

**Actions Addressing Main Deck Cargo 9g Crash Barrier**

(h) For airplanes that have been converted from a passenger- to a cargo-carrying ("freighter") configuration in accordance with STC SA1377SO: Within 3 years or 4,000 flight cycles after the effective date of this AD, whichever occurs first, install a main deck cargo 9g crash barrier that complies with the applicable requirements of CAR part 4b, in accordance with a method approved by the Manager, Los Angeles ACO.

**Alternative Methods of Compliance**

(i) An alternative method of compliance or adjustment of the compliance time that provides an acceptable level of safety may be used if approved by the Manager, Los Angeles ACO, FAA. Operators shall submit their requests through an appropriate FAA Principal Maintenance Inspector, who may add comments and then send it to the Manager, Los Angeles ACO.

**Note 3:** Information concerning the existence of approved alternative methods of compliance with this AD, if any, may be obtained from the Los Angeles ACO.

**Special Flight Permit**

(j) Special flight permits may be issued in accordance with sections 21.197 and 21.199 of the Federal Aviation Regulations (14 CFR 21.197 and 21.199) to operate the airplane to a location where the requirements of this AD can be accomplished.

**Effective Date**

(k) This amendment becomes effective on January 30, 2002.

Issued in Renton, Washington, on December 13, 2001.

**Kalene C. Yanamura,**

*Acting Manager, Transport Airplane Directorate, Aircraft Certification Service.*

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**DEPARTMENT OF THE TREASURY****Internal Revenue Service****26 CFR Parts 1 and 602**

[TD 8971]

RIN 1545-BA49

**New Markets Tax Credit**

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Temporary regulations.

**SUMMARY:** This document contains temporary regulations that provide guidance for taxpayers claiming the new markets tax credit under section 45D. A taxpayer making a qualified equity investment in a qualified community development entity that has received a new markets tax credit allocation may claim a 5-percent tax credit with respect

to the qualified equity investment on each of the first 3 credit allowance dates and a 6-percent tax credit with respect to the qualified equity investment on each of the remaining 4 credit allowance dates. The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in REG-119436-01 published elsewhere in this issue of the **Federal Register**.

**DATES:** *Effective Date:* These regulations are effective December 26, 2001.

*Date of Applicability:* For date of applicability of § 1.45D-1T, see § 1.45D-1T(h).

**FOR FURTHER INFORMATION CONTACT:** Paul Handleman, (202) 622-3040.

**SUPPLEMENTARY INFORMATION:****Paperwork Reduction Act**

These regulations are being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collections of information contained in these regulations have been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget under control number 1545-1765. Responses to these collections of information are mandatory.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

For further information concerning these collections of information, and where to submit comments on the collections of information and the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble to the cross-referencing notice of proposed rulemaking published in the Proposed Rules section of this issue of the **Federal Register**.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

**Background**

This document contains temporary regulations relating to the new markets tax credit under section 45D of the Internal Revenue Code (Code). This provision was added to the Code by section 121(a) of the Community Renewal Tax Relief Act of 2000

(Pub. L. 106-554). The Secretary has delegated certain administrative, application, allocation, monitoring, and other programmatic functions relating to the new markets tax credit program to the Under Secretary (Domestic Finance), who in turn has delegated those functions to the Community Development Financial Institutions Fund (CDFI Fund).

On May 1, 2001, the IRS published an advance notice of proposed rulemaking in the **Federal Register** (66 FR 21844) inviting comments relating to tax issues arising under section 45D. Numerous comments have been received. The IRS and Treasury Department have reviewed and considered all the comments in the process of preparing this Treasury decision. This preamble to the temporary regulations describes many, but not all, of the comments received by the IRS.

**Explanation of Provisions***General Overview*

Taxpayers may claim a new markets tax credit on a credit allowance date in an amount equal to the applicable percentage of the taxpayer's qualified equity investment in a qualified community development entity (CDE). The credit allowance date for any qualified equity investment is the date on which the investment is initially made and each of the 6 anniversary dates thereafter. The applicable percentage is 5 percent for the first 3 credit allowance dates and 6 percent for the remaining credit allowance dates.

A CDE is any domestic corporation or partnership if: (1) The primary mission of the entity is serving or providing investment capital for low-income communities or low-income persons; (2) the entity maintains accountability to residents of low-income communities through their representation on any governing board of the entity or on any advisory board to the entity; and (3) the entity is certified by the Secretary for purposes of section 45D as being a CDE.

The new markets tax credit may be claimed only for a qualified equity investment in a CDE. A qualified equity investment is any equity investment in a CDE for which the CDE has received an allocation from the Secretary if, among other things, the CDE uses substantially all of the cash from the investment to make qualified low-income community investments. Under a safe harbor, the substantially-all requirement is treated as met if at least 85 percent of the aggregate gross assets of the CDE are invested in qualified low-income community investments.

Qualified low-income community investments consist of: (1) Any capital or equity investment in, or loan to, any qualified active low-income community business; (2) the purchase from another CDE of any loan made by such entity that is a qualified low-income community investment; (3) financial counseling and other services to businesses located in, and residents of, low-income communities; and (4) certain equity investments in, or loans to, a CDE.

In general, a qualified active low-income community business is a corporation or a partnership if for the taxable year: (1) At least 50 percent of the total gross income of the entity is derived from the active conduct of a qualified business within any low-income community; (2) a substantial portion of the use of the tangible property of the entity is within any low-income community; (3) a substantial portion of the services performed for the entity by its employees is performed in any low-income community; (4) less than 5 percent of the average of the aggregate unadjusted bases of the property of the entity is attributable to certain collectibles; and (5) less than 5 percent of the average of the aggregate unadjusted bases of the property of the entity is attributable to certain nonqualified financial property.

