

Empowerment Zone Tax Incentive Use: What the 1996 Data Indicate

by Edith Brashares

Studies of the Federal Empowerment Zone/Enterprise Community (EZ/EC) Program have tended to focus on the effectiveness of Federal grants to encourage the revitalization of these low-income areas. This emphasis on the effect of Federal grants partially reflects the availability of data. For the program, EZ's were required to develop a set of benchmarks and to report regularly to either the Department of Housing and Urban Development or the Department of Agriculture, as appropriate, on their progress toward meeting the outcomes of their local policy initiatives. No such comparable reporting is required of the use of EZ tax incentives, although the initial Treasury Department estimate was that 66 percent of Federal aid specific to the EZ's would come in the form of tax incentives to businesses. While a 1999 study by the U.S. General Accounting Office provides relatively comprehensive information on tax incentive use, the low survey response rates by some businesses make some of the estimates of the amounts claimed unreliable.

To facilitate examination of the tax incentives, the Treasury Department began to obtain data on use of the EZ employment (EZE) credit. The EZE credit was estimated to account for 95 percent of the tax incentives used in the EZ's and EC's. By examining the EZE credit claimed, the vast majority of the tax incentives used in the zones can be followed. This article provides the first analysis of these data for

Tax Year 1996. For that year, there were 1,254 taxpayers (1,040 were individuals, and 214 were taxable corporations) with EZE credits taken against regular tax liability. In total, \$15,118,000 in EZE credits against regular

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tax liability were claimed, of which \$9,593,000 were claimed by individuals and \$5,525,000 by taxable corporations. (Excluded from this analysis were the EZE credits against the "alternative minimum tax" or AMT because of resource constraints as explained later.)

The Empowerment Zone/Enterprise Community Program

The Omnibus Budget Reconciliation Act of 1993 (OBRA 93) authorized a 10-year Federal demonstration project whereby nine "Empowerment Zones" (EZ's) and 95 "Enterprise Communities" (EC's) were designated in a competitive application process. While all EZ's and EC's had to satisfy the same eligibility criteria, EZ's were to receive most of the Federal grants and tax incentives. This differential treatment was an attempt to see whether more Federal dollars directly translated into a greater degree of revitalization. In order to compete for designation, EZ's and EC's were required to satisfy certain eligibility criteria, including specified poverty rates, as well as population and geographic size limitations. These relatively small geographic areas, with high concentrations of poverty, were to receive Federal grants and tax incentives for 10 years. Combined with a locally initiated redevelopment strategy, these incentives were intended to encourage investment in these low income areas and lead to their revitalization.

Under OBRA 93 provisions, each census tract within an EZ or EC must have a poverty rate of at least 20 percent, while 90 percent of the tracts within an EZ or EC must have a poverty rate of at least 25 percent, and 50 percent of the tracts must have a poverty rate of at least 35 percent. In an urban area, an EZ or EC can have a maximum population of the lesser of 200,000 or the greater of 50,000 or 10 percent of the population of the city within which the EZ or EC is located. Finally, urban EZ's or EC's cannot exceed 20 square miles, while rural EZ's or EC's are limited to 1,000 square miles.

As required by OBRA 93, six EZ's were to be located in urban areas (with the aggregate population for the six designated urban EZ's limited to 750,000), and three in rural areas. The nine EZ's initially designated (on December 21, 1994) are referred to as "First-Round EZ's" and include parts of Atlanta, Georgia; Chicago, Illinois; Kentucky Highlands,

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Kentucky; Baltimore, Maryland; Detroit, Michigan; Mid-Delta, Mississippi; Harlem and the Bronx, New York City, New York; Philadelphia/Camden, Pennsylvania/New Jersey; and Rio Grande Valley, Texas.

In addition to Federal grants, certain businesses located in these EZ's are eligible for three Federal tax incentives beginning December 21, 1994 [1]:

- a credit against income tax for the first \$15,000 of wages paid to a zone resident who works in the zone;
- an additional \$20,000 of expensing (current deduction) of the cost of depreciable "qualified zone property," under Internal Revenue Code section 179, placed in service by an "enterprise zone business"; and
- tax-exempt private activity bonds for certain zone facilities, subject to the private activity bond volume cap for the State in which the EZ is designated [2].

When originally passed, the cost of the EZ/EC program was estimated by the Treasury Department at \$3.8 billion over 5 years (Fiscal Years 1994 through 1998): \$1.3 billion in grants and \$2.5 billion in tax incentives. Of the \$2.5 billion, Treasury estimated that approximately 85 percent would be due to the EZE credit, with the additional expensing of qualified property costs and of tax-exempt bond incentives accounting for the rest of the estimated cost. Subsequent estimates cited by the U.S. General Accounting Office have lowered the estimated tax incentive cost to \$2.5 billion over the full 10-year life of the program, but increased the proportion attributable to the EZE credit to 95 percent of the cost [3]. Thus, in order to track the revenue cost of the tax incentives of the EZ/EC program, understanding the use of the EZE credit is critical.

Compared to the revenue loss of approximately \$250 million per year cited by the U.S. General Accounting Office, tax return data suggest that the actual credit claimed was approximately 7 percent of what was estimated. While the EZE credit claimed against the AMT is not included in the tax return data, this omission is unlikely to account for much of the difference from the \$250-million estimate. Instead, there are a number of possible explanations.

In particular, the low credit usage may reflect the general problem with using non-refundable tax credits to benefit businesses and individuals in distressed areas whose tax liability may already be small. Tax credits can only be used to the extent taxpayers have tax liabilities and satisfy the limitations on the amount that can be taken. If the approximately 15,000 businesses operating in the EZ's follow the general pattern, then only half (7,500) pay tax and could potentially take advantage of a credit, such as the EZE [4]. While the "general business credit" carryforward rules (the EZE credit is considered to be part of the general business credit) would enable use of the tentative credit for 1996 to be used in the future, these returns would only show up in future studies. Moreover, the targeting requirements, such as that eligible employees live and work in the zone, decrease the potential number of eligible businesses. Finally, there are lags in credit usage as EZ businesses learn about the credit or set up operations to take advantage of it. For example, anecdotal evidence suggests that some major new EZ employers were not operating until 1998.

The EZE Credit

The EZE credit rate is 20 percent of qualified costs through 2001, then decreases by 5 percentage points per year until the program expires in 2005. Wages eligible for the credit include certain training and education expenses paid by the employer. As with other wage tax credits, employers must reduce their deductions for wages and salaries and certain educational and training costs by the amount of wages and training costs tentatively claimed under the credit.

Eligible employees must live in the EZ and perform substantially all of their services for the employer in the EZ. This means that subsidiaries or affiliates of larger corporations with establishments in an EZ can potentially be eligible for the EZE credit [5]. Similarly, EZ businesses that provide services both in and outside of the zone can potentially take advantage of the credit if they use their EZ resident employees for work in the EZ [6]. Eligible employees do not include relatives of the owner, 5 percent-or-more owners of the business, and employees who work for less than 90 days. Certain businesses are also not eligible, such as gambling establishments, liquor stores, and massage parlors, and farms with

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assets greater than \$500,000.

As already indicated, the EZE credit is part of the “general business tax credit,” so a claimant may be restricted in how much of the EZE credit can be claimed against taxes for any year. Employers claiming the credit determine the eligible wages and resulting “tentative credit” for the year. The business then determines whether it has sufficient tax liability with which to satisfy the EZE credit limitations in order to claim all or part of the “tentative credit” against current year regular and “alternative minimum tax” (AMT) liabilities [7]. If they do not, the unused credits can be carried back as far as 1994, then forward 15 years [8].

