LG
Thanks, Let's talk ASAP
GS 5/13/99

DRAFT MEMORANDUM TO GENE SPERLING

DATE: May 11, 1999

FROM: LISA GREEN

SUBJECT: THE AMERICAN COMMUNITY RENEWAL ACT OF 1999 (H.R. 815) (The Talent-Watts Bill)

The purpose of this memorandum is to provide an analysis of the Talent-Watts bill referenced above, as it compares to the New Markets Initiative (NMI) and existing community development programs.

Lisa G.
I need your ideas on what we could live with not just what is consistent w/ new markets
I imagine more SB expens + work opp tax credit could be O.K. what else?
GS 5/13/99

Summary of Bill
The American Community Renewal Act would provide for up to 100 renewal communities designated through a competitive process similar to that of the current Empowerment Zone and Enterprise Community (EZ/EC) Programs. Renewal Communities would be eligible for numerous tax incentives including zero percent capital gains, commercial revitalization tax credits, expensing for small businesses and Brownfields, expansion of the work opportunity tax credit, and family development accounts.

Background and History
The current bill has evolved from several earlier proposals to create a Renewal Community Program. Earlier versions include public school vouchers, which made the bill unacceptable to several Democrats, such as former Congressman Floyd Flake, who had expressed an initial interest. The bill outlines some of the same types of programs promoted by then HUD Secretary Jack Kemp's in his proposal for Enterprise Zones. The bill was previously introduced as HR3685 under the same name.

Overall Conclusions
Based on my review of the bill, a meeting with a subset of the New Markets Initiative inter-agency working group (see list attached), and analyses completed by HUD and Treasury, I have reached the following conclusions.

Capital Gains Opening: The Talent-Watts bill is principally a Republican attempt to create an opening for a capital gains tax through a program that addresses ideological and social issues that are of concern to Democrats. **The main objection raised by several agencies to this bill is the zero percent capital gains** provision for the sale of certain business property and assets held for more than 5 years. Eligibility includes a requirement that 35% of employees reside in the Renewal Community.

Because it is a back-end solution, a zero percent capital gains tax is not a logical incentive for investment in distressed economic communities. Potential investors in these areas may not be motivated by a benefit that comes only upon the sale of an investment in an area where they are unlikely to experience appreciation in property values. There is a much greater need for upfront and ongoing incentives to draw investment into such communities. This type of tax incentive could have the perverse and presumably unintended consequence of encouraging more disinvestment in distressed areas as owners might flip businesses and properties to receive this tax benefit. Treasury has raised additional, well-founded concerns about a capital gains tax for investment in distressed communities, as outlined in the attached May 5 draft memorandum from Michael Barr.

Incentives for Capital Investment versus Labor Investments: With the exception of the zero capital gains provision, this bill, places more emphasis on investment in labor rather than capital investments. The NMI was designed to encourage capital investment in distressed communities, through loan guarantees and tax credits. H.R. 815 provides tax benefits for businesses to locate and operate in distressed areas and to hire individuals living there. The bill also includes provisions to encourage savings by residents of these areas.

Just write from you to me -- don't include

Considerations Related to Specific Provisions

Potentially Acceptable Provisions: Some specific provisions of the bill would be acceptable to various agencies if incorporated into the NMI. These provisions include:

- Use of poverty and unemployment rates to target funding, and
- Expansion of the work opportunity tax credit for certain targeted groups

Duplicative Provisions: There are several areas of the bill considered to be duplicative of existing programs or other legislative proposals.

- Designation of distressed communities that would receive special tax treatment coordinated assistance from the local government and the private sector, is an almost **identical concept to the EZ/EC initiative**.
- Some aspects of the **Family Development Account (FDA)** proposal mirror the Administration's Individual Development Account proposal; however the approach proposed by Senator Coats is preferable to that outlined in H.R. 815. In addition, the FDA proposal outlined in this bill would involve a matching program administered by HUD, requiring resources that HUD does not have at this time.
- Expensing for small business and Brownfields was provided for in the Taxpayer Relief Act of 1997.