#### *Substantially All*

As indicated above, a CDE must use substantially all of the cash from a qualified equity investment to make qualified low-income community investments. Most commentators suggest that the substantially-all test should require that at least 85 percent of the taxpayer's cash be committed to, or invested in, qualified low-income community investments. Some commentators propose that in order to provide CDEs with financial flexibility in managing their investments, the percentage should be reduced for the later years of the 7-year credit period. The temporary regulations adopt the suggestion to define *substantially all* as 85 percent or more and reduce the substantially-all percentage to 75 percent for the seventh year of the 7-year credit period.

Some commentators suggest that a CDE's costs of obtaining equity investments in the CDE (such as underwriters' fees and broker fees) and the CDE's overhead expenses (such as staff salaries) should count toward satisfying the substantially-all requirement. Some commentators suggest that reserves maintained by the CDE of up to 10 percent of the taxpayer's cash investment in the CDE

should count toward satisfying the substantially-all requirement. The temporary regulations do not include issuance costs or CDE overhead expenses as counting toward the substantially-all requirement. However, the temporary regulations provide that reserves (but not in excess of 5 percent of the taxpayer's cash investment) for loan losses and for additional investments in existing qualified low-income community investments are treated as invested in a qualified low-income community investment.

Several commentators suggest that, for purposes of the "85 percent of the aggregate gross assets" safe harbor, aggregate gross assets should be determined according to cost basis and not, for example, fair market value. The temporary regulations adopt this suggestion. Cost basis is defined under the temporary regulations as cost basis under section 1012.

Commentators propose that a CDE should have from 12 months to 5 years to invest the cash from a qualified equity investment in a qualified low-income community investment, depending upon the type of investment. The temporary regulations adopt a 12-month period for investing the taxpayer's cash investment.

Commentators propose that repayments to a CDE of equity or principal from qualified low-income community investments should have to be reinvested by the CDE within 12 months, but that no reinvestment should be required in the sixth and seventh years of the 7-year credit period. One commentator proposes that reinvestment should be encouraged, but not required. Another commentator would limit the time period to 45 days for identifying the investment and 180 days for making the investment. The temporary regulations adopt the suggestion that repayment amounts reinvested within 12 months are treated as continuously invested in qualified low-income community investments. In addition, repayments received in the seventh year of the 7-year credit period are not required to be reinvested.

#### *Qualified Active Low-Income Community Businesses*

As indicated above, qualified low-income community investments include any capital or equity investment in, or loan to, any qualified active low-income community business. A business is a qualified active low-income community business only if, among other things: (1) At least 50 percent of the total gross income of the business is derived from the active conduct of a qualified business within any low-income

community; (2) a substantial portion of the use of the tangible property of the business is within any low-income community; and (3) a substantial portion of the services performed for the business by its employees is performed in any low-income community.

Commentators propose that, to satisfy the "50 percent of the total gross income \* \* \* derived from the active conduct" requirement (50-percent requirement) in the case of a manufacturing business, 50 percent of production, but not sales, should have to occur within a low-income community. For a services business, commentators recommend a requirement that at least 50 percent of the services be provided by employees of offices in low-income communities even if the services are provided elsewhere. One commentator suggests that the 50-percent requirement should be deemed met if the business is located in the low-income community and most of the employees are residents of the low-income community. Another commentator suggests that the requirement should be satisfied if 50 percent of the total gross income is derived from: (1) The operation of, or production at, a facility located in a low-income community; (2) most of the employees are based at such a facility; and (3) the management is located within the low-income community.

For purposes of the tangible property and services performed requirements, recommendations for the percentage that should constitute a substantial portion range from 20 percent to 50 percent. Alternatively, some commentators propose that the tangible property and services performed requirements should be satisfied if the business satisfies one of the following: (1) The business is located in a qualified area; (2) the business operates a major facility in a qualified area; (3) the business' primary business activity takes place in a qualified area; or (4) the business' primary mission is working with people in qualified areas.

For purposes of the tangible property and services performed requirements, the temporary regulations define a substantial portion as 40 percent. In addition, the temporary regulations provide that the 50-percent requirement is deemed to be satisfied if the entity meets the requirements of either the tangible property test or the services performed test, if 50 percent is substituted for 40 percent. Further, the entity may satisfy the 50-percent requirement based on all the facts and circumstances.

Commentators propose that for purposes of determining when a trade or business constitutes a qualified active

low-income community business, an entity should qualify as a qualified active low-income community business if the CDE reasonably expects, at the time the CDE makes the capital or equity investment in, or loan to, the entity, that the entity will satisfy the requirements to be a qualified active low-income community business throughout the entire period of the investment or loan. This proposal has been adopted in the temporary regulations, except in the case where the CDE controls the entity.

If the CDE controls the entity at any time during the 7-year credit period, the reasonable expectation test does not apply and the entity must be a qualified active low-income community business during the entire period the CDE controls the entity. Commentators suggest that control for this purpose should be defined as at least 50 percent of voting power. Some commentators suggest that control should be determined based on whether the CDE is related to the entity within the meaning of sections 267(b) or 707(b)(1). The temporary regulations define control with respect to an entity as direct or indirect ownership (based on value) or control (based on voting or management rights) of 33 percent or more of the entity. However, a CDE does not control an entity if an unrelated person possesses greater control over the entity than the CDE.

