

Part III - Administrative, Procedural, and Miscellaneous

New York Liberty Zone Questions and Answers

Notice 2002-42

PURPOSE

This notice provides guidance concerning the New York Liberty Zone business employee credit, Qualified New York Liberty Bonds, and Liberty Advance Refunding Bonds.

BACKGROUND

Section 301 of the Job Creation and Worker Assistance Act of 2002, Pub.L. No.107-147, provides various tax benefits for the area of New York City damaged or affected by the terrorist attack on September 11, 2001. This notice provides guidance with respect to three of these provisions: (1) section 1400L(a) of the Internal Revenue Code, which provides a new targeted group for the Work Opportunity Tax Credit (WOTC), (2) section 1400L(d), which authorizes issuance of an aggregate of \$8 billion of tax-exempt private activity bonds to finance the acquisition, construction, reconstruction and renovation of certain nonresidential real property, residential rental property, and public utility property, and (3) section 1400L(e), which authorizes the issuance of an aggregate of \$9 billion of certain tax-exempt, advance refunding bonds.

OVERVIEW OF THE PROVISIONS

New York Liberty Zone business employee credit

Under Section 51 of the Code, the WOTC is available on an elective basis to an employer that hires individuals from one or more of eight targeted groups. To qualify as a member of a targeted group, the employee must be certified by a state employment security agency. The credit equals 40 percent of the qualified first-year wages of an employee who is employed 400 or more hours (25 percent for those employed fewer than 400 hours but at least 120 hours). Generally, qualified first-year wages are wages attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual begins work for the employer. The maximum credit per employee is \$2,400 (40 percent of the first \$6,000 of qualified first-year wages).

Section 1400L(a) provides for a new targeted group for the WOTC: New York Liberty Zone business employees. The new targeted group includes individuals who perform substantially all of their services in the New York Liberty Zone (NYLZ), and may include individuals who perform substantially all of their services elsewhere in New York City for a business that relocated from the NYLZ due to the physical destruction or damage of its workplace within the NYLZ by the September 11, 2001, terrorist attack. Instead of being based on “qualified first-year wages,” the new credit is based on “qualified wages,” which are wages paid or incurred to a NYLZ business employee for work performed during 2002 and 2003. With the exception of the certification requirement, the other section 51 rules regarding the WOTC apply.

Qualified New York Liberty Bonds and Liberty Advance Refunding Bonds

Section 1400L(d) creates a new type of tax-exempt bond known as Qualified New York Liberty bonds (Liberty Bonds). Section 1400L(e) provides for additional advance refundings of certain tax-exempt bonds (Liberty Advance Refunding Bonds). In general, Liberty Bonds and Liberty Advance Refunding Bonds may be issued by certain eligible issuers in the State of New York if, among other things, they are designated as Liberty Bonds or Liberty Advance Refunding Bonds by the Governor of New York or the Mayor of New York City. These Bonds must be issued after March 9, 2002, and before January 1, 2005. Liberty Bonds and Liberty Advance Refunding Bonds are subject to certain of the provisions of sections 103 and 141-150 of the Code.

Section 149(e) and the regulations thereunder require issuers of tax-exempt bonds to report certain bond related information to the Internal Revenue Service. That information is reported on Form 8038 series information returns. The information is generally required to be submitted by the 15th day of the second calendar month after the close of the calendar quarter in which the bonds were issued. These provisions apply to the issuance of Liberty Bonds and Liberty Advance Refunding Bonds.

QUESTIONS AND ANSWERS

Set forth below are questions and answers with regard to these provisions.

NYLZ Business Employee Credit

In general

Q1. What is a NYLZ business?

A1. A NYLZ business is any business that is either (1) located in the NYLZ, or (2) located in New York City, outside the NYLZ, as a result of physical destruction or damage of the place of business by the September 11, 2001, terrorist attack. A NYLZ business does not include, however, any business that employed an average of more than 200 employees on business days during the taxable year. See Q/A 9-12 for the calculation of the average number of employees on business days.

Q2. What is the NYLZ?

A2. The NYLZ is that portion of Manhattan in New York, New York, located on or south of Canal Street, East Broadway (east of its intersection with Canal Street), or Grand Street (east of its intersection with East Broadway).

NYLZ Business Employee

Q3. Who is a NYLZ business employee?

A3. For any period, a NYLZ business employee is any employee of a NYLZ business who performs substantially all of his or her services during the period for the business in the NYLZ. The term can also include an employee of a NYLZ business located outside of the NYLZ if substantially all of the employee's services are performed during the period in New York City.

Q4. What does "substantially all" of the services performed by the employee mean?

A4. For this purpose, "substantially all" means 80 percent or more.