The EZE credit limitations mentioned above are complex rules that are not particularly intuitive and are described in more detail in Appendix 1. Because more of the tentative EZE credit can offset AMT liability than can the other general business credit components, a separate EZE credit limitation applies [9]. This limitation ensures that taxpayers can use all or part of their tentative EZE credits while still paying “enough” regular tax or AMT. Small taxpayers with total tax liabilities (regular tax before EZE credit plus AMT) of \$25,000 or less can take EZE credits equal to up to their excess of the total tax liability above 75 percent of their “tentative AMT [10].” This tentative AMT is essentially the tax they would have paid using the AMT rules whether or not they are actually subject to the AMT. Taxpayers with total tax liabilities greater than \$25,000 take EZE credits equal to up to their total tax liabilities in excess of the greater of 75 percent of their tentative AMT, or 25 percent of regular tax liability over \$25,000. After applying the EZE credit limitations to determine how much of the tentative EZE credit can be taken, the EZE credit is first taken against any regular tax liability with the residual being taken against AMT liability.

Tax Credit Claimants

Tax return data used by Treasury’s Office of Tax Analysis typically come from stratified samples of tax returns used for Statistics of Income. These samples are designed to represent U.S. taxpayers as a whole, rather than just taxpayers operating in the limited geographic areas comprising EZ’s. Therefore, there was a concern that the samples would not provide reliable data on the EZE credit usage, since relatively

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few taxpayers operating in EZ’s would likely be included in the samples.

To deal with this potential problem, the IRS Individual Master File (IMF) and the IRS Business Master File

(BMF) were expanded to include data on the EZE credit claimed against regular taxes. A special credits extract file was created by Statistics of Income for Tax Year 1996 that included all the data on the IMF and BMF for taxpayers who claimed an EZE credit against current, regular tax. These Master Files contain information from all the returns filed by individuals and corporations. As a result, the extract file contained data on EZE credit claimed against regular taxes for the entire population of EZE credit claimants. Taxpayers who earned tentative EZE credits that they were unable to use against regular tax for 1996, such as those claiming the credit against the AMT, were not included. Only one data item, the EZE credit claimed against the regular tax, was available from the Master Files because of Master File resource constraints [11].

Unlike Statistics of Income data which are edited to help ensure consistency, only limited mathematical checks are performed on the Master File, and, hence, on the extract data [12]. As a result, the amounts are generally as reported on the tax return. In addition, because the Master Files are used for many purposes, and, again, because of resource constraints, the tax return data on the Master Files tend to be more limited. For purposes of the statistics, some of these limitations were overcome by imputation of values [13]. Amended returns and returns for 1996 processed in later years are not included in the extract. In addition, returns from prior tax years were excluded. Also, taxable corporation coverage was defined as tax years that ended between July 1996 and June 1997.

For Tax Year 1996, there were 1,254 taxpayers (1,040 were individuals, and 214 were taxable corporations) with EZE credits taken against regular tax liability. The individual taxpayers included sole proprietors, partners, S corporation shareholders, beneficiaries of estates and trusts, and cooperative patrons. In comparison, for 1996, there were approximately

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28.9 million individual income tax returns with Schedules C, E, or F used to report business income and 2.3 million returns of taxable corporations (S corporations are excluded). In total, \$15,118,000 in EZE credits were claimed, of which \$9,593,000 were claimed by individuals and \$5,525,000 by taxable corporations. This suggests that approximately 5,000 employees were subsidized. The 5,000 estimate is generated by dividing the total credits (\$15 million) by the maximum per employee credit amount (\$3,000). This is an underestimate of the number of zone residents assisted, since not all eligible employees would have been paid the maximum amount of eligible wages (\$15,000), and the EZE credits against the AMT were excluded from the statistics. The Form 8844 filed to claim the EZE credit asks only for the total wages of eligible employees and does not require credit claimants to provide the number of such eligible employees.

The credits are earned at the business entity level, but the EZE credit limitations apply either at the entity or owner's level depending on the legal form of business organization. For taxable corporations, the EZE credit limitations apply at the business entity level. For other business forms, the entities themselves do not pay income tax, but, instead, pass through both the income and expenses to their owners who are taxed. The EZE credit limitations in these cases thus apply at the ownership level. As a result, there is no comparable unit on the individual and business files for analyzing who claims the credit. On the individual side, the analysis is in terms of the owner's characteristics, and not those of the business entity. On the corporate side, the analysis is of the business characteristics with no information on business owners' characteristics.

Individual EZE Credit Claimants

For sole proprietors, partners, S corporation shareholders, beneficiaries of estates and trusts, and cooperative patrons, the credit per claimant for 1996 varied from approximately \$30 to \$310,000 per tax return, with a mean value of \$9,224. However, this is somewhat misleading because some taxpayers "owned" all of the credit for a business, while others "owned" only a fraction of the credit. For example, each shareholder of an S corporation would claim a fraction of the total credits available to the S corporation in proportion to his or her ownership share.

There is no information on the ownership share reported on Form 8844 or elsewhere in the IMF.

Table 1 presents the amount of credit claimed by the size of the credit.

Fifty-one percent of taxpayers claiming the EZE credit claimed \$3,000 or less. Less than 5 percent claimed a credit greater than \$50,000.

Where more than one legal form of business organization is reported on a particular individual return or where a Schedule E is part of the return, it is not possible to determine the legal form of business organization to which the tax credit is related. This is because only the total credit claimed is collected, and this total is not allocated among what may be multiple businesses. Furthermore, Schedule E is filed by more than one type of business organization. However, some generalizations about the types of business tax organizations included in the return can be made. In particular, sole proprietors file Schedule C, while farmers file Schedule F, with their individual tax returns. Schedule E is used not only for the other businesses owned by individuals fully or in part, including partners and S corporation shareholders, but also used by beneficiaries of estates and trusts, and those with income and loss from rental real estate, royalties, and residual interests in Real Estate Mortgage Investment Conduits (REMIC's), among others. Moreover, more than one business may be reported under a specific business type. For example, the IMF reports the total for all sole proprietorship operations of an individual taxpayer, some limited information on the two largest businesses, and the total for the remaining businesses. In addition, taxpayers may have interests in more than one form of business, such as a sole proprietorship and an S corporation. There is no way of knowing the particular business entity operating in the EZ, based on what is reported on the Individual Master File.