#### *Financial Counseling and Other Services*

Commentators suggest that the definition of financial counseling and other services should include services for identifying CDE investment opportunities; preparing business owners to use financial products; underwriting loans and investments; helping business owners create viable business plans; and, after loans and investments are made, enhancing business planning, marketing, management, and financial skills of business owners and serving on their boards of directors. The temporary regulations define *financial counseling and other services* as advice provided by the CDE relating to the organization or operation of a trade or business that is provided to a qualified active low-income community business or to residents of a low-income community.

#### *Investments in Other CDEs*

Commentators propose that, for purposes of the substantially-all requirement, tracing should not be required when a CDE invests in another CDE, but other mechanisms should be required (for example, decertifying the

recipient CDE if it does not use funds properly). Alternatively, commentators propose tracing at the recipient CDE level, but minimizing the reporting and recapture burdens for the recipient CDEs. Some commentators suggest that the recipient CDE should have the same restrictions placed on it as the investing CDE. The temporary regulations provide that an equity investment in, or loan to, another CDE is a qualified low-income community investment only to the extent that the recipient CDE uses the proceeds: (1) For either an investment in, or a loan to, a qualified active low-income community business, or financial counseling and other services; and (2) in a manner that would constitute a qualified low-income community investment if it were made directly by the CDE making the equity investment or loan.

#### *Recapture*

A recapture event requiring an investor to recapture credits previously taken may occur for an equity investment in a CDE if the CDE: (1) Ceases to be a CDE; (2) ceases to use substantially all of the proceeds of the equity investment for qualified low-income community investments; or (3) redeems the investor's equity investment. Commentators suggest that a CDE should be permitted to take remedial actions to avoid recapture. The temporary regulations adopt this suggestion by providing a CDE the opportunity to request a waiver of a requirement or an extension of time to meet a deadline contained in the temporary regulations if such waiver or extension does not materially frustrate the purposes of section 45D and the regulations thereunder. A CDE that believes it has good cause for a waiver or an extension may request relief from the Commissioner in a ruling request. In considering such a ruling request, the Commissioner may consult with the CDFI Fund in a manner consistent with section 6103. The granting of a waiver or an extension may require adjustments of the CDE's requirements under section 45D and the regulations thereunder as may be appropriate.

#### *Other Federal Tax Benefits*

The Treasury Department is authorized to prescribe regulations that limit the new markets tax credit for investments that are directly or indirectly subsidized by other Federal tax benefits (including the low-income housing tax credit under section 42 and the exclusion from gross income under section 103). Commentators suggest that a CDE should not be permitted to use the proceeds of a qualified equity

investment to purchase tax-exempt bonds. However, the same commentators state that there should be no restriction on the receipt of tax-exempt bond proceeds by a qualified active low-income community business. The temporary regulations do not prohibit a CDE from purchasing tax-exempt bonds because tax-exempt financing provides a subsidy to borrowers and not bondholders. Moreover, a loan by a CDE directly to a qualified active low-income community business cannot be a tax-exempt bond because the loan is not an obligation of a state or local government. Because the rental to others of residential rental property cannot be a qualified active low-income community business, a taxpayer cannot receive the low-income housing tax credit and new markets tax credit on the same investment. Although the temporary regulations do not provide specific rules on double tax benefit issues, the IRS and the Treasury Department request additional comments on what Federal tax benefits should limit the new markets tax credit.

#### *Reporting Requirements*

The Treasury Department is authorized to prescribe regulations that impose appropriate reporting requirements for the new markets tax credit. Commentators suggest that the information reporting to the Treasury Department should be undertaken on an annual basis and that CDEs should be required to provide the following information: Financial statements, a list of investors and closing and commitment dates, a list of eligible investments, terms of investments and location of investments, information on loan loss or investments reserves, and information on financial counseling and other services.

The reporting requirements in the temporary regulations require a CDE to provide notice: (1) To any taxpayer who acquires a qualified equity investment in the CDE at its original issue that the equity investment is a qualified equity investment entitling the taxpayer to claim the new markets tax credit; and (2) in the case of a recapture event, to each holder of an equity investment, including all prior holders of that investment, that a recapture event has occurred. CDEs must comply with such reporting requirements to the Secretary as the Secretary may prescribe. Taxpayers may claim the new markets tax credit by completing Form 8874, "New Markets Credit," and by filing the form with the taxpayer's Federal income tax return.

**Special Analyses**

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that any burden on taxpayers is minimal. Accordingly, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

**Drafting Information**

The principal author of these regulations is Paul F. Handleman, Office of the Associate Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

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

Income taxes, Reporting and recordkeeping requirements.

*26 CFR Part 602*

Reporting and recordkeeping requirements.

**Amendments to the Regulations**

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

**PART 1—INCOME TAXES**

**Paragraph 1.** The authority citation for part 1 is amended by adding an entry in numerical order to read as follows:

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

Section 1.45D–1T also issued under 26 U.S.C. 45D(i); \* \* \*

**Par. 2.** Section 1.45D–1T is added to read as follows:

**§ 1.45D–1T New markets tax credit.**

(a) *Table of contents.* This paragraph lists the headings that appear in § 1.45D–1T.

- (a) Table of contents.
- (b) Allowance of credit
  - (1) In general.
  - (2) Credit allowance date.
  - (3) Applicable percentage.
  - (4) Amount paid at original issue.
- (c) Qualified equity investment.
  - (1) In general.