Areas of Concern and Potentially Unacceptable Provisions: Specific agencies have raised concerns about several issues. These issues are not of equal concern to all agencies.

- **Funding for the program under PAYGO provisions.** Earlier versions of the Act proposed funding of the program using existing budget authority for CDBG. This proposal was unacceptable to community development interest groups and many Democrats and has since been eliminated. However, the current proposal to fund the program out of the surplus is considered an unreasonable solution by Treasury, particularly given unresolved issues around Social Security.
- **Inclusion of a commercial revitalization tax credit for projects located in Renewal Communities.** Project based tax credits have been used successfully for low-income housing where State Housing Agencies have been able to monitor and administer the program. However it would be very difficult for Treasury to monitor credits for commercial properties, as there are no similar state or local entities equipped to provide oversight. Treasury has also raised a concern that a commercial revitalization credit could result in negative effective tax rates and cause investors to make purely tax-motivated decisions in order to shelter other income from higher taxes.
- **Requirement for the transfer of any HUD-owned property to the local government.** Both HUD and OMB raised serious objections to this provision which requires HUD to transfer to the local government any substandard multifamily property, or any vacant single family property that is located in a Renewal Community. HUD's position is well outlined in the attached comments from David Kaas.
- **Proposal for charitable choices that allow religious organizations to be treated in the same manner as other non-profit organizations.**

General Comparison with the New Markets Initiative and the Empowerment Zone and Enterprise Community Programs

A detailed comparison of the bill's provisions and requirements to those of the NMI and to the Communi Empowerment Program can be found in the attached chart. The following are general observations.

Criteria for Targeting: The criteria for selection as a Renewal Community:

- Is more restric~~tive than requirements~~ for NMI and less restrictive than those for EZ/ECs;
- Utilizes ~~a~~ place based approach, similar to both NMI and EZ/ECs;
- Incorporates unemployment rates into the selection criteria which is not part of the targeting for NMI ~~or~~ EZ/ECs; and
- Allows for overlap between designations as a Renewal Community and an EZ/EC, which may be confusing for taxpayers.

The logic behind NMI was that targeting should be relatively broad (approximately 40% of the country is eligible) giving investors more choice and flexibility in determining where to place their funds, thereby making the program more attractive to the private sector. This issue has been argued both ways --- there is also benefit to more narrow criteria, which assures that funds reach the most distressed areas. The EZ/EC uses a more targeted approach for this reason.

Expensing Provisions: The bill includes expensing provisions for certain qualified Renewal Community Businesses as well as for Brownfields expensing. Expensing is already available for small businesses; however this Act would increase the phase-out range. In addition it would provide an additional $35,000 per year of expensing for depreciable property. The proposed bill would also extend the period for Brownfields expensing that is currently available.

The Work Opportunity Tax Credit: H.R. 815 would expand the existing law to include Renewal Community residents who work in Renewal Community businesses. The bill would also provide a different tax credit rate and maximum on wages, resulting in a more generous credit for the new target group in the second year of employment. Renewal Community youth, even those who work outside of community would be eligible for the same treatment available to youth under the EZ program which requires that substantially all of the employees' services be provided in the EZ.

Final Considerations

In our meetings with the New Markets working group and legislative subset of the working group, Talent-Watt has never been raised as an alternative proposal to NMI. Although most of the members of the group are familiar with the proposal, they consider this bill to be completely unacceptable, if only because of the zero capital gains tax provision. There is some interest in the Watts-Talent bill from industry groups. It is included on the proposed agenda for a policy workshop in June sponsored in part by the National Congress for Community Economic Development (Roy Priest) and American Association of Enterprise Zones

As outlined in this memorandum there are a few provisions that could, if necessary, be incorporated into our NMI proposal. However, the central provisions of the Talent-Watts Bill --- zero capital gains and incentives for business to locate in distressed areas --- are inconsistent with the thinking behind NMI. As you know the impetus for the NMI was to address inefficiencies in the capital markets. The Talent-Watts bill does not directly address this fundamental issue.