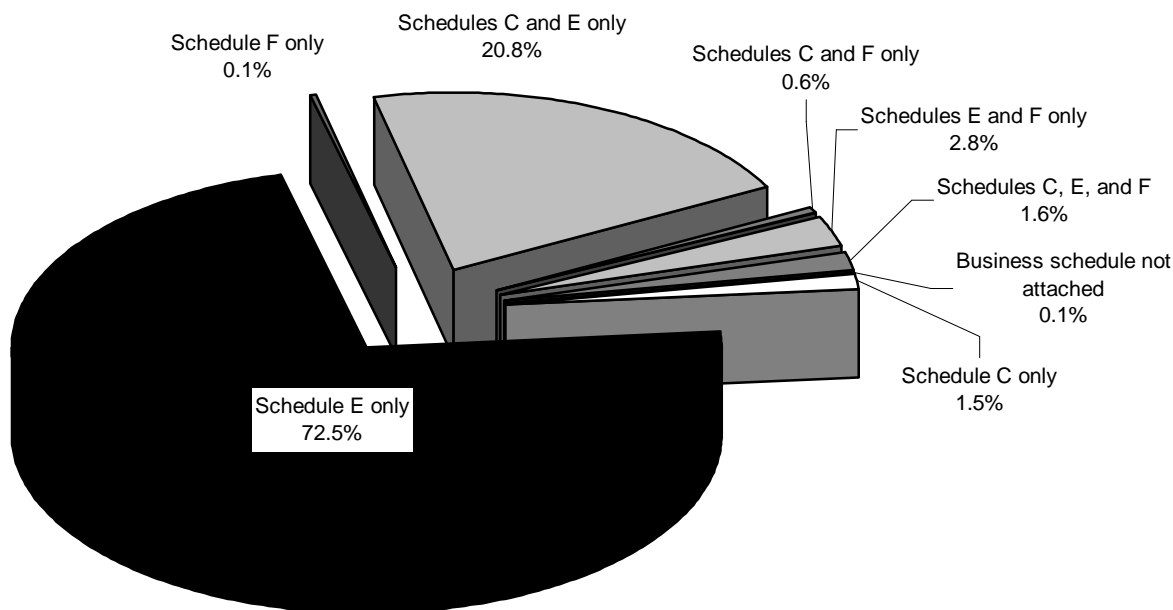
Figure A shows that almost 73 percent of the EZE credit was claimed by those filing Schedule E, while Figure B shows that 61 percent of the taxpayers claiming the credit filed Schedule E. The mean value of the credit claimed per return was \$10,881, the equivalent of about 3.5 employees per claimant. The next largest category was for taxpayers with

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\$3,000 or less.**

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Figure A

Percentage of EZE Credit by Type of Business Schedule Attached to Individual Income Tax Returns, Tax Year 1996



NOTE: Schedule C is filed by nonfarm sole proprietors; Schedule E, by partnerships, shareholders of S corporations, beneficiaries of estates and trusts, cooperative patrons, and recipients of income or loss from rental real estate, royalties, and residual interests in Real Estate Mortgage Investment Conduits (REMIC's); and Schedule F, by farm proprietors.

both Schedules C and E, accounting for 21 percent of the credit claimed and 24 percent of the claimants. The mean value of the credit claimed per return was \$7,902, the equivalent of about 2.5 employees per claimant, assuming eligibility for the maximum credit amount. Sole proprietorships alone, the traditional small business form, accounted for only 2 percent of the credit amount and 5 percent of the taxpayers claiming the credit. On average, these businesses hired approximately one eligible employee. However, only 16 percent of the Schedule C profits were reported by those filing only a Schedule C, with 72 percent due to those filing both Schedules C and E. The predominance of Schedule E returns suggests that even small business owners may be more sophisticated than the stereotype of a “mom and pop store,” though this inference partially reflects the fact that there are multiple owners of S corporations and partnerships, among others.

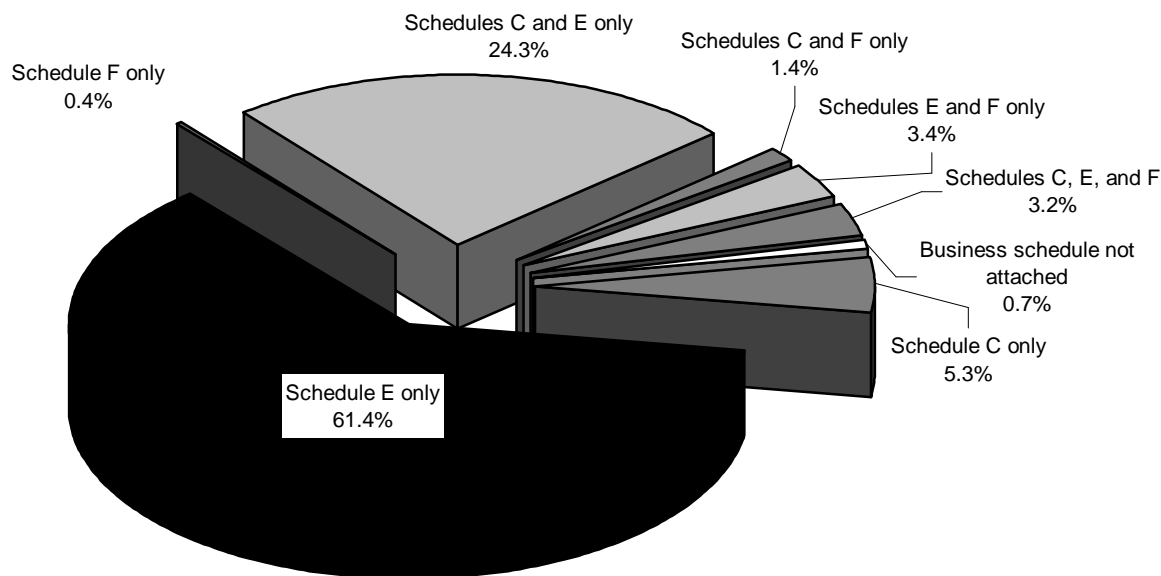
As shown in Table 2, for the different tax schedules filed, the distribution of taxpayers by size of EZE credit is relatively similar. Most taxpayers reported less than \$1,000 in EZE credits, with a decline in the percentage of claimants as the credit amount increased. In general, Schedule E filers dominated, alone and in combination with other schedules, because there were so many more of these types of filers.

Looking at the “adjusted gross income” (AGI), it is not surprising that most of the credit was claimed by those with high incomes (Table 3). High-income taxpayers tend to have sufficient tax liabilities with which to offset all or most of the tentative credit. Lower-income taxpayers pay tax at lower rates and are less likely to have sufficient tax with which to offset the credit. The data do not include statistics from taxpayers who computed the tentative credit, but were unable to claim the credit against regular

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Figure B

Percentage of Individual Income Tax Returns with an EZE Credit, by Type of Business Schedule Attached, Tax Year 1996



NOTES: Schedule C is filed by nonfarm sole proprietors; Schedule E, by partnerships, shareholders of S corporations, beneficiaries of estates and trusts, cooperative patrons, and recipients of income or loss from rental real estate, royalties, and residual interests in Real Estate Mortgage Investment Conduits (REMIC's); and Schedule F, by farm sole proprietors.
Detail may not add to 100 percent because of rounding.

tax for 1996, either because they had no regular tax or because other credits took precedence in offsetting tax. Thus, 77 percent of the credit was claimed by individuals with an AGI of \$200,001 to \$5 million, for example, even though this group accounted for only 43 percent of the taxpayers claiming the credit. Those with an AGI of \$50,000 or less accounted for 17 percent of the claimants, but only 3 percent of the credit claimed. Results are similar if size of regular tax before and after credits is substituted for size of adjusted gross income.

Given the more stringent EZE limitations for taxpayers who are subject to the AMT, it is not surprising that 92 percent of those claiming the EZE credit did not have any AMT liability [14]. Of those that did, 3 percent had AMT liabilities of \$5,001 to \$40,000, while the remaining 5 percent had AMT liabilities of \$5,000 or less. While the AMT ensures that taxpayers with limited income tax liabilities pay at least some tax, those paying the AMT are more likely to be limited in the tentative EZE credit they

can claim. By business organization, Schedule C and F filers reported no AMT liability, while 8 percent of Schedule E filers did. Of those filing both Schedules C and E, 11 percent reported some AMT liability. On the other hand, many taxpayers with combinations of business schedules generally reported being subject to the AMT.

As described earlier, the EZE credit taken against regular tax may be limited by the amount of regular tax liability above \$25,000, as well as combinations of regular tax and AMT. To test whether the EZE credit limitations appear to affect the size of the credit taken, the EZE credit taken was compared to the approximate limitations. For 92 percent of EZE credit claimants, accounting for 99 percent of the EZE credit, the limitations did not appear to apply. The remaining owners appear to be affected by the AMT, whereby the EZE credit is limited to 75 percent of the "tentative AMT." All these taxpayers had EZE credits of \$10,000 or less. Note that this is an understatement, in as much as taxpayers whose

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total EZE credit was offset by the regular tax liability and AMT constraints would not be included in the data.