- (2) Equity investment.
- (3) Equity investments made prior to allocation.
  - (i) In general.
  - (ii) Exception.
  - (iii) Initial investment date.
- (4) Limitations.
  - (i) In general.
  - (ii) Allocation limitation.
  - (5) Substantially all.
    - (i) In general.
    - (ii) Direct-tracing calculation.
    - (iii) Safe harbor calculation.
    - (iv) Time limit for making investments.
  - (v) Reduced substantially-all percentage.
- (6) Aggregation of equity investments.
- (7) Subsequent purchasers.
- (d) Qualified low-income community investments.
  - (1) In general.
    - (i) Investment in a qualified active low-income community business.
    - (ii) Purchase of certain loans from CDEs.
    - (iii) Financial counseling and other services.
    - (iv) Investments in other CDEs.
  - (2) Payments of, or for, capital, equity or principal.
    - (i) In general.
    - (ii) Subsequent reinvestments.
    - (iii) Special rule for loans.
    - (iv) Example.
- (3) Special rule for reserves.
- (4) Qualified active low-income community business.
  - (i) In general.
  - (A) Gross-income requirement.
  - (B) Use of tangible property.
  - (C) Services performed.
  - (D) Collectibles.
  - (E) Nonqualified financial property.
  - (ii) Proprietorships.
  - (iii) Portions of business.
- (5) Qualified business.
  - (i) In general.
  - (ii) Rental of real property.
  - (iii) Exclusions.
- (A) Trades or businesses involving intangibles.
- (B) Certain other trades or businesses.
- (C) Farming.
- (6) Qualifications.
  - (i) In general.
  - (ii) Control.
    - (A) In general.
    - (B) Definition of control.
  - (7) Financial counseling and other services.
- (e) Recapture.
  - (1) In general.
  - (2) Recapture event.
  - (3) Bankruptcy.
  - (4) Waiver of requirement or extension of time.
    - (i) In general.
    - (ii) Manner for requesting a waiver or extension.
    - (iii) Terms and conditions.
- (5) Example.
- (f) Basis reduction.
  - (1) In general.
  - (2) Adjustment in basis of interest in partnership or S corporation.
- (g) Other rules.
  - (1) Anti-abuse.
  - (2) Reporting requirements.
- (i) Notification by CDE to taxpayer.
- (A) Allowance of new markets tax credit.

- (B) Recapture event.
- (ii) CDE reporting requirements to Secretary.
- (iii) Manner of claiming new markets tax credit.
- (iv) Reporting recapture tax.
- (h) Effective date.

(b) *Allowance of credit*—(1) *In general.* For purposes of the general business credit under section 38, a taxpayer holding a qualified equity investment on a credit allowance date which occurs during the taxable year may claim the new markets tax credit determined under section 45D and this section for such taxable year in an amount equal to the applicable percentage of the amount paid to a qualified community development entity (CDE) for such investment at its original issue. *Qualified equity investment* is defined in paragraph (c) of this section. *Credit allowance date* is defined in paragraph (b)(2) of this section. Applicable percentage is defined in paragraph (b)(3) of this section. A CDE is a qualified community development entity as defined in section 45D(c). The amount paid at original issue is determined under paragraph (b)(4) of this section.

(2) *Credit allowance date.* The term *credit allowance date* means, with respect to any qualified equity investment—

(i) The date on which the investment is initially made; and

(ii) Each of the 6 anniversary dates of such date thereafter.

(3) *Applicable percentage.* The *applicable percentage* is 5 percent for the first 3 credit allowance dates and 6 percent for the other 4 credit allowance dates.

(4) *Amount paid at original issue.* The amount paid to the CDE for a qualified equity investment at its original issue consists of all amounts paid by the taxpayer to, or on behalf of, the CDE (including any underwriter's fees) to purchase the investment at its original issue.

(c) *Qualified equity investment*—(1) *In general.* The term *qualified equity investment* means any equity investment (as defined in paragraph (c)(2) of this section) in a CDE if—

(i) The investment is acquired by the taxpayer at its original issue (directly or through an underwriter) solely in exchange for cash;

(ii) Substantially all (as defined in paragraph (c)(5) of this section) of such cash is used by the CDE to make qualified low-income community investments (as defined in paragraph (d)(1) of this section); and

(iii) The investment is designated for purposes of section 45D and this section

by the CDE on its books and records using any reasonable method.

(2) *Equity investment.* The term *equity investment* means any stock (other than nonqualified preferred stock as defined in section 351(g)(2)) in an entity that is a corporation for Federal tax purposes and any capital interest in an entity that is a partnership for Federal tax purposes. See §§ 301.7701–1 through 301.7701–3 of this chapter for rules governing when a business entity, such as a business trust or limited liability company, is classified as a corporation or a partnership for Federal tax purposes.

(3) *Equity investments made prior to allocation—(i) In general.* Except as provided in paragraph (c)(3)(ii) of this section, an equity investment in an entity is not eligible to be designated as a qualified equity investment if it is made before the entity enters into an allocation agreement with the Secretary. An *allocation agreement* is an agreement between the Secretary and a CDE relating to a new markets tax credit allocation under section 45D(f)(2).

(ii) *Exception.* Notwithstanding paragraph (c)(3)(i) of this section, an equity investment in an entity is eligible to be designated as a qualified equity investment under paragraph (c)(1)(iii) of this section if—

(A) The equity investment is made on or after April 20, 2001;

(B) The entity in which the equity investment is made is certified by the Secretary as a CDE under section 45D(c) before January 1, 2003;

(C) The entity in which the equity investment is made receives notification of the credit allocation (with the actual receipt of such credit allocation contingent upon subsequently entering into an allocation agreement) from the Secretary before January 1, 2003; and

(D) The equity investment otherwise satisfies the requirements of section 45D and this section.

(iii) *Initial investment date.* If an equity investment is designated as a qualified equity investment in accordance with paragraph (c)(3)(ii) of this section, the investment is treated as initially made on the effective date of the allocation agreement between the CDE and the Secretary.

