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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B06 – GENIN-168203-02

Date:
March 24, 2004

Re: Tax Incentives for Renewal Communities, Empowerment
Zones, and Enterprise Communities

Dear _____ :

As discussed with _____ of our office on February 24, 2004, an information letter is not appropriate for addressing the questions in your inquiry dated December 3, 2002, regarding the application of the tax incentives for a renewal community, an empowerment zone, and an enterprise community to a client of a professional employer organization (“PEO”).

Your inquiry advised us that a PEO is a company that provides human resources and other services to clients, which are mostly small businesses with 12-20 employees. The PEO has contracts with their clients pursuant to which the clients’ employees are co-employed by the PEO. The employees would be expected to continue as employees of the clients in the event of termination of a PEO agreement. The PEO assumes payroll and payroll withholding responsibilities as the W-2 employer.

Pursuant to section 2.04 of Rev. Proc. 2004-1, 2004-1 I.R.B. 1, 7 (and its predecessors), an information letter calls attention to a well-established interpretation or principle of tax law without applying it to a specific set of facts. Your inquiry raised the issue of whether the client of a PEO is eligible for the tax incentives applicable to a renewal community, an empowerment zone, and an enterprise community. As discussed below, the resolution of this issue for these tax incentives, except the commercial revitalization deduction, depends in part on a determination of whether the client or the PEO is treated as the employer. Because this determination is not a matter of settled law and would also depend on the facts and circumstances of each client, an information letter is not the proper vehicle to address the issue.

Most of the tax incentives referred to in your inquiry apply to a corporation, partnership, or proprietorship that qualifies as an enterprise zone business as defined in section 1397C of the Internal Revenue Code or as a renewal community business as defined in section 1400G. Below is a list of these tax incentives. One of the criteria for qualifying as an enterprise zone business is that at least 35 percent of the employees of the corporation, partnership, or proprietorship are residents of an empowerment zone. Similarly, one of the criteria for qualifying as a renewal community business is that at least 35 percent of the employees of the corporation, partnership, or proprietorship are residents of a renewal community. Accordingly, the resolution of the issue of whether the client of a PEO is eligible for the following tax incentives depends in part on a determination of whether the client or the PEO is treated as the employer.

1. Partial exclusion of gain from the sale or exchange of qualified small business stock (section 1202): under the jurisdiction of the Office of Associate Chief Counsel, Income Tax and Accounting, Branch 5 (CC:ITA:5), at [REDACTED].
2. Tax-exempt enterprise zone facility bonds (section 1394): under the jurisdiction of the Office of Associate Chief Counsel, Tax Exempt and Government Entities, Exempt Organizations/Employment Tax/Government Entities, Tax Exempt Bonds Branch (CC:TEGE:EOEG:TEB), at [REDACTED].
3. Increased section 179 deduction available to an enterprise zone business (section 1397A): under the jurisdiction of our office.
4. Rollover of gain from the sale of a qualified empowerment zone asset (section 1397B): under the jurisdiction of our office.
5. Capital gain exclusion for the sale or exchange of a qualified community asset (section 1400F): under the jurisdiction of our office and other Offices of Associate Chief Counsel.
6. Increased section 179 deduction available to a renewal community business (section 1400J): under the jurisdiction of our office.

In addition to the above tax incentives, your inquiry covered the empowerment zone and renewal community employment credits, the new markets tax credit, and the commercial revitalization deduction.

With respect to the employment credits applicable to eligible employers in an empowerment zone (section 1396) or a renewal community (section 1400H), the amount of these credits is a specified percentage of "qualified zone wages." Section 1396(c)(1) defines "qualified zone wages" as meaning any wages paid or incurred by an

employer for services performed by an employee while that employee is a “qualified zone employee” as that term is defined in section 1396(d). Therefore, the resolution of the issue of whether the client of a PEO is eligible for these employment credits also depends in part on a determination of whether the client or the PEO is treated as the employer. The empowerment zone employment credit and the renewal community employment credit are under the jurisdiction of the Office of Associate Chief Counsel, Tax Exempt and Government Entities, Employee Benefits, Health and Welfare Branch (CC:TEGE:EB:HW), at [REDACTED].

