101st Cong., 1st Sess. § 231(a) (proposing I.R.C. § 197(c)(2)(B)(ii)).

$125,000 of which $50,000 would be ordinary income and $75,000 capital gain.[261] If the sale took place on December 31, 1991, the taxpayer's tax for 1991 would be increased by the enterprise stock recapture amount. In this case the enterprise stock recapture amount would be determined by taking the applicable interest rate, under section 6621 of the Code, for the period of December 31, 1989 to December 31, 1991 and applying it to the $14,000 decrease in tax the taxpayer received from the allowed deduction for the disposed enterprise stock.[262]

b. Tax Treatment when Corporate Issuer Ceases to be a Qualified Issuer

If, after issuing enterprise stock to which an election was made, the qualified issuer becomes unqualified before the end of the fifth taxable year after the enterprise stock was issued, the taxpayer must include as ordinary income the amount allowed as a deduction for the purchase of enterprise stock with respect to the nonqualifying issuer.[263] In addition, the tax for the taxable year will be increased by the amount of section 6621 interest which would accrue during the period beginning on the date such enterprise stock was purchased by the taxpayer, and ending on the disqualification date, and which would accrue on the decrease in tax of the taxpayer resulting from the deduction allowed with respect to the enterprise stock.[264]

For purposes of this provision, the term "disqualification date" is the earlier of either the date of the issuance by the qualified issuer of any regulated security, or the last day of the taxable year in which the qualified issuer either fails to conduct a qualified business or derives more than fifty percent of its gross receipts from royalties, rents, dividends, interest, annuities, or sales and ex-

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[261] To arrive at the $50,000 ordinary income portion, the total gain of $125,000 must be compared with the amount deducted that is attributable to the stock being sold. In this case, because 50% of the stock is being sold, it is only half of the $100,000, or $50,000. The ordinary income portion is the lower of the total gain ($125,000) and the deduction attributed to the sold stock ($50,000).

[262] While the taxpayer actually received a $28,000 decrease in tax for the purchase of the stock, only $14,000 was attributable to the stock which is being sold.

[263] H.R. 6, 101st Cong., 1st Sess. § 231(a) (proposing I.R.C. § 197(d)(1)-(2)).

[264] H.R. 6, 101st Cong., 1st Sess. § 231(a) (proposing I.R.C. § 197(d)(2)(B)).

changes of stock or securities.[265]

c. Example I

For example, if taxpayer E purchases $100,000 of enterprise stock from a qualified issuer on December 31, 1989, he may elect to take a $100,000 deduction on his 1989 tax return, and if he is in the 28 percent tax bracket, he will save $28,000 of taxes. If the qualified issuer ceases to conduct a qualified business on December 31, 1992, it will cease to be considered a qualified issuer. In this case, the taxpayer must report on his 1992 tax return $100,000 as ordinary income, which is the amount of the deduction with respect to the enterprise stock. Additionally, the taxpayer's 1992 tax will be increased by the amount equal to the applicable section 6621 interest rate for the period beginning on December 31, 1989, and ending on December 31, 1992, applied to the $28,000 decrease in tax in 1989.

E. Other Incentives

Along with the four major tax incentives mentioned above,[266] H.R. 6 would provide three additional ones.[267] While not as significant as the incentives already discussed, they are still important and profitable measures.

1. Loss Deduction for Worthless Enterprise Zone Securities

The first of these proposed tax incentives would amend subsection 165(g) of the Code to include the following paragraph:

> (4) Securities of Enterprise Zone Business. - If any security of a qualified business (as defined in section 1043(b)) which is a capital asset becomes worthless during the taxable year -
>
> (A) paragraph (1) shall not apply, and
>
> (B) the loss resulting therefrom shall, for purposes of this subtitle, be treated as a loss from the sale or exchange, on the last day of the taxable year, of property which is not a capital asset.[268]

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[265] H.R. 6, 101st Cong., 1st Sess. § 231(a) (proposing I.R.C. § 197(d)(3)).

[266] See supra notes 116-264 and accompanying text.

[267] H.R. 6, 101st Cong., 1st Sess. §§ 241, 251, and 261.