(4) *Limitations—(i) In general.* The term *qualified equity investment* does not include—

(A) Any equity investment issued by a CDE more than 5 years after the date the CDE enters into an allocation agreement (as defined in paragraph (c)(3)(i) of this section) with the Secretary; and

(B) Any equity investment by a CDE in another CDE, if the CDE making the

investment has received an allocation under section 45D(f)(2).

(ii) *Allocation limitation.* The maximum amount of equity investments issued by a CDE that may be designated under paragraph (c)(1)(iii) of this section by the CDE may not exceed the portion of the limitation amount allocated to the CDE by the Secretary under section 45D(f)(2).

(5) *Substantially all—(i) In general.* Except as provided in paragraph (c)(5)(v) of this section, the term *substantially all* means at least 85 percent. The substantially-all requirement must be satisfied for each annual period in the 7-year credit period using either the direct-tracing calculation under paragraph (c)(5)(ii) of this section, or the safe harbor calculation under paragraph (c)(5)(iii) of this section. The substantially-all requirement is treated as satisfied for an annual period if either the direct-tracing calculation under paragraph (c)(5)(ii) of this section, or the safe harbor calculation under paragraph (c)(5)(iii) of this section, is performed every six months and the average of the two calculations for the annual period is at least 85 percent. For purposes of this paragraph (c)(5)(i), the *7-year credit period* means the period of 7 years beginning on the date the qualified equity investment is initially made. See paragraph (c)(6) of this section for circumstances in which a CDE may treat more than one equity investment as a single qualified equity investment.

(ii) *Direct-tracing calculation.* The substantially-all requirement is satisfied if at least 85 percent of the taxpayer's investment is directly traceable to qualified low-income community investments as defined in paragraph (d)(1) of this section. The direct-tracing calculation is a fraction the numerator of which is the CDE's aggregate cost basis determined under section 1012 in all of the qualified low-income community investments that are directly traceable to the taxpayer's cash investment, and the denominator of which is the amount of the taxpayer's cash investment under paragraph (b)(4) of this section. For purposes of this paragraph (c)(5)(ii), cost basis includes the cost basis of any qualified low-income community investment that becomes worthless. See paragraph (d)(2) of this section for the treatment of amounts received by a CDE in payment of, or for, capital, equity or principal with respect to a qualified low-income community investment.

(iii) *Safe harbor calculation.* The substantially-all requirement is satisfied if at least 85 percent of the aggregate gross assets of the CDE are invested in

qualified low-income community investments as defined in paragraph (d)(1) of this section. The safe harbor calculation is a fraction the numerator of which is the CDE's aggregate cost basis determined under section 1012 in all of its qualified low-income community investments, and the denominator of which is the CDE's aggregate cost basis determined under section 1012 in all of its assets. For purposes of this paragraph (c)(5)(iii), cost basis includes the cost basis of any qualified low-income community investment that becomes worthless. See paragraph (d)(2) of this section for the treatment of amounts received by a CDE in payment of, or for, capital, equity or principal with respect to a qualified low-income community investment.

(iv) *Time limit for making investments.* The taxpayer's cash investment received by a CDE is treated as invested in a qualified low-income community investment as defined in paragraph (d)(1) of this section only to the extent that the cash is so invested no later than 12 months after the date the cash is paid by the taxpayer (directly or through an underwriter) to the CDE.

(v) *Reduced substantially-all percentage.* For purposes of the substantially-all requirement (including the direct-tracing calculation under paragraph (c)(5)(ii) of this section and the safe harbor calculation under paragraph (c)(5)(iii) of this section), 85 percent is reduced to 75 percent for the seventh year of the 7-year credit period (as defined in paragraph (c)(5)(i) of this section).

(6) *Aggregation of equity investments.* A CDE may treat any qualified equity investments issued on the same day as one qualified equity investment. If a CDE aggregates equity investments under this paragraph (c)(6), the rules in this section shall be construed in a manner consistent with that treatment.

(7) *Subsequent purchasers.* A qualified equity investment includes any equity investment that would (but for paragraph (c)(1)(i) of this section) be a qualified equity investment in the hands of the taxpayer if the investment was a qualified equity investment in the hands of a prior holder.

(d) *Qualified low-income community investments—(1) In general.* The term qualified low-income community investment means any of the following—

(i) *Investment in a qualified active low-income community business.* Any capital or equity investment in, or loan to, any qualified active low-income community business (as defined in paragraph (d)(4) of this section).

(ii) *Purchase of certain loans from CDEs.* The purchase from another CDE (whether or not that CDE has received an allocation from the Secretary under section 45D(f)(2)) of any loan made by such entity that is a qualified low-income community investment. A loan purchased from another CDE is a qualified low-income community investment if it qualifies as such either—

(A) At the time the selling CDE made the loan; or

(B) At the time the loan is purchased from the selling CDE.

(iii) *Financial counseling and other services.* Financial counseling and other services (as defined in paragraph (d)(7) of this section) provided to any qualified active low-income community business, or to any residents of a low-income community (as defined in section 45D(e)).

(iv) *Investments in other CDEs.* Any equity investment in, or loan to, any CDE, but only to the extent that the CDE in which the equity investment or loan is made uses the proceeds of the investment or loan in a manner—

(A) That is described in paragraphs (d)(1)(i) or (iii) of this section; and

(B) That would constitute a qualified low-income community investment if it were made directly by the CDE making such equity investment or loan.