Q5. Must the employee be a new hire for the employer to claim a credit under this provision?

A5. No. The employee may be an existing employee, a new employee, or a rehire.

Q6. Are independent contractors, partners, and self-employed persons considered "employees" for purposes of the NYLZ business employee credit?

A6. No.

Qualified Wages

Q7. What are "qualified wages"?

A7. "Qualified wages" are wages paid or incurred by the employer during the tax year to a NYLZ business employee of the employer for work performed during 2002 or 2003.

Q8. Is there a limit to the amount of wages that an employer can take into account for any employee?

A8. Yes. The qualified wages that may be taken into account for any employee are limited to the first \$6,000 of qualified wages per calendar year.

NYLZ Business

Q9. How does an employer determine whether it has met the average 200 employee limit for the purpose of claiming the NYLZ business credit?

A9. An employer can use any reasonable method of calculating the average number of employees on business days during the taxable year. For example, an employer may count employees on each business day and average the numbers, or count employees on the last day of each pay-period and average those numbers. If an employer uses different pay periods for different groups of employees, it may calculate the average number of employees in the groups separately, and then add the averages. See also Q/A 11 for controlled corporations, partnerships, etc.; and Q/A 12 for part-time employees.

Q10. What is a business day for this purpose?

A10. A business day is any day on which the business is open to the public or business is regularly conducted.

Q11. How does an employer count employees if it is part of a controlled group of corporations or a member of partnerships, proprietorships, etc., that are under common control?

A11. The rules of section 52 of the Code, which provides special rules for the WOTC for employers that are members of controlled groups or under common control, apply for purposes of determining the average number of employees in Q/A9.

Q12. When calculating the average number of employees, how does the employer count part-time employees?

A12. The employer may count each part-time employee as one employee. In the alternative, the employer may count each part-time employee as a fraction of an employee, using any reasonable method of determining full-time equivalents. Q&A-5 of § 54.4980B-2 of the Qualified Pension, Etc. Plans Regulations provides examples of reasonable methods.

Q13. Is a franchisee eligible to claim this credit?

A13. Yes.

Q14. Will the Service require an employer to have the New York State Department of Labor determine the number of its employees on September 11, 2001?

A14. No.

Q15. Can a tax-exempt organization claim the NYLZ business employee credit?

A15. No.

Other Issues

Q16. How do the rules differ for a NYLZ business with employees inside the NYLZ and one that includes employees outside the NYLZ?

A16. A NYLZ business located inside the NYLZ may claim the credit on the basis of qualified wages it pays to all of its NYLZ business employees. In the case of a NYLZ business located outside the NYLZ, the number of employees that it can take into account on a given day is limited to the excess of the number of employees of the employer in the NYLZ on September 11, 2001, over the number of NYLZ business employees located within the NYLZ on that day. The examples below illustrate these rules, including the situation in which a NYLZ business is located both within and outside the NYLZ.

Example 1. A is a NYLZ business that remained in the NYLZ. Throughout 2002, A had 40 NYLZ business employees. A did not exceed the 200-employee limit for 2002. A can claim the credit on the basis of the qualified wages it paid to each of its employees without regard to the number of employees it had on September 11.

Example 2. B is a NYLZ business that relocated to a location outside the NYLZ but within New York City. On September 11, 2001, B had 130 employees in the NYLZ. On each business day in 2002, B had 150 employees within New York City but outside the NYLZ. B did not exceed the 200-employee limit for 2002. B can claim the credit on the basis of the qualified wages it paid to no more than 130 of its employees.

Example 3. C is a NYLZ business that had two places of business in the NYLZ on September 11, 2001. One place of business remained in the NYLZ. C relocated the other place of business to a location outside the NYLZ but within New York City. On September 11, 2001, C had 60 employees in the NYLZ. Throughout 2002, 40 employees performed services at the place of business inside the NYLZ, and 30 employees performed services at the place of business outside the NYLZ. C did not exceed the 200-employee limit for 2002. C can claim the credit on the basis of the qualified wages it paid to no more than 60 employees (the 40 employees inside the NYLZ and 20 of the employees outside the NYLZ).

Example 4. The facts are the same as in Example 3, except that, throughout 2002, 70 employees performed services at the place of business inside the NYLZ, and 20 employees performed services at the place of business outside the NYLZ. C can claim the credit on the basis of the qualified wages it paid to all 70 employees inside the NYLZ. C cannot claim the credit on the basis of the qualified wages it paid to any of the employees outside the NYLZ.

Q17. Can a NYLZ business use wages paid to an employee to claim both the new credit and the existing WOTC or Welfare-to-Work credit?