[268] H.R. 6, 101st Cong., 1st Sess. § 251(a) (proposing I.R.C. § 165(g)(4)).

This provision would allow the taxpayer with enterprise zone stock that has become worthless to take an ordinary loss rather than a capital loss, thus affording the taxpayer two favorable results. First, by allowing the loss to be ordinary as opposed to capital, the taxpayer will not be restricted by the capital loss limitations of section 1211 of the Code.[269] Second, the taxpayer will not be limited in his loss by the alternative $100,000 ceiling of section 1244.[270]

2. *Increase in Research Credit*

The second tax incentive in this group would provide an increase in the credit allowed for research conducted in enterprise zones. Presently, the general rule of section 41 of the Code allows a tax credit equal to the sum of "(1) 20 percent of the excess (if any) of— (A) the qualified research expenses for the taxable year, over (B) the base amount, and (2) 20 percent of the basic research payments determined under subsection (e)(1)(A)."[271]

Section 261 of the Act would amend section 41 of the Code by adding subsection (i).[272] The new subsection would amend section 41(a)(1) of the Code by substituting "37 ½ percent" for "20 percent" with respect to the lesser of the excess of qualified research expenses over the base amount or the above-mentioned excess of qualified research expenses, if only research conducted in enterprise zones is taken into account.[273]

3. *Private Activity Bonds*

The final second-level tax incentive involves the tax effects of private activity bonds. Section 241 of H.R. 6 would provide two

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[269] Section 1211 allows an individual to take capital losses to the extent of capital gains plus the lower of $3,000 or the amount by which the capital losses exceed the capital gains for the taxable year. I.R.C. § 1211.

[270] Section 1244 of the Code provides for ordinary loss treatment in the event of corporate stock becoming worthless. The section, however, imposes a $100,000 limit. See I.R.C. § 1244 and its accompanying regulations.

[271] I.R.C. § 41(a). This section is entitled "CREDIT FOR INCREASING RESEARCH ACTIVITIES."

[272] H.R. 6, 101st Cong., 1st Sess. § 261(a) (proposing I.R.C. § 41(i)). This section would be entitled "INCREASE IN CREDIT FOR RESEARCH CONDUCTED IN ENTERPRISE ZONE."

[273] Id.

important exceptions to the tax treatment of such bonds as they relate to the area of enterprise zones.

Presently, section 168(g) of the Code limits the use by taxpayers of the accelerated cost recovery method on property financed with tax-exempt bonds. It requires taxpayers to use the alternative depreciation system instead of any accelerated method of cost recovery.[274] Under the first exception to section 168(g) of the Code, the alternative depreciation system limitation would not be applied and the regular accelerated cost recovery method would be applied for any property placed in service as new enterprise zone construction property or in connection with any qualified residential rental project, regardless of whether the property is financed with tax-exempt bonds.[275]

The second exception would provide a limited reprieve from the termination of small issue exemptions. The rule that terminates the small issue exemption would not apply to any obligation which is part of an issue where substantially all of the proceeds are used to finance facilities within an enterprise zone, if such facilities are placed in service while the designation as an enterprise zone is in effect.[276]

F. Economic Analysis of the Proposed Tax Incentives

While H.R. 6 clearly would stimulate activity in disadvantaged geographic areas, it is unclear what effects it will have on areas designated as enterprise zones or on society at large. While conceding that tax incentives for enterprise zones could reduce revenue,[277] proponents of the enterprise zone system cite two potential advan-

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[274] See I.R.C. § 168(g).

[275] H.R. 6, 101st Cong., 1st Sess. § 241(a) (proposing a replacement of I.R.C. § 168(g)(5)(C)).

[276] H.R. 6, 101st Cong., 1st Sess. § 241(a) (proposing I.R.C. § 142(a)(12)(D)).

[277] Most estimates are that tax incentives for enterprise zones will cost hundreds of millions of dollars. Dana Trier, Treasury Tax Legislative Counsel, estimates that the cost will be $150 million in 1990, $200 million in 1991, $300 million in 1992, and $400 million in 1993. See Statement of Dana Trier, Treasury Tax Legislative Counsel, at Senate Finance Committee Hearing on Tax Proposals in the Administration's Budget (Mar. 15, 1989).