THE WHITE HOUSE

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DATE: ____________ PAGES TO FOLLOW: ________

COMMENTS: HUD Comments on ACR - H.R. 815

H.R.815

American Community Renewal Act of 1999 (Introduced in the House)

HR 815 IH

106th CONGRESS

1st Session

H. R. 815

To amend the Internal Revenue Code of 1986 to provide for the designation of renewal communities, to provide tax incentives relating to such communities, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

February 24, 1999

Mr. WATTS of Oklahoma (for himself, Mr. DAVIS of Illinois, Mr. TALENT, Mr. CLYBURN, Mr. ARMEY, Mr. FROST, Mrs. FOWLER, Mr. ENGLISH, Mr. FORD, Ms. PRYCE of Ohio, Mr. KING, Mr. LIPINSKI, Mrs. BONO, Mr. KOLBE, Mr. DELAY, Mrs. CHRISTIAN-CHRISTENSEN, Mrs. EMERSON, Mr. KNOLLENBERG, Mr. HAYWORTH, Mrs. CUBIN, Mr. HORN, Mr. HILL of Montana, Mr. WELDON of Florida, Mr. TERRY, Mr. SOUDER, Mr. BALLENGER, Mr. CHABOT, Mr. CHAMBLISS, Mr. WELLER, Mr. TANCREDO, Mr. SENSENBRENNER, Mr. NORWOOD, Mr. METCALF, Mr. DICKEY, Mr. GILLMOR, Mr. GREEN of Wisconsin, Mr. HULSHOF, Mr. LARGENT, Mr. SCARBOROUGH, Mr. PITTS, Mr. ROHRABACHER, Mr. BURR of North Carolina, Mr. EHLERS, Mr. BUYER, Mr. LATHAM, Mr. SIMPSON, Mr. MCCOLLUM, Mr. LATOURETTE, Mr. CUNNINGHAM, Mr. COOK, Mr. LEWIS of Kentucky, Mr. BLUNT, Mr. NEY, Mr. GARY MILLER of California, Mr. PICKERING, Mr. NETHERCUTT, Mr. MCHUGH, Ms. GRANGER, Mr. FORBES, Mrs. MYRICK, Mr. SHOWS, Mrs. KELLY, Mr. OWENS, Mr. THOMPSON of Mississippi, and Mr. COBURN) introduced the following bill; which was referred to the Committee on Ways and Means, and in addition to the Committees on Banking and Financial Services, Commerce, and the Budget, for a period to be determined by the Speaker, in each case for consideration of such provisions as fall within the jurisdiction of the committee concerned

A BILL

To amend the Internal Revenue Code of 1986 to provide for the designation of renewal communities, to provide tax incentives relating to such communities, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; ETC.

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(b) AMENDMENT OF 1986 CODE- Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1986.

(c) TABLE OF CONTENTS-

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'Part I. Designation.

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'Part I. Designation.

'Part II. Renewal community capital gain; renewal community business.

'Part III. Family development accounts.

'Part IV. Additional incentives.

'PART I--DESIGNATION

'Sec. 1400E. Designation of renewal communities.

'SEC. 1400E. DESIGNATION OF RENEWAL COMMUNITIES.

'(a) DESIGNATION-

'(1) DEFINITIONS- For purposes of this title, the term 'renewal community' means any area--

'(A) which is nominated by one or more local governments and the State or States in which it is located for designation as a renewal community (hereinafter in this section referred to as a 'nominated area'); and

'(B) which the Secretary of Housing and Urban Development designates as a renewal community, after consultation with--

'(i) the Secretaries of Agriculture, Commerce, Labor, and the Treasury; the Director of the Office of Management and Budget; and the Administrator of the Small Business Administration; and

'(ii) in the case of an area on an Indian reservation, the Secretary of the Interior.