No information is available on Form 8844 that identifies the specific EZ where the wage credits are earned. In an attempt to allocate the credit by zone, each tax return was assigned to a State based on the postal ZIP Code of the individual filing the return. This may be a poor proxy for EZ business location, however. In particular, a business may be located in a different State other than that in which the owner resides. Similarly, owners of subchapter S corporations, partners in partnerships, and others may reside in completely different States than where the eligible business activity takes place. Finally, the address on the return may be that of a tax preparer rather than the taxpayer.

Despite the problems with using the ZIP Code to proxy the EZ within which the business is located, results in Figures C and D offer clues. Eighty-four percent of the EZE credit can be attributed to States where EZ's are located. The Chicago, Illinois, EZ

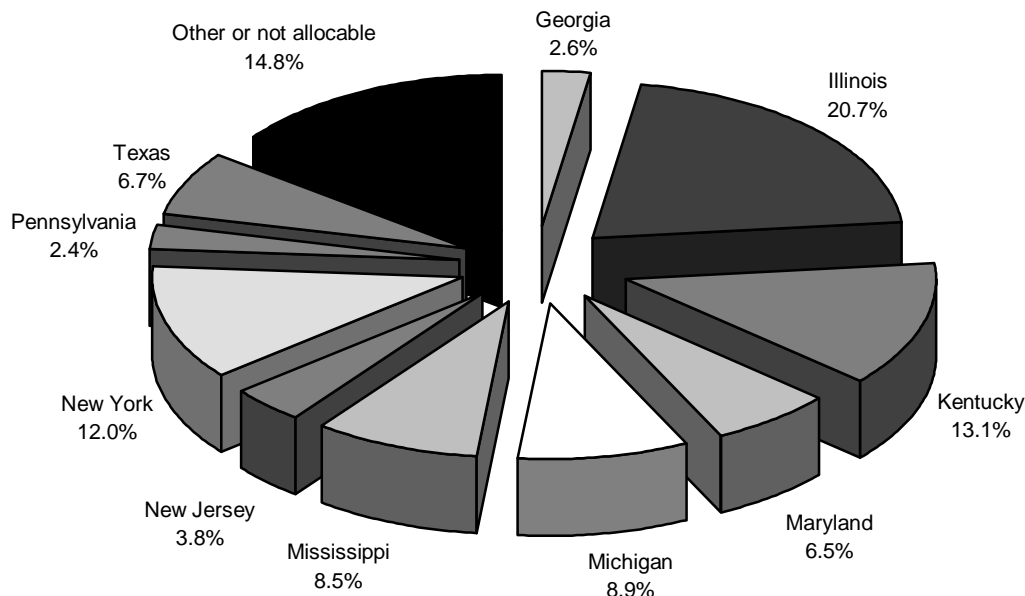
appears to have accounted for approximately one-quarter of the credit claimed on individual income tax returns, while New York State accounted for the next largest percentage (17 percent). Pennsylvania and New Jersey had the lowest percentages of credits claimed, but this is somewhat misleading because these two States combined contained only one zone.

Table 4 shows the distribution within each State of the EZE credit amount claimed on individual income tax returns. For the EZ States with rural zones (Kentucky, Mississippi, and Texas), EZE credit distributions are comparable to those for States that had urban zones. However, roughly 70 percent of the credit claims of these three States were for amounts of \$5,000 or less. The remaining 30 percent, with larger credit claims, included taxpayers from States with large urban zones (Illinois, Michigan, and New York).

Analysis by State provides other clues, as well. Not surprisingly, those claimants filing Schedule F

Figure C

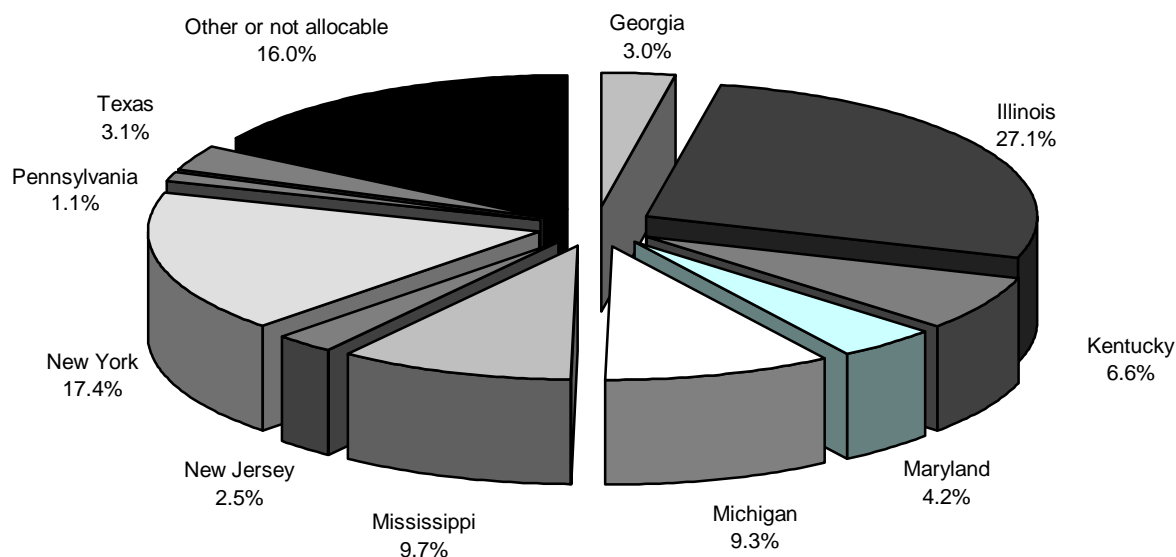
Percentage of EZE Credit Reported on Individual Income Tax Returns, by Selected States, Tax Year 1996



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Figure D

Percentage of Individual Income Tax Returns with an EZE Credit, by Selected States, Tax Year 1996



(farm) returns were concentrated in the three States (Mississippi, Texas, and Kentucky) with rural zones [15]. Only two States without EZ's, Arizona and Florida, reported more than 3 percent of the total EZE credits. In both of these latter States, Schedule E filers, and combinations of Schedule C and E filers, were the ones claiming the credits. Compared to States with EZ's, returns from States without EZ's reported somewhat higher income taxpayers. Some 12 percent of the EZE credits and 2 percent of the credit claimants were from States without EZ's and reported AGI's of over \$1 million. Only Illinois had a greater representation in this size class, with 15 percent of the EZE credit and 4 percent of credit claimants reporting an AGI of more than \$1 million.

Corporate EZE Claimants

EZE claimant data for taxable corporations were obtained from the Business Master File. Because taxable corporations may file a consolidated return and combine the income from affiliated corporations operating in different lines of business and in different States, it can be difficult to interpret the results. For corporations, the smallest credit value reported for 1996 was approximately \$30 and the largest

\$770,000, with the mean value \$25,819. Table 5 shows the distribution of the number of returns by the size of the credit. Unlike individuals, where about half claimed an EZE credit of \$3,000 or less, only 27 percent of corporations did so. Approximately 21 percent of the corporation income tax returns showed an EZE credit in the \$5,000 to \$10,000 range, and approximately 75 percent of credit claimants reported credits of \$20,000 or less.