A17. No. However, the business can use the employee's wages to claim the other credit, if the employee's wages are not used to claim the NYLZ credit and the employee is either a member of a targeted group for purposes of the WOTC (section 51) or a long-term family assistance recipient for purposes of the Welfare-to-Work credit (section 51A). In addition, wages paid to the same employee in different tax years might be used to obtain two different tax credits.

Example 5. The facts are the same as in Example 4 above. C cannot claim the WOTC or the Welfare-to-Work credit on the basis of wages paid to any of the NYLZ employees. C can claim the WOTC or the Welfare-to-Work credit on the basis of wages paid to the employees outside the NYLZ, provided all the requirements for the credit are met.

Q18. When claiming the credit, must a NYLZ business outside of the NYLZ provide substantiation that it relocated as a result of the physical destruction or damage of its place of business by the September 11, 2001, terrorist attack?

A18. No. The Service could, of course, request this substantiation on examination.

Claiming the Credit

Q19. How does an employer claim the credit?

A19. An employer must attach Form 8884, *New York Liberty Zone Business Employee Credit*, to its income tax return. An employer who claims the WOTC for any other targeted group will also have to attach Form 5884, *Work Opportunity Credit*.

Liberty Bonds and Liberty Advance Refunding Bonds

Q20. How are the limitation amounts in section 1400L(d)(3)(B) allocated?

A20. One-half of each limitation amount is allocated to bonds designated by the Governor, and the other half is allocated to bonds designated by the Mayor. The Governor and the Mayor are not required to utilize these limitation amounts at the same time. In addition, the Governor and the Mayor may utilize the limitation amounts in any order relative to their designation of bonds for other qualified project costs.

Q21. Is the New York City Municipal Water Finance Authority eligible for the advance refunding provisions of section 1400L(e)(1)?

A21. Yes. The reference in section 1400L(e)(2)(B) to the "New York Municipal Water Finance Authority" is deemed to refer to the New York City Municipal Water Finance Authority.

Q22. Are bonds issued by the New York City Transit Authority (NYCTA) or the Triborough Bridge and Tunnel Authority (TBTA) eligible for the advance refunding provisions of section 1400L(e)(1) if they otherwise satisfy the requirements of that provision?

A22. Yes. Bonds issued by NYCTA and TBTA that otherwise satisfy the provisions of section 1400L(e)(1) are treated as issued by the Metropolitan Transportation Authority of the State of New York.

Q23. Are bonds issued by the Municipal Assistance Corporation for The City of New York (MAC) eligible for the advance refunding provisions in section 1400L(e)(1) if they otherwise satisfy the requirements of that section?

A23. Yes. The Chairmen and Ranking Members of both the House Ways and Means Committee and the Senate Finance Committee have advised the Treasury Department that they believe bonds issued by the MAC should be included in these provisions, and that they plan to introduce and enact legislation to clarify this treatment, effective as if originally included in the Job Creation and Worker Assistance Act of 2002, at the earliest opportunity.

Q24. What information must an issuer of Liberty Bonds provide to the Service in order to comply with section 149(e)?

A24. An issuer of Liberty Bonds must complete Form 8038, *Information Return for Tax-Exempt Private Activity Bond Issues*, in accordance with the instructions and complete Part II by checking the box on Line 11m (Other), write in "Liberty Bonds" for the description, and enter the amount of the bonds in the Issue Price Column. In addition, the Issuer must attach a copy of the document used by the Governor or Mayor to designate the bonds as Liberty Bonds.

Q25. What information must an issuer of Liberty Advance Refunding Bonds provide to the Service in order to comply with section 149(e)?

A25. An issuer of Liberty Advance Refunding Bonds must complete the appropriate Form 8038 Series return (Form 8038, 8038-G, or 8038-GC) in accordance with the instructions for a refunding bond and attach a copy of the document used by the Governor or Mayor to designate the bonds as Liberty Advance Refunding Bonds.

IRS WEBSITE

This notice is also available on the Internal Revenue Service website (www.irs.gov). Any additional questions and answers the Service develops will be released in further guidance and placed on the website.

QUALIFIED NEW YORK LIBERTY ZONE PROPERTY UNDER THE ACT

For guidance regarding qualified property or qualified New York Liberty Zone property provided by sections by sections 168(k) and 1400L(b), see Rev. Proc. 2002-33, 2002-20 I.R.B. 963 (May 20, 2002).

DRAFTING INFORMATION

The principal author of this notice is Shoshanna Chaiton of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this notice, including the New York Liberty Zone business employee credit, please contact Ms. Chaiton at (202) 622-6080 (not a toll-free call). For questions concerning the Liberty Bonds and Liberty Advance Refunding Bonds provisions, please contact Timothy L. Jones at (202) 622-3980 (not a toll-free call).