'(2) NUMBER OF DESIGNATIONS-

'(A) IN GENERAL- The Secretary of Housing and Urban Development may designate not more than 100 nominated areas as renewal communities.

'(B) MINIMUM DESIGNATION IN RURAL AREAS- Of the areas designated under paragraph (1), at least 20 percent must be areas--

'(i) which are within a local government jurisdiction or jurisdictions with a population of less than 50,000,

'(ii) which are outside of a metropolitan statistical area (within the meaning of section 143(k)(2)(B)), or

'(iii) which are determined by the Secretary of Housing and Urban Development, after consultation with the Secretary of Commerce, to be rural areas.

'(3) AREAS DESIGNATED BASED ON DEGREE OF POVERTY, ETC-

'(A) IN GENERAL- Except as otherwise provided in this section, the nominated areas designated as renewal communities under this subsection shall be those nominated areas with the highest average ranking with respect to the criteria described in subparagraphs (B), (C),

and (D) of subsection (c)(3). For purposes of the preceding sentence, an area shall be ranked within each such criterion on the basis of the amount by which the area exceeds such criterion, with the area which exceeds such criterion by the greatest amount given the highest ranking.

'(B) EXCEPTION WHERE INADEQUATE COURSE OF ACTION, ETC- An area shall not be designated under subparagraph (A) if the Secretary of Housing and Urban Development determines that the course of action described in subsection (d)(2) with respect to such area is inadequate.

'(C) PRIORITY FOR EMPOWERMENT ZONES AND ENTERPRISE COMMUNITIES WITH RESPECT TO FIRST HALF OF DESIGNATIONS- With respect to the first 50 percent of the designations made under this section--

'(i) half shall be chosen from nominated areas which are empowerment zones or enterprise communities (and are otherwise eligible for designation under this section); and

'(ii) 20 percent shall be areas described in paragraph (2)(B).

'(4) Limitation on designations-

'(A) PUBLICATION OF REGULATIONS- The Secretary of Housing and Urban Development shall prescribe by regulation no later than 4 months after the date of the enactment of this section, after consultation with the officials described in paragraph (1)(B)--

'(i) the procedures for nominating an area under paragraph (1)(A);

'(ii) the parameters relating to the size and population characteristics of a renewal community; and

'(iii) the manner in which nominated areas will be evaluated based on the criteria specified in subsection (d).

'(B) TIME LIMITATIONS- The Secretary of Housing and Urban Development may designate nominated areas as renewal communities only during the 24-month period beginning on the first day of the first month following the month in which the regulations described in subparagraph (A) are prescribed.

'(C) PROCEDURAL RULES- The Secretary of Housing and Urban Development shall not make any designation of a nominated area as a renewal community under paragraph (2) unless--

'(i) the local governments and the States in which the nominated area is located have the authority--

'(I) to nominate such area for designation as a renewal community;

'(II) to make the State and local commitments described in subsection (d); and

'(III) to provide assurances satisfactory to the Secretary of Housing and Urban Development that such commitments will be fulfilled, '(ii) a nomination regarding such area is submitted in such a manner and in such form, and contains such information, as the Secretary of Housing and Urban Development shall by regulation prescribe; and

'(iii) the Secretary of Housing and Urban Development determines that any information furnished is reasonably accurate.

'(5) NOMINATION PROCESS FOR INDIAN RESERVATIONS- For purposes of this subchapter, in the case of a nominated area on an Indian reservation, the reservation governing body (as determined by the Secretary of the Interior) shall be treated as being both the State and local governments with respect to such area.

'(b) Period for Which Designation Is In Effect-

'(1) IN GENERAL- Any designation of an area as a renewal community shall remain in effect during the period beginning on the date of the designation and ending on the earliest of--

'(A) December 31, 2007,

'(B) the termination date designated by the State and local governments in their nomination, or

'(C) the date the Secretary of Housing and Urban Development revokes such designation.