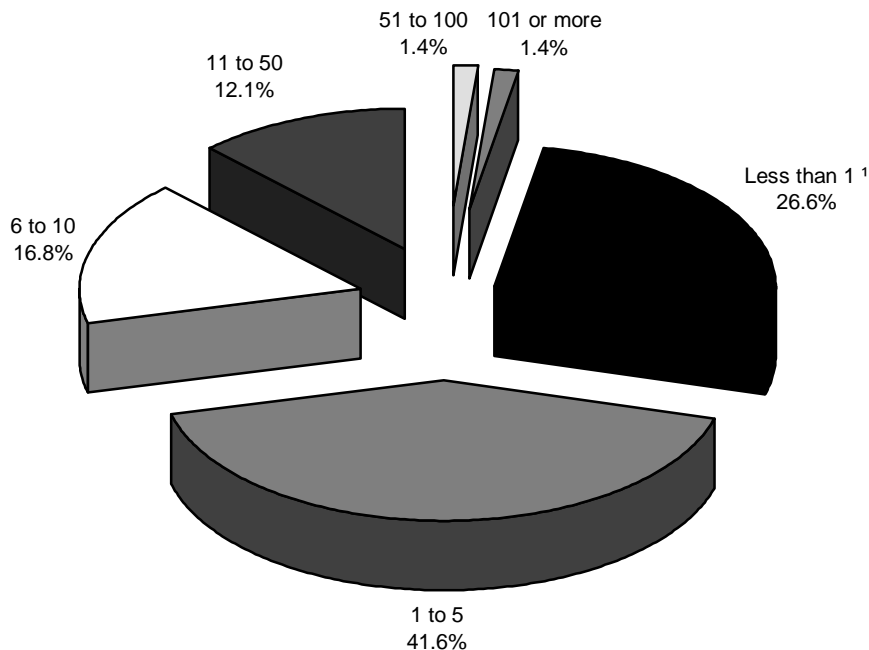
Figure E distributes the potential number of employees eligible for the credit per corporate business credit claimant. Over a quarter (27 percent) claimed an EZE credit for less than the maximum amount that could be due to one employee. Almost 42 percent of corporations claiming the credit were estimated to have had 1 to 5 eligible employees. Ninety-seven percent had 50 or fewer eligible employees. This suggests that the vast majority of corporations taking the credit for 1996 were relatively small in size. However, the relatively small number of larger-sized corporations accounted for the majority of the dollar amount claimed.

To get a better profile of those corporations claiming the EZE credit, Table 6 distributes the credit and tax liability by the size of total assets shown on

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Figure E

Estimated Number of Eligible Employees for Whom Corporations Claimed an EZE Credit, Tax Year 1996



¹ Represents corporations with eligible employees with annual earnings less than the creditable \$15,000 per employee, e.g., for employees who worked only part time or for only part of the year. The credit allowable for such an employee was less than the \$3,000 maximum. Because the number of employees was estimated from the statistics by dividing annual EZE credit claimed by \$3,000, the result was less than one employee.

NOTES: Excludes S corporations electing to be taxed through shareholders. Detail may not add to 100 percent because of rounding.

the corporate return. Though a larger percentage of the population, those corporations with total assets of \$10 million or less accounted for 73 percent of corporate claimants, but only 29 percent of the credit amount. The lion's share of the credit (72 percent) was claimed by the 27 percent of taxpayers with assets over \$10 million. This is a typical pattern as, by number, small businesses dominated, but, by economic activity, large ones did. This is seen in starkest terms by the last column in Table 6, where 98 percent of the tax liability of corporate taxpayers that benefited from the credit was reported on returns with total assets over \$500 million. These general results held, whether the EZE credit was distributed by size of net income (Table 7) or size of business receipts (Figures F and G). Table 8 essentially flips the argument on its head and notes that, in general, those returns with the largest EZE credit tended to be large whether measured by assets, net income, or tax.

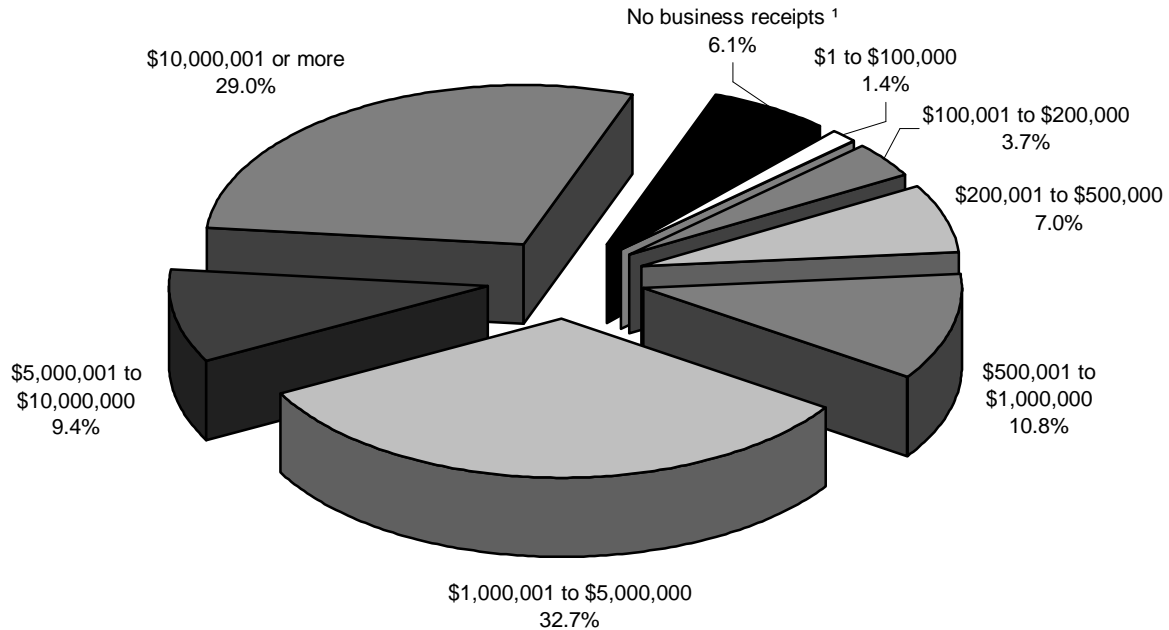
The EZE credit limitations did not appear to affect 72 percent of those corporations with the EZE credit [16]. This group reported 96 percent of the credit. However, when the limitation did apply, it appears to have been the tentative AMT limitation that mattered. Twenty-nine percent of the claimants (4 percent of the EZE credit claimed) appear to have been affected by this. Seventy-nine percent of those limited by the tentative AMT claimed a credit of \$5,000 or less. Unlike individuals, relatively more corporate taxpayers appear to have been affected by the AMT limitation.