(2) *Payments of, or for, capital, equity or principal—(i) In general.* Except as otherwise provided in this paragraph (d)(2), amounts received by a CDE in payment of, or for, capital, equity or principal with respect to a qualified low-income community investment must be reinvested by the CDE in a qualified low-income community investment no later than 12 months from the date of receipt to be treated as continuously invested in a qualified low-income community investment. If the amounts received by the CDE are equal to or greater than the cost basis of the original qualified low-income community investment (or applicable portion thereof), and the CDE reinvests, in accordance with this paragraph (d)(2)(i), an amount at least equal to such original cost basis, then an amount equal to such original cost basis will be treated as continuously invested in a qualified low-income community investment. In addition, if the amounts received by the CDE are equal to or greater than the cost basis of the original qualified low-income community investment (or applicable portion thereof), and the CDE reinvests, in accordance with this paragraph (d)(2)(i), an amount less than such original cost basis, then only the amount so reinvested will be treated as

continuously invested in a qualified low-income community investment. If the amounts received by the CDE are less than the cost basis of the original qualified low-income community investment (or applicable portion thereof), and the CDE reinvests an amount in accordance with this paragraph (d)(2)(i), then the amount treated as continuously invested in a qualified low-income community investment will equal the excess (if any) of such original cost basis over the amounts received by the CDE that are not so reinvested. Amounts received by a CDE in payment of, or for, capital, equity or principal with respect to a qualified low-income community investment during the seventh year of the 7-year credit period (as defined in paragraph (c)(5)(i) of this section) do not have to be reinvested by the CDE in a qualified low-income community investment in order to be treated as continuously invested in a qualified low-income community investment.

(ii) *Subsequent reinvestments.* In applying paragraph (d)(2)(i) of this section to subsequent reinvestments, the original cost basis is reduced by the amount (if any) by which the original cost basis exceeds the amount determined to be continuously invested in a qualified low-income community investment.

(iii) *Special rule for loans.* Periodic amounts received during a calendar year as repayment of principal on a loan that is a qualified low-income community investment are treated as continuously invested in a qualified low-income community investment if the amounts are reinvested in another qualified low-income community investment by the end of the following calendar year.

(iv) *Example.* The application of paragraphs (d)(2)(i) and (ii) of this section is illustrated by the following example:

*Example.* On April 1, 2003, A, B, and C each pay \$100,000 to acquire a capital interest in X, a partnership. X is a CDE that has received a new markets tax credit allocation from the Secretary. X treats the 3 partnership interests as one qualified equity investment under paragraph (c)(6) of this section. In August 2003, X uses the \$300,000 to make a qualified low-income community investment under paragraph (d)(1) of this section. In August 2005, the qualified low-income community investment is redeemed for \$250,000. In February 2006, X reinvests \$230,000 of the \$250,000 in a second qualified low-income community investment and uses the remaining \$20,000 for operating expenses. Under paragraph (d)(2)(i) of this section, \$280,000 of the proceeds of the qualified equity investment is treated as continuously invested in a qualified low-income community investment. In December

2008, X sells the second qualified low-income community investment and receives \$400,000. In March 2009, X reinvests \$320,000 of the \$400,000 in a third qualified low-income community investment. Under paragraphs (d)(2)(i) and (ii) of this section, \$280,000 of the proceeds of the qualified equity investment is treated as continuously invested in a qualified low-income community investment (\$40,000 is treated as invested in another qualified low-income community investment in March 2009).

(3) *Special rule for reserves.* Reserves (not in excess of 5 percent of the taxpayer's cash investment under paragraph (b)(4) of this section) maintained by the CDE for loan losses or for additional investments in existing qualified low-income community investments are treated as invested in a qualified low-income community investment under paragraph (d)(1) of this section.

(4) *Qualified active low-income community business—(i) In general.* The term *qualified active low-income community business* means, with respect to any taxable year, a corporation (including a nonprofit corporation) or a partnership, if the requirements in paragraphs (d)(4)(i)(A), (B), (C), (D), and (E) of this section are met.

(A) *Gross-income requirement.* At least 50 percent of the total gross income of such entity is derived from the active conduct of a qualified business (as defined in paragraph (d)(5) of this section) within any low-income community (as defined in section 45D(e)). An entity is deemed to satisfy this paragraph (d)(4)(i)(A) if the entity meets the requirements of either paragraph (d)(4)(i)(B) or (C) of this section, if "50 percent" is applied instead of 40 percent. In addition, an entity may satisfy this paragraph (d)(4)(i)(A) based on all the facts and circumstances.

(B) *Use of tangible property.* At least 40 percent of the use of the tangible property of such entity (whether owned or leased) is within any low-income community. This percentage is determined based on a fraction the numerator of which is the average value of the tangible property owned or leased by the entity and used by the entity during the taxable year in a low-income community and the denominator of which is the average value of the tangible property owned or leased by the entity and used by the entity during the taxable year. Property owned by the entity is valued at its cost basis as determined under section 1012. Property leased by the entity is valued at a reasonable amount established by the entity.

(C) *Services performed.* At least 40 percent of the services performed for such entity by its employees are performed in a low-income community. This percentage is determined based on a fraction the numerator of which is the total amount paid by the entity for employee services performed in a low-income community during the taxable year and the denominator of which is the total amount paid by the entity for employee services during the taxable year.

(D) *Collectibles.* Less than 5 percent of the average of the aggregate unadjusted bases of the property of such entity is attributable to collectibles (as defined in section 408(m)(2)) other than collectibles that are held primarily for sale to customers in the ordinary course of business.