'(2) REVOCATION OF DESIGNATION- The Secretary of Housing and Urban Development may revoke the designation under this section of an area if

such Secretary determines that the local government or the State in which the area is located--

'(A) has modified the boundaries of the area, or

'(B) is not complying substantially with, or fails to make progress in achieving, the State or local commitments, respectively, described in subsection (d).

'(c) Area and Eligibility Requirements-

'(1) IN GENERAL- The Secretary of Housing and Urban Development may designate a nominated area as a renewal community under subsection (a) only if the area meets the requirements of paragraphs (2) and (3) of this subsection.

'(2) AREA REQUIREMENTS- A nominated area meets the requirements of this paragraph if--

'(A) the area is within the jurisdiction of one or more local governments;

'(B) the boundary of the area is continuous; and

'(C) the area--

'(i) has a population, of at least--

'(I) 4,000 if any portion of such area (other than a rural area described in subsection (a)(2)(B)(i)) is located within a metropolitan statistical area (within the meaning of section 143(k)(2)(B)) which has a population of 50,000 or greater; or

'(II) 1,000 in any other case; or

'(ii) is entirely within an Indian reservation (as determined by the Secretary of the Interior).

'(3) ELIGIBILITY REQUIREMENTS- A nominated area meets the requirements of this paragraph if the State and the local governments in which it is located certify (and the Secretary of Housing and Urban Development, after such review of supporting data as he deems appropriate, accepts such certification) that--

'(A) the area is one of pervasive poverty, unemployment, and general distress;

'(B) the unemployment rate in the area, as determined by the most recent available data, was at least 1 1/2 times the national unemployment rate for the period to which such data relate;

'(C) the poverty rate for each population census tract within the nominated area is at least 20 percent; and

'(D) in the case of an urban area, at least 70 percent of the households living in the area have incomes below 80 percent of the median income of households within the jurisdiction of the local government (determined in the same manner as under section 119(b)(2) of the Housing and Community Development Act of 1974).

'(4) CONSIDERATION OF HIGH INCIDENCE OF CRIME- The Secretary of Housing and Urban Development shall take into account, in selecting nominated areas for designation as renewal communities under this section, the extent to which such areas have a high incidence of crime.

'(5) CONSIDERATION OF COMMUNITIES IDENTIFIED IN GAO STUDY- The Secretary of Housing and Urban Development shall take into account, in selecting nominated areas for designation as renewal communities under this section, if the area has census tracts identified in the May 12, 1998, report of the Government Accounting Office regarding the identification of economically distressed areas.

'(d) Required State and Local Commitments-

'(1) IN GENERAL- The Secretary of Housing and Urban Development may designate any nominated area as a renewal community under subsection (a) only if--

'(A) the local government and the State in which the area is located agree in writing that, during any period during which the area is a renewal community, such governments will follow a specified course of action which meets the requirements of paragraph (2) and is designed to reduce the various burdens borne by employers or employees in such area; and

'(B) the economic growth promotion requirements of paragraph (3) are met.

'(2) COURSE OF ACTION-

'(A) IN GENERAL- A course of action meets the requirements of this paragraph if such course of action is a written document, signed by a State (or local government) and neighborhood organizations, which evidences a partnership between such State or government and community-based organizations and which commits each signatory to specific and measurable goals, actions, and timetables. Such course

of action shall include at least five of the following:

'(i) A reduction of tax rates or fees applying within the renewal community.

'(ii) An increase in the level of efficiency of local services within the renewal community.

'(iii) Crime reduction strategies, such as crime prevention (including the provision of such services by nongovernmental entities).

'(iv) Actions to reduce, remove, simplify, or streamline governmental requirements applying within the renewal community.

'(v) Involvement in the program by private entities, organizations, neighborhood organizations, and community groups, particularly those in the renewal community, including a commitment from such private entities to provide jobs and job training for, and technical, financial, or other assistance to, employers, employees, and residents from the renewal community.

'(vi) State or local income tax benefits for fees paid for services performed by a nongovernmental entity which were formerly performed by a governmental entity.