While the information on the tax return, and, hence, on the special credits BMF extract did not enable an analysis of the location of the corporation claiming the credit, it did provide information on the principal business activity [17]. Table 9 distributes the EZE credit, the number of potentially eligible employees, and the number of returns claiming the credit, by industry grouping [18]. Manufacturing as a

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Figure F

Percentage of Corporation Income Tax Returns with an EZE Credit, by Size of Gross Receipts, Tax Year 1996

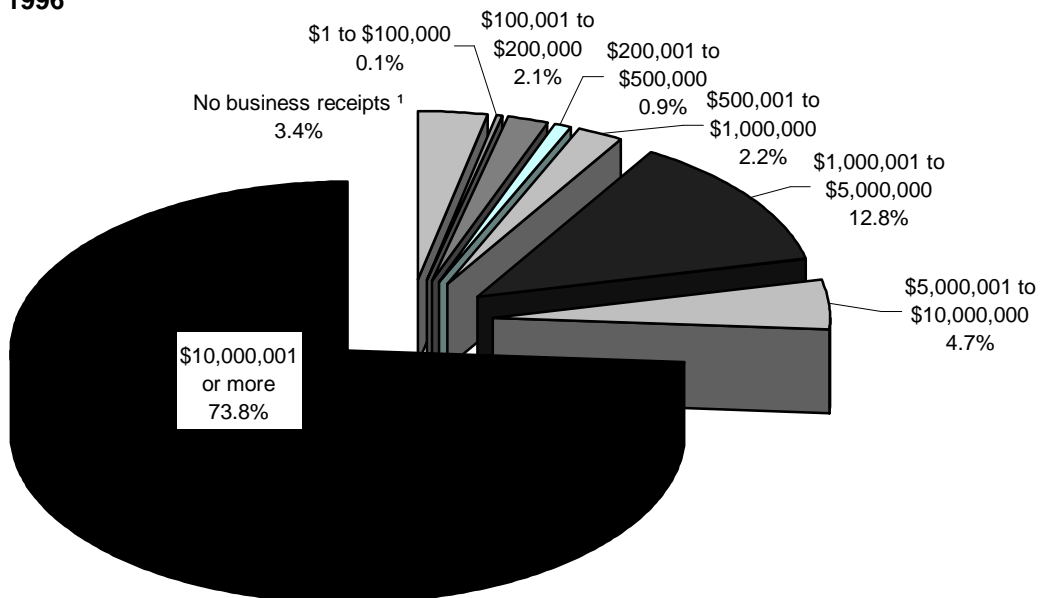


¹ May include corporations with only investment income and new corporations without gross receipts.

NOTES: Excludes S corporations electing to be taxed through shareholders. Detail may not add to 100 percent because of rounding.

Figure G

Percentage of EZE Credit Reported on Corporation Income Tax Returns, by Size of Gross Receipts, Tax Year 1996



¹ May include corporations with only investment income and new corporations without gross receipts.

NOTES: Excludes S corporations electing to be taxed through shareholders.

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principal activity accounted for 58 percent of the credit, in effect subsidizing an estimated 1,069 employees out of the total of 1,841 employees for all corporate claimants. This is despite manufacturing accounting for only 29 percent of EZE corporate taxpayers. Of the categories within manufacturing, stone and metal fabrication, as well as motor vehicles and textile and apparel, seem to have accounted for many of the manufacturing jobs.

With respect to the size of the EZE credit by principal business activity (Table 10), only manufacturing, wholesale trade, and services accounted for a significant proportion of corporate taxpayers with EZE credits between \$50,001 and \$1 million. Instead, the majority of businesses reported receiving credits in the \$5,001 to \$50,000 range, with the next largest category reporting \$5,000 or less.

Summary

This article provides the first descriptive statistics on the use of the "Empowerment Zone employment" (EZE) credit for 1996. To ensure that the 1996 data would appropriately capture activity in the "Empowerment Zones" (EZ's), special extracts of all EZE claimants were obtained from the IRS Master Files, inasmuch as the samples of returns used for Statistics of Income were inadequate for this purpose. Of the 1,254 taxpayers identified as claiming the credit, 1,040 were individuals, and 214 were taxable corporations. Individuals included sole proprietors, partners, S corporation shareholders, beneficiaries of estates and trusts, and cooperative patrons. In total, \$15,118,000 of EZE credits were claimed, \$9,593,000 by individuals and \$5,525,000 by taxable corporations. On the individual side, "owners" claiming the credit tended to file Schedule E (indicating income from partnerships, S corporations, estates, or trusts) and reported significant amounts of "adjusted gross income." On the corporate side, larger businesses tended to make up a smaller percentage of businesses claiming the credit, but accounted for a larger proportion of the credit claimed. Analysis of data on the 1997 EZE credit may shed more light on whether the low takeup rates for 1996 reflect an early point on the learning curve or a more fundamental problem with the EZE concept.

Appendix 1

EZE Credit Limit Based on the Amount of Tax

Taxpayers with regular tax liabilities of \$25,000 or less are generally limited in the EZE credit they can claim by the size of their income tax (regular tax plus AMT) less 75 percent of the tentative AMT (whether they actually have to pay the AMT or not). Those with regular tax in excess of \$25,000 are limited to income tax less the greater of 75 percent of the "tentative AMT" or 25 percent of regular tax liability above \$25,000. In determining the tax liabilities, adjustment is first made for other nonrefundable credits. While all taxpayers must technically calculate their tentative AMT to determine their EZE credit limitations, for those without an AMT liability, the limits effectively depend on the regular tax liability. Those with regular tax liability of \$25,000 or less can generally use all of their tentative EZE credits if the credits are approximately less than 25 percent of their regular tax liability. Those without AMT liability who do have regular tax liabilities in excess of \$25,000 may also be potentially limited by 75 percent of the regular tax liability plus \$6,250.

Taxpayers with AMT liability are essentially subject to more stringent limitations because EZE credits tend to be limited by regular tax liability which is less than the sum of regular and AMT liability. In general, AMT taxpayers with regular tax liability of \$25,000 or less can use all of their tentative EZE credits if the credits are less than the regular and AMT liability less 75 percent of the tentative AMT tax liability. In general, taxpayers with combined regular and AMT liabilities in excess of \$25,000 are limited to regular and AMT liability less the greater of 75 percent of the tentative minimum tax liability or 25 percent of the regular tax liability in excess of \$25,000.

Notes and References

- [1] According to the U.S. General Accounting Office, *op. cit.*, the urban EZ's received \$100 million in Federal grants each, while rural EZ's received \$40 million each in grants.
- [2] These so-called "EZ bonds" can be sold at a higher price than other comparable instruments

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because interest paid on such obligations is not subject to Federal income taxation. The result is a lower effective interest rate paid by the borrower and, hence, lower financing costs. EC's are also eligible for this tax-exempt financing, again subject to the State volume cap.

- [3] (1999) *Businesses' Use of Empowerment Zone Tax Incentives* RCED-99-253.
- [4] This estimate is from the U.S. General Accounting Office (1999) *Businesses' Use of Empowerment Zone Tax Incentives* RCED-99-253 and is not directly comparable to the tax return information since the General Accounting Office used businesses as their unit of analysis. Tax return data may have more than one business "owner" filing a return for businesses that were partnerships or S corporations, for example.
- [5] The eligibility requirements for the additional expensing of qualified property costs prevent most larger businesses that purchase more than approximately \$250,000 of depreciable assets from benefiting.
- [6] Employers can use a calendar year or pay-period-by-pay-period approach for all potentially eligible employees in determining whether substantially all services have been provided in the EZ. The pay-period option enables some businesses that provide services to be eligible for the EZE credit. See IRS Final Rules (TD 87 47) on Empowerment Zone Employment Credits, December 29, 1997, for details.
- [7] For sole proprietors, S corporations, partnerships, estates, trusts, and cooperatives, the limitation on the credit claimed applies at the "owner" level (i.e., by the owner, shareholder, partner, beneficiary, or patron).

- [8] Starting with 1998, credits are carried back only 1 year, then forward 20 years.
- [9] This limitation is calculated on Form 8844, Empowerment Zone Employment Credit.
- [10] This discussion assumes taxpayers have no other credits. Regular tax liability is increased for other tax credits in determining the EZE limitations.
- [11] More specifically, this amount was the "Credit allowed against regular tax," line 22, Form 8844, Empowerment Zone Employment Credit.
- [12] Data problems for Tax Years 1994 and 1995 prevented studies for these earlier years.
- [13] Details of the editing and imputation of these data are available on request.
- [14] The statistics cited in this paragraph and the one that follows are from unpublished tabulations.
- [15] The statistics cited in this paragraph are from unpublished tabulations.
- [16] The statistics cited in this paragraph are from unpublished tabulations.
- [17] For larger corporations that file consolidated returns, the address of the headquarters may be the only one that appears on the return. Since the eligible activity for the EZE credit may occur elsewhere, the address information would be misleading. In addition, for many taxable corporations reporting EZE credits, address information was missing making location analysis impossible.
- [18] Again, this was estimated as the total credit amount claimed on each return divided by the maximum credit amount (\$3,000).