(E) *Nonqualified financial property.* Less than 5 percent of the average of the aggregate unadjusted bases of the property of such entity is attributable to nonqualified financial property (as defined in section 1397C(e)). Because the definition of *nonqualified financial property* in section 1397C(e) includes debt instruments with a term in excess of 18 months, banks, credit unions, and other financial institutions are generally excluded from the definition of a *qualified active low-income community business*.

(ii) *Proprietorships.* Any business carried on by an individual as a proprietor is a qualified active low-income community business if the business would meet the requirements of paragraph (d)(4)(i) of this section if the business were incorporated.

(iii) *Portions of business.* A CDE may treat any trade or business as a qualified active low-income community business if the trade or business would meet the requirements of paragraph (d)(4)(i) of this section if the trade or business were separately incorporated.

(5) *Qualified business—(i) In general.* Except as otherwise provided in this paragraph (d)(5), the term *qualified business* means any trade or business. There is no requirement that employees of a *qualified business* be residents of a low-income community.

(ii) *Rental of real property.* The rental to others of real property located in any low-income community (as defined in section 45D(e)) is a *qualified business* if and only if the property is not residential rental property (as defined in section 168(e)(2)(A)) and there are substantial improvements located on the real property.

(iii) *Exclusions—(A) Trades or businesses involving intangibles.* The term *qualified business* does not include any trade or business consisting

predominantly of the development or holding of intangibles for sale or license.

(B) *Certain other trades or businesses.* The term *qualified business* does not include any trade or business consisting of the operation of any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises.

(C) *Farming.* The term *qualified business* does not include any trade or business the principal activity of which is farming (within the meaning of section 2032A(e)(5)(A) or (B)) if, as of the close of the taxable year of the taxpayer conducting such trade or business, the sum of the aggregate unadjusted bases (or, if greater, the fair market value) of the assets owned by the taxpayer that are used in such a trade or business, and the aggregate value of the assets leased by the taxpayer that are used in such a trade or business, exceeds \$500,000. For purposes of this paragraph (d)(5)(iii)(C), two or more trades or businesses will be treated as a single trade or business under rules similar to the rules of section 52(a) and (b).

(6) *Qualifications—(i) In general.* Except as provided in paragraph (d)(6)(ii) of this section, an entity is treated as a qualified active low-income community business for the duration of the CDE's investment in the entity if the CDE reasonably expects, at the time the CDE makes the capital or equity investment in, or loan to, the entity, that the entity will satisfy the requirements to be a qualified active low-income community business under paragraph (d)(4)(i) of this section throughout the entire period of the investment or loan.

(ii) *Control—(A) In general.* If a CDE controls or obtains control of an entity at any time during the 7-year credit period (as defined in paragraph (c)(5)(i) of this section), the entity will be treated as a qualified active low-income community business only if the entity satisfies the requirements of paragraph (d)(4)(i) of this section throughout the entire period the CDE controls the entity.

(B) *Definition of control.* Generally, control means, with respect to an entity, direct or indirect ownership (based on value) or control (based on voting or management rights) of 33 percent or more of the entity. However, a CDE does not control an entity if an unrelated person possesses greater control over the entity than the CDE.

(7) *Financial counseling and other services.* The term *financial counseling*

and other services means advice provided by the CDE relating to the organization or operation of a trade or business.

(e) *Recapture—(1) In general.* If, at any time during the 7-year period beginning on the date of the original issue of a qualified equity investment in a CDE, there is a recapture event under paragraph (e)(2) of this section with respect to such investment, then the tax imposed by Chapter 1 of the Internal Revenue Code for the taxable year in which the recapture event occurs is increased by the credit recapture amount under section 45D(g)(2). A recapture event under paragraph (e)(2) of this section requires recapture of credits allowed to the taxpayer who purchased the equity investment from the CDE at its original issue and to all subsequent holders of that investment.

(2) *Recapture event.* There is a recapture event with respect to an equity investment in a CDE if—

(i) The entity ceases to be a CDE;

(ii) The proceeds of the investment cease to be used in a manner that satisfies the substantially-all requirement of paragraph (c)(1)(ii) of this section; or

(iii) The investment is redeemed by the CDE.

(3) *Bankruptcy.* Bankruptcy of a CDE is not a recapture event.

(4) *Waiver of requirement or extension of time—(i) In general.* The Commissioner may waive a requirement or extend a deadline if such waiver or extension does not materially frustrate the purposes of section 45D and this section.

(ii) *Manner for requesting a waiver or extension.* A CDE that believes it has good cause for a waiver or an extension may request relief from the Commissioner in a ruling request. The request should set forth all the relevant facts and include a detailed explanation describing the event or events relating to the request for a waiver or an extension. For further information on the application procedure for a ruling, see Rev. Proc. 2001-1 (2001-1 I.R.B. 1) (see § 601.601(d)(2) of this chapter).

(iii) *Terms and conditions.* The granting of a waiver or an extension to a CDE under this section may require adjustments of the CDE's requirements under section 45D and this section as may be appropriate.

(5) *Example.* The application of this paragraph (e) is illustrated by the following example:

*Example.* In 2003, A and B acquire separate qualified equity investments in X, a partnership. X is a CDE that has received a new markets tax credit allocation from the Secretary. X uses the proceeds of A's



qualified equity investment to make a qualified low-income community investment in Y, and X uses the proceeds of B's qualified equity investment to make a qualified low-income community investment in Z. Y and Z are not CDEs. X controls both Y and Z within the meaning of paragraph (d)(6)(ii)(B) of this section. In 2003, Y and Z are qualified active low-income community businesses. In 2007, Y, but not Z, is a qualified active low-income community business and X does not satisfy the substantially-all requirement using the safe harbor calculation under paragraph (c)(5)(iii) of this section. A's equity investment satisfies the substantially-all requirement of paragraph (c)(1)(ii) of this section using the direct-tracing calculation of paragraph (c)(5)(ii) of this section because A's equity investment is traceable to Y. However, B's equity investment fails the substantially-all requirement using the direct-tracing calculation because B's equity investment is traceable to Z. Therefore, under paragraph (e)(2)(ii) of this section, there is a recapture event for B's equity investment (but not A's equity investment).