With respect to the new markets tax credit, section 45D(a)(1) provides that a taxpayer may claim this credit on a taxpayer’s qualified equity investment in a qualified community development entity (CDE). Section 45D(b) provides that a qualified equity investment is any equity investment in a CDE for which the CDE has received an allocation from the Secretary of the Treasury if, among other things, the CDE uses substantially all of the cash from the investment to make qualified low-income community investments. Section 45D(d)(1) provides that qualified low-income community investments consist of, among other investments, any capital or equity investment in, or loan to, any qualified active low-income community business. In general, a qualified active low-income community business is a corporation or partnership if for the taxable year, among other things, at least 40 percent of the services performed for the entity by its employees are performed in any low-income community. See section 45(d)(2)(A) and section 1.45D-1T(d)(4)(C) of the Temporary Income Tax Regulations. Accordingly, the resolution of the issue of whether the client of a PEO is eligible for the new markets tax credit depends in part on a determination of whether the client or the PEO is treated as the employer. The new markets tax credit is under the jurisdiction of the Office of Associate Chief Counsel, Passthroughs and Special Industries, Branch 5 (CC:PSI:5), at [REDACTED].

As to the commercial revitalization deduction under section 1400I, this deduction is available to a taxpayer that places in service a “qualified revitalization building” in a renewal community after 2001 and before 2010. Pursuant to section 1400I(a), a taxpayer may elect either (1) to deduct one-half of any qualified revitalization expenditures (as defined in section 1400I(b)(2)) chargeable to a capital account with respect to any qualified revitalization building (as defined in section 1400I(b)(1)) in the taxable year in which the building is placed in service by the taxpayer, or (2) to deduct such qualified revitalization expenditures ratably over the 120-month period beginning with the month in which the qualified revitalization building is placed in service by the taxpayer. To be eligible to make this election, the taxpayer must receive an allocation of a commercial revitalization expenditure amount for the qualified revitalization building from the applicable State’s commercial revitalization agency. Pursuant to section 1400I(e)(1), this amount must be allocated pursuant to a “qualified allocation plan” of the commercial revitalization agency. Section 1400I(e)(2) defines a qualified allocation plan as meaning any plan that, among other things, considers the amount of any

increase in permanent, full-time employment by reason of any project. Accordingly, the determination of whether the client of a PEO is eligible to elect the commercial revitalization deduction for the client's building depends on whether the client receives an allocation from the applicable State's commercial revitalization agency for such building, whether the client's building is a qualified revitalization building, and whether the expenditures incurred or paid by the client for such building are qualified revitalization expenditures. Because this determination depends on the facts and circumstances of each client of a PEO, an information letter is not the proper vehicle to address whether a particular client of a PEO is eligible to elect the commercial revitalization deduction. This deduction is under the jurisdiction of our office.

As previously mentioned, an information letter is not the proper vehicle to address the issue of whether the client of a PEO is eligible for the tax incentives applicable to a renewal community, an empowerment zone, and an enterprise community. Instead, a client of a PEO should submit a request for a private letter ruling to the appropriate Office of Associate Chief Counsel. The requests must comply with all the requirements of section 7 of Rev. Proc. 2004-1, 2004-1 I.R.B. 1 (or its successors).

Rev. Proc. 2004-1 provides the general procedures the Internal Revenue Service follows in issuing private letter rulings and the related instructions for the submission of private letter ruling requests by taxpayers. In addition, taxpayers are required by statute to pay user fees for requests for private letter rulings. Under section 15 of Rev. Proc. 2004-1, the user fee must accompany the request in order to be processed by the Service. In general, the user fee is \$6,000 for private letter rulings. However, there is a reduced fee of \$500 for a request involving a business-related tax issue from a taxpayer with a gross income of less than \$1 million. See Appendix A of Rev. Proc. 2004-1.

If a client of a PEO requests a private letter ruling, section 7.03 of Rev. Proc. 2004-1 provides information as to where to send the request. Also, as we have noted above, section 7 of Rev. Proc. 2004-1 provides general instructions for requesting a private letter ruling.

This letter has called your attention to certain general principles of tax law. It is intended for informational purposes only and does not constitute a ruling. See section 2.04 of Rev. Proc. 2004-1. If you should have any additional questions or comments, please contact our office at [REDACTED].

Sincerely yours,

Kathleen Reed

KATHLEEN REED

GENIN-168203-02

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