SOURCE: IRS, Statistics of Income Bulletin, Summer 2000, Publication 1136 (Rev. 8-2000).

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Table 1.--Percentage of Individual Income Tax Returns with an Empowerment Zone Employment (EZE) Credit, by Size of EZE Credit

Size of EZE credit	Percentage of returns with an EZE credit
Total.....	100.0
\$1,000 or less.....	27.3
\$1,001 to \$2,000.....	12.8
\$2,001 to \$3,000.....	11.1
\$3,001 to \$4,000.....	7.6
\$4,001 to \$5,000.....	6.7
\$5,001 to \$10,000.....	16.1
\$10,001 to \$15,000.....	5.2
\$15,001 to \$20,000.....	3.1
\$20,001 to \$25,000.....	2.8
\$25,001 to \$30,000.....	1.6
\$30,001 to \$35,000.....	1.0
\$35,001 to \$40,000.....	0.8
\$40,001 to \$50,000.....	0.7
\$50,001 to \$75,000.....	0.8
\$75,001 to \$100,000.....	1.3
\$100,001 to \$500,000.....	1.4
\$500,001 or more.....	--

Detail may not add to total because of rounding.

Table 2.--Percentage of Individual Income Tax Returns with an Empowerment Zone Employment Credit, by Type of Business Schedule Attached and Size of EZE Credit

Size of EZE credit	Attached Business Schedule						
	Schedule C only	Schedule E only	Schedule F only	Schedules C and E only	Schedules C and F only	Schedules E and F only	Schedules C, E, and F
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Total ¹.....	5.3	61.4	0.4	24.3	1.4	3.4	3.2
Less than \$1,000.....	1.2	17.9	} 0.4	6.3	} 0.8	1.1	0.5
\$1,001 to \$2,000.....	0.9	7.0		3.5		0.5	0.7
\$2,001 to \$3,000.....	1.5	6.8	} 0.7	1.9	} 0.6	0.4	} 0.5
\$3,001 to \$4,000.....	0.9	3.4		1.9		0.5	
\$4,001 to \$5,000.....	} 1.0	3.2	--	1.9	} 0.4	} 0.4	0.6
\$5,001 to \$10,000.....		10.5	--	4.7			0.5
\$10,001 to \$15,000.....	--	3.5	--	1.3	} 0.5	} 0.5	(²)
\$15,001 to \$20,000.....	--	2.2	--	0.8			--
\$20,001 to \$25,000.....	--	2.0	--	0.6	--	} 0.5	(²)
\$25,001 to \$30,000.....	--	0.9	--	0.6	--		(²)
\$30,001 to \$35,000.....	--	0.6	--	} 0.4	--	} 0.5	(²)
\$35,001 to \$40,000.....	--	0.6	--		--		(²)
\$40,001 to \$75,000.....	--	0.6	--	(²)	--	(²)	--
\$75,001 to \$100,000.....	--	0.7	--	} 0.5	--	(²)	--
\$100,001 to \$500,000.....	--	1.1	--		--	--	(²)
\$500,001 or more.....	--	--	--	--	--	--	--

¹ No schedule was attached for 0.7 percent of the EZE credit.

² Less than 0.05 percent.

NOTE: Detail may not add to total because of rounding.

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Table 3.--Percentage of Individual Income Tax Returns with an Empowerment Zone Employment (EZE) Credit and Total EZE Credit, by Size of Adjusted Gross Income of Business Owner

Size of adjusted gross income of business owner	Percentage of returns with an EZE credit	Percentage of total EZE credit
Total.....	100.0	100.0
\$15,000 or less	2.2	0.1
\$15,001 to \$20,000.....	3.4	0.3
\$20,001 to \$25,000.....	2.0	0.3
\$25,001 to \$30,000.....	1.5	0.3
\$30,001 to \$35,000.....	1.8	0.3
\$35,001 to \$40,000.....	3.2	0.7
\$40,001 to \$45,000.....	1.5	0.4
\$45,001 to \$50,000.....	1.7	0.5
\$50,001 to \$75,000.....	12.1	3.5
\$75,001 to \$100,000.....	7.4	2.6
\$100,001 to \$200,000.....	18.7	7.7
\$200,001 to \$500,000.....	22.1	19.6
\$500,001 to \$1,000,000.....	11.0	14.2
\$1,000,001 to \$5,000,000.....	9.7	43.2
\$5,000,001 to \$10,000,000.....	0.8	2.9
\$10,000,001 or more.....	0.9	3.6

Detail may not add to total because of rounding.

Table 4.--Percentage of Empowerment Zone Employment (EZE) Credit Reported on Individual Income Tax Returns, by Size of EZE Credit and Selected States

Size of EZE credit	Selected State					
	Georgia	Illinois	Kentucky	Maryland	Michigan	Mississippi
	(1)	(2)	(3)	(4)	(5)	(6)
Total (percentage).....	100.0	100.0	100.0	100.0	100.0	100.0
\$1,000 or less.....	25.9	23.7	16.2	26.5	30.1	33.0
\$1,001 to \$5,000.....	33.3	32.6	63.2	35.3	33.3	40.9
\$5,001 to \$10,000.....	18.5	17.2	9.6	19.1	19.4	10.2
\$10,001 to \$30,000.....	22.2	17.7	11.1	19.1	11.8	10.2
\$30,001 to \$50,000.....		4.2			5.4	5.7
\$50,001 or more.....		4.7				

Size of EZE credit	Selected State--continued				Other States or State unknown
	New Jersey	New York	Pennsylvania	Texas	
	(7)	(8)	(9)	(10)	(11)
Total (percentage).....	100.0	100.0	100.0	100.0	100.0
\$1,000 or less.....	28.2	27.2	24.0	12.9	44.8
\$1,001 to \$5,000.....	41.0	25.6	44.0	58.6	26.6
\$5,001 to \$10,000.....	12.8	16.8	20.0	18.3	18.2
\$10,001 to \$30,000.....	18.0	20.8	12.0	10.0	2.6
\$30,001 to \$50,000.....		4.8			2.6
\$50,001 or more.....		4.8			5.2

NOTE: Detail may not add to totals because of rounding.

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Table 5.--Percentage of Corporation Income Tax Returns with an Empowerment Zone Employment (EZE) Credit, by Size of EZE Credit

Size of EZE Credit	Percentage of returns with an EZE credit
Total.....	100.0
\$1,000 or less.....	7.9
\$1,001 to \$2,000.....	12.1
\$2,001 to \$3,000.....	6.5
\$3,001 to \$4,000.....	5.6
\$4,001 to \$5,000.....	6.1
\$5,001 to \$10,000.....	20.6
\$10,001 to \$15,000.....	9.3
\$15,001 to \$20,000.....	7.0
\$20,001 to \$25,000.....	6.5
\$25,001 to \$30,000.....	3.3
\$30,001 to \$35,000.....	1.4
\$35,001 to \$40,000.....	2.8
\$40,001 to \$50,000.....	1.9
\$50,001 to \$75,000.....	3.3
\$75,001 to \$200,000.....	2.8
\$200,001 to \$1,000,000.....	2.8
\$1,000,001 or more.....	--

NOTE: Excludes S corporations electing to be taxed through shareholders.