(f) *Basis reduction*—(1) *In general.* A taxpayer's basis in a qualified equity investment is reduced by the amount of any new markets tax credit determined under paragraph (b)(1) of this section with respect to the investment. A basis reduction occurs on each credit allowance date under paragraph (b)(2) of this section. This paragraph (f) does not apply for purposes of sections 1202, 1400B, and 1400F.

(2) *Adjustment in basis of interest in partnership or S corporation.* The adjusted basis of either a partner's interest in a partnership, or stock in an S corporation, must be appropriately adjusted to take into account adjustments made under paragraph (f)(1) of this section in the basis of a qualified equity investment held by the partnership or S corporation (as the case may be).

(g) *Other rules*—(1) *Anti-abuse.* If a principal purpose of a transaction or a series of transactions is to achieve a result that is inconsistent with the purposes of section 45D and this section, the Commissioner may treat the transaction or series of transactions as causing a recapture event under paragraph (e)(2) of this section.

(2) *Reporting requirements*—(i) *Notification by CDE to taxpayer*—(A) *Allowance of new markets tax credit.* A CDE must provide notice to any taxpayer who acquires a qualified equity investment in the CDE at its original issue that the equity investment is a qualified equity investment entitling the taxpayer to claim the new markets tax credit. The notice must be provided by the CDE to the taxpayer no later than 60 days after the date the taxpayer makes the investment in the CDE. The notice must contain the amount paid to the

CDE for the qualified equity investment at its original issue and the taxpayer identification number of the CDE.

(B) *Recapture event.* If, at any time during the 7-year period beginning on the date of the original issue of a qualified equity investment in a CDE, there is a recapture event under paragraph (e)(2) of this section with respect to such investment, the CDE must provide notice to each holder, including all prior holders, of the investment that a recapture event has occurred. The notice must be provided by the CDE no later than 60 days after the date the CDE becomes aware of the recapture event.

(ii) *CDE reporting requirements to Secretary.* Each CDE must comply with such reporting requirements to the Secretary as the Secretary may prescribe.

(iii) *Manner of claiming new markets tax credit.* A taxpayer may claim the new markets tax credit for each applicable taxable year by completing Form 8874, "New Markets Credit," and by filing Form 8874 with the taxpayer's Federal income tax return.

(iv) *Reporting recapture tax.* If there is a recapture event with respect to a taxpayer's equity investment in a CDE, the taxpayer must include the credit recapture amount under section 45D(g)(2) on the line for recapture taxes on the taxpayer's Federal income tax return for the taxable year in which the recapture event under paragraph (e)(2) of this section occurs (or on the line for total tax, if there is no such line for recapture taxes) and write *NMCR* (new markets credit recapture) next to the entry space.

(h) *Effective date.* This section applies on or after December 26, 2001.

**PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT**

**Par. 3.** The authority citation for part 602 continues to read as follows:

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

**Par. 4.** In § 602.101, paragraph (b) is amended by adding an entry to the table in numerical order to read as follows:

**§ 602.101 OMB Control numbers.**

*	*	*	*	*
(b) * * *				

CFR part or section where identified and described	Current OMB control No.
* * * * *	* * * * *
1.45D-1T .....	1545-1765

CFR part or section where identified and described	Current OMB control No.
* * * * *	* * * * *

Approved: December 17, 2001.  
**Robert E. Wenzel,**  
*Deputy Commissioner of Internal Revenue.*  
**Mark Weinberger,**  
*Assistant Secretary of the Treasury.*  
 [FR Doc. 01-31528 Filed 12-21-01; 8:45 am]  
**BILLING CODE 4830-01-P**

**DEPARTMENT OF THE INTERIOR**  
**Office of Surface Mining Reclamation and Enforcement**

**30 CFR Part 917**

[KY-221-FOR]

**Kentucky Regulatory Program**

**AGENCY:** Office of Surface Mining Reclamation and Enforcement (OSM), Interior.

**ACTION:** Final rule.

**SUMMARY:** OSM is approving an amendment to the Kentucky regulatory program (Kentucky program) under the Surface Mining Control and Reclamation Act of 1977 (SMCRA). Kentucky is proposing revisions to the Kentucky Administrative Regulations (KAR) pertaining to the general requirements for performance bonds and liability insurance. Kentucky intends to revise its program to be consistent with the corresponding Federal regulations.

**EFFECTIVE DATE:** December 26, 2001.

**FOR FURTHER INFORMATION CONTACT:** William J. Kovacic, Field Office Director, Lexington Field Office, 2675 Regency Road, Lexington, Kentucky 40503. Telephone: (859) 260-8400. Internet address: bkovacic@osmre.gov.

**SUPPLEMENTARY INFORMATION:**

- I. Background on the Kentucky Program
- II. Submission of the Amendment
- III. Director's Findings
- IV. Summary and Disposition of Comments
- V. Director's Decision
- VI. Procedural Determinations

**I. Background on the Kentucky Program**

Section 503(a) of SMCRA permits a State to assume primacy for the regulation of surface coal mining and reclamation operations on non-Federal and non-Indian lands within its borders by demonstrating that its State program includes, among other things, "a State law which provides for the regulation of