The Joint Committee on Taxation estimates that the tax incentives measure in President Bush's 1990 budget proposal would cost $200 million in 1990, $200 million in 1991, $300 million in 1992, $400 million in 1993, and $500 million in 1994. See Joint Committee on Taxation, Summary of Revenue Provisions in President Bush's Budget Proposal for Fiscal Year 1990 (Mar. 3, 1989).

tages. First, the increased investment and employment stimulated by enterprise zone tax incentives may generate enough revenue not only to offset the cost of the tax preferences, but also to create positive tax revenues. Second, the economic lives of the people who live and work in depressed geographic areas will be improved.

1. Increased Tax Revenue

According to a Congressional Research Service paper,[278] H.R. 6 would stimulate growth in the enterprise zones. Under present law, the rental cost of capital ranges from $0.1615 per dollar of investment for an asset financed with 10 percent tax-exempt debt to $0.1548 per dollar of investment for an asset financed with a 50 percent tax-exempt debt.[279] By combining the credits for tangible investments[280] and research activities[281] with the allowance of full accelerated depreciation deductions for the tax-exempt bond-financed portion of assets,[282] along with the deduction for the purchase of enterprise stock,[283] the rental cost of capital would decline. Under H.R. 6, the rental cost of capital would range from $0.1333 per dollar of investment, for an asset financed with a 10 percent tax-exempt debt, to $0.1245 per dollar of investment, for an asset financed with a 50 percent tax-exempt debt.[284] Due to this tax-induced reduction in the rental cost of capital, the estimated demand for capital within enterprise zones would increase 17.46 percent, if assets were financed with 10 percent tax-exempt bonds, and 19.57 percent if assets were financed with 50 percent tax-exempt bonds.[285]

In the area of wage costs, the tax incentives introduced in H.R. 6 would also have a marked effect. Presently, wages that have 10 percent of every dollar devoted to economically disadvantaged workers reduce the employer's cost, through the mechanism of the

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[278] See generally Zimmerman, Federal Tax Incentives for Enterprise Zones: Analysis of Economic Effects and Rationales, CRS Report for Congress (June 15, 1989). The Zimmerman paper analyzes not only H.R. 6, but also the other five bills presently before Congress.

[279] Id. at 7.

[280] See supra notes 196-220 and accompanying text.

[281] See supra notes 271-73 and accompanying text.

[282] See supra notes 274-76 and accompanying text.

[283] See supra notes 238-65 and accompanying text.

[284] See Zimmerman, supra note 278, at 7.

[285] Id. at 9.

Target Job Tax Credit, to $0.96.[286] But the introduction of the credit for enterprise zone employment[287] would reduce the actual wage costs to $0.8888, if 10 percent of the wages are devoted to economically disadvantaged workers, and to $0.6902 if 50 percent of the wages go to economically disadvantaged workers.[288] It is estimated that this decrease in actual wage cost could result in an increase in the demand for labor in enterprise zones by as much as 13.73 percent.[289] Furthermore, by combining the reductions in the cost of capital and labor and applying a fixed factor share, it is estimated that H.R. 6 would increase the demand for products produced by firms within enterprise zones by as much as 15.19 percent.[290]

While the addition of tax incentives by H.R. 6 to the enterprise zone program would potentially increase economic activity in enterprise zones, the total effect of the program would probably not result in a net gain in federal revenue. Increases in investment, employment, and productivity in enterprise zones as a result of the tax incentives would most likely be offset by reduced investment, employment, and productivity in other locales. In essence, the revenue increase associated with increased enterprise zone activity would be offset by non-enterprise zone revenue decreases. However, even if the increase in economic activity in enterprise zones did result in a net revenue gain for the economy, some analysts suggest that this gain could be obtained through some other federal subsidy program without interrupting the status quo.[291]

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[286] Id. at 8.

[287] See supra notes 116-95 and accompanying text.

[288] See Zimmerman, supra note 278, at 7.