Table 6.--Corporation Income Tax Returns with an Empowerment Zone Employment (EZE) Credit: Percentage of Returns with an EZE Credit and Total EZE Credit, and Total EZE Credit as a Percentage of Income Tax Liability, by Size of Total Assets

Size of total assets	Percentage of returns with EZE credit	Percentage of total EZE credit	Percentage of income tax liability after credits ¹
	(1)	(2)	(3)
All returns with an EZE credit, total.....	100.0	100.0	100.0
\$100,000 or less	12.5	1.4	(²)
\$100,001 to \$250,000.....	9.8	1.7	(²)
\$250,001 to \$500,000.....	8.9	2.8	(²)
\$500,001 to \$1,000,000.....	14.0	5.0	(²)
\$1,000,001 to \$10,000,000.....	27.6	17.6	0.1
\$10,000,001 to \$50,000,000.....	10.3	25.5	0.2
\$50,000,001 to \$100,000,000.....	3.7	8.1	0.3
\$100,000,001 to \$250,000,000.....	1.4	10.6	0.5
\$250,000,001 to \$500,000,000.....	2.3	6.6	0.7
\$500,000,001 or more.....	9.4	20.8	98.2

¹ Total tax liability after credits and the AMT.

² Less than 0.05 percent.

NOTES: Excludes S corporations electing to be taxed through shareholders. Detail may not add to totals because of rounding.

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Table 7.--Corporation Income Tax Returns with an Empowerment Zone Employment (EZE) Credit: Percentage of Returns With EZE Credit and Total EZE Credit, by Size of Net Income

Size of net income	Percentage of returns with EZE credit	Percentage of EZE credit
All returns with an EZE credit, total.....	100.0	100.0
\$1 to \$5,000.....	5.1	0.1
\$5,001 to \$20,000.....	14.0	1.1
\$20,001 to \$35,000.....	7.5	1.2
\$35,001 to \$50,000.....	7.0	1.5
\$50,001 to \$75,000.....	10.8	3.2
\$75,001 to \$100,000.....	10.3	4.1
\$100,001 to \$200,000.....	7.9	6.5
\$200,001 to \$500,000.....	8.4	6.7
\$500,001 to \$1,000,000.....	6.5	9.0
\$1,000,001 to \$5,000,000.....	7.0	23.1
\$5,000,001 to \$10,000,000.....	2.8	6.2
\$10,000,001 or more.....	12.6	37.3

NOTES: Excludes S corporations electing to be taxed through shareholders.
Detail may not add to totals because of rounding.

Table 8.--Corporation Income Tax Returns with an Empowerment Zone Employment (EZE) Credit: Percentage of Returns, Total Assets, Net Taxable Income, and Income Tax Liability, by Size of EZE Credit

Size of EZE credit	Percentage of returns with an EZE credit	Percentage of total assets	Percentage of net taxable income	Percentage of income tax liability
	(1)	(2)	(3)	(4)
All returns with an EZE credit, total.....	100.0	100.0	100.0	100.0
\$1 to \$1,000.....	7.9	(¹)	(¹)	(¹)
\$1,001 to \$2,000.....	12.2	(¹)	0.1	(¹)
\$2,001 to \$3,000.....	6.5	1.0	0.1	0.1
\$3,001 to \$4,000.....	5.6	(¹)	(¹)	(¹)
\$4,001 to \$5,000.....	6.1	0.8	0.1	0.1
\$5,001 to \$10,000.....	20.6	30.0	24.8	24.8
\$10,001 to \$15,000.....	9.4	7.8	4.4	5.1
\$15,001 to \$20,000.....	7.0	4.8	2.5	2.7
\$20,001 to \$25,000.....	6.5	0.7	0.9	1.0
\$25,001 to \$30,000.....	3.3	(¹)	(¹)	(¹)
\$30,001 to \$35,000.....	1.4	(¹)	(¹)	(¹)
\$35,001 to \$40,000.....	2.8	8.7	14.1	11.2
\$40,001 to \$50,000.....	1.9	(¹)	(¹)	(¹)
\$50,001 to \$75,000.....	3.3	1.3	0.1	0.6
\$75,001 to \$200,000.....	2.8	15.8	30.7	36.0
\$200,001 to \$1,000,000.....	2.8	29.1	21.1	18.4
\$1,000,001 or more.....	--	--	--	--

¹ Less than 0.05 percent.

NOTES: Excludes S corporations electing to be taxed through shareholders. Detail may not add to totals because of rounding.

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Table 9.--Corporation Income Tax Returns with an Empowerment Zone Employment (EZE) Credit: Percentage of Total Returns with EZE Credit, Total EZE Credit, and Total Estimated Eligible Employees for Whom Credit was Claimed, by Selected Industrial Group

Selected industrial group	Percentage of corporation income tax returns with EZE credit	Percentage of total EZE credit	Total estimated eligible employees for whom credit was claimed
	(1)	(2)	(3)
All industries.....	100.0	100.0	1,841
Agriculture, forestry, and fishing; mining.....	4.2	0.9	16
Construction.....	4.7	2.7	49
Manufacturing, total.....	28.5	58.1	1,069
Food and kindred products.....	3.3	3.6	66
Textile mill products; apparel and other textile products.....	3.3	11.7	215
Lumber and paper.....	5.1	3.5	64
Printing and publishing; chemicals and allied products; petroleum and coal products; rubber and miscellaneous plastic products.....	4.2	1.5	27
Stone, clay, and glass products; primary metals industries; fabricated metal products.....	7.9	23.7	436
Machinery; electric and electronic equipment.....	1.4	0.3	5
Motor vehicles and equipment.....	1.4	11.7	216
Instruments and related products.....	1.9	2.2	41
Transportation and public utilities.....	3.3	1.3	24
Wholesale trade.....	12.6	11.7	215
Retail trade.....	17.3	7.6	140
Finance, insurance, and real estate.....	10.3	7.1	131
Services.....	15.9	9.8	180
Nature of business not allocable.....	3.3	0.9	17

NOTES: May include returns claiming less than the full EZE credit (\$3,000). Excludes S corporations electing to be taxed through shareholders. Detail may not add to totals because of rounding.

Table 10.--Corporation Income Tax Returns with an Empowerment Zone Employment (EZE) Credit: Percentage of Total Returns with EZE Credit by Size of EZE Credit and by Selected Industrial Group

Selected industrial group	Size of EZE credit				
	Total	\$5,000 or less	\$5,001 to \$50,000	\$50,001 to \$1,000,000	\$1,000,001 or more
	(1)	(2)	(3)	(4)	(5)
Agriculture, forestry, and fishing; mining.....	100.0	87.5	(¹)	(¹)	--
Construction.....	100.0	40.0	60.0	--	--
Manufacturing.....	100.0	26.2	59.0	14.8	--
Transportation and public utilities.....	100.0	42.9	57.0	(²)	(²)
Wholesale trade.....	100.0	33.3	55.5	11.1	--
Retail trade.....	100.0	46.0	51.4	(¹)	(¹)
Finance, insurance, and real estate.....	100.0	40.9	50.0	(¹)	(¹)
Services.....	100.0	41.2	47.1	11.8	--
Nature of business not allocable.....	100.0	42.9	57.2	--	--

¹ There are so few corporations in these cells that taxpayer disclosure problems arise if these percentages are reported.

² Less than 0.05 percent.

NOTES: Excludes S corporations electing to be taxed through shareholders. Detail may not add to total because of rounding.