[289] Id. at 9. H.R. 6 is estimated to increase the labor demand in enterprise zones by 7.42%, if 10% of the wages are devoted to economically disadvantaged workers, by 9.52% if 25% of the wages are devoted to these disadvantaged workers, and by 13.73% if 50% of the wages are devoted in this manner.

[290] Id. at 9. It is estimated that the increase in demand for products produced by enterprise zone firms would be 9.93%, if 10% tax-exempt financing were used and 10% of the wages were devoted to economically disadvantaged workers. This would increase to 11.70% if 25% tax-exempt financing were used and 25% of the wages were devoted to economically disadvantaged workers. If 50% tax-exempt financing were used and 50% of the wages go to economically disadvantaged workers, the potential increase in demand for products produced by enterprise zone firms could be 15.19%.

[291] Id. at 10, 11.

2. Social Benefits

Absent a gain in federal revenue, the addition of federal tax incentives to the federal enterprise zone concept must be justified on other grounds. By guiding investment and employment to geographic areas that have had low economic activity, rather than already prosperous regions, it is possible to argue that society as a whole benefits. According to this argument, the redistribution of investment and employment gains is more important than increased revenue, and is desirable even to the point of a net revenue loss.

Accepting the importance of this social benefit, the success of the federal enterprise zone program must be judged by the direct increases in income and employment of the residents of the enterprise zone and by the physical improvements made in the zone. The purchase of capital equipment and buildings by residents of enterprise zones, as well as the employment of enterprise zone residents, would represent such a direct increase. Outsider purchases of capital for enterprise zones, as well as the establishment of new businesses, would also provide a direct increase in investment in enterprise zones. Moreover, the increased economic activities stimulated by the formation of businesses within enterprise zones would also produce a variety of indirect benefits.[292] The potential social benefits may be reduced, however, if some or all of the direct benefits do not accrue to the actual residents of the enterprise zones. If the capital equipment purchased and the structures built or rehabilitated do not employ the labor of enterprise zone residents, there will be little direct benefit from this capital infusion. While H.R. 6 provides an incentive to hire economically disadvantaged enterprise zone residents, it also provides incentives to hire workers who are neither economically disadvantaged nor residents of enterprise zones. If an employer believes, correctly or not, that the productivity of enterprise zone residents will be lower than that of nonresidents, he can hire a well-off, nonresident worker and still receive significant tax benefits.[293] This incentive system

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[292] Id. at 11-12. For example, some of these indirect benefits would be employee purchases of lunches and other consumption items, as well as the establishment of subsidiary firms to supply the enterprise business.

[293] Id. at 13. Mr. Zimmerman presents a comparison of this point. He states ". . . a firm hiring no economically disadvantaged workers receives 86.5 percent of the subsidy (tax in-

must change in order to promote the hiring of more needy, local workers in the zone. Only in this way will the social benefits accrue to the enterprise zone and its residents.

V. Conclusion

In a speech to the National League of Cities on September 8, 1989, Jack Kemp, Secretary of HUD, stated that economic development will be furthered successfully on the federal level only if the principles behind the current enterprise zone legislation are coupled with tax incentives.[294] It is clear that the federal enterprise zone concept is doomed to failure unless stronger incentives are created, incentives like the tax reforms in H.R. 6.

While the tax incentives in H.R. 6 may very well cause a revenue loss, the potential social benefits would justify such a loss. Instead of attempting to help residents of disadvantaged, low-growth areas by passive social transfer programs, the federal enterprise zone concept, armed with the tax incentives introduced by H.R. 6, would allow these residents to more actively participate in a growing economy. Without a doubt, H.R. 6 utilizes the Code to address serious social ills that have long been neglected. Adding the tax incentives of H.R. 6 to the federal enterprise zone legislation may finally give this well-intentioned legislation the strength it deserves.

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centive) received by a firm hiring 10 percent disadvantaged workers. Even when one firm hires 50 percent disadvantaged workers, a firm hiring no such workers receives a 7.70 percent subsidy, which is 56.1 percent of the subsidy available to the first firm." Id.

[294] Speech by Jack Kemp, Secretary of Hous. & Urb. Dev., to the National League of Cities (Sept. 8, 1989).