'(vii) The gift (or sale at below fair market value) of surplus real property (such as land, homes, and commercial or industrial structures) in the renewal community to neighborhood organizations, community development corporations, or private companies.

'(B) RECOGNITION OF PAST EFFORTS- For purposes of this section, in evaluating the course of action agreed to by any State or local government, the Secretary of Housing and Urban Development shall take into account the past efforts of such State or local government in reducing the various burdens borne by employers and employees in the area involved.

'(3) ECONOMIC GROWTH PROMOTION REQUIREMENTS- The economic growth promotion requirements of this paragraph are met with respect to a nominated area if the local government and the State in which such area is located certify in writing that such government and State, respectively, have repealed or otherwise will not enforce within the area, if such area is designated as a renewal community--

'(A) licensing requirements for occupations that do not ordinarily require a professional degree;

'(B) zoning restrictions on home-based businesses which do not create a public nuisance;

'(C) permit requirements for street vendors who do not create a public nuisance;

'(D) zoning or other restrictions that impede the formation of schools or child care centers; and

'(E) franchises or other restrictions on competition for businesses providing public services, including but not limited to taxicabs, jitneys, cable television, or trash hauling,

except to the extent that such regulation of businesses and occupations is necessary for and well-tailored to the protection of health and safety.

'(e) COORDINATION WITH TREATMENT OF EMPOWERMENT ZONES AND ENTERPRISE COMMUNITIES- For purposes of this title, if there are in effect with respect to the same area both--

'(1) a designation as a renewal community; and

'(2) a designation as an empowerment zone or enterprise community,

both of such designations shall be given full effect with respect to such area.

'(f) DEFINITIONS AND SPECIAL RULES- For purposes of this subchapter--

'(1) GOVERNMENTS- If more than one government seeks to nominate an area as a renewal community, any reference to, or requirement of, this section shall apply to all such governments.

'(2) STATE- The term 'State' includes Puerto Rico, the Virgin Islands of the United States, Guam, American Samoa, the Northern Mariana Islands, and any other possession of the United States.

'(3) LOCAL GOVERNMENT- The term 'local government' means--

'(A) any county, city, town, township, parish, village, or other general purpose political subdivision of a State;

'(B) any combination of political subdivisions described in subparagraph (A) recognized by the Secretary of Housing and Urban Development; and

'(C) the District of Columbia.

'(4) APPLICATION OF RULES RELATING TO CENSUS TRACTS AND CENSUS

DATA- The rules of sections 1392(b)(4) and 1393(a)(9) shall apply.

'PART II--RENEWAL COMMUNITY CAPITAL GAIN; RENEWAL COMMUNITY BUSINESS

'SEC. 1400F. RENEWAL COMMUNITY CAPITAL GAIN.

'(a) GENERAL RULE- Gross income does not include any qualified capital gain recognized on the sale or exchange of a qualified community asset held for more than 5 years.

'(b) QUALIFIED COMMUNITY ASSET- For purposes of this section--

'(1) IN GENERAL- The term 'qualified community asset' means--

'(A) any qualified community stock;

'(B) any qualified community partnership interest; and

'(C) any qualified community business property.

'(2) QUALIFIED COMMUNITY STOCK-

'(A) IN GENERAL- Except as provided in subparagraph (B), the term 'qualified community stock' means any stock in a domestic corporation if--

'(i) such stock is acquired by the taxpayer after December 31, 2000, and before January 1, 2008, at its original issue (directly or through an underwriter) from the corporation solely in exchange for cash;

'(ii) as of the time such stock was issued, such corporation was a renewal community business (or, in the case of a new corporation, such corporation was being organized for purposes of being a renewal community business); and

'(iii) during substantially all of the taxpayer's holding period for such stock, such corporation qualified as a renewal community business.

'(B) REDEMPTIONS- A rule similar to the rule of section 1202(c)(3) shall apply for purposes of this paragraph.

'(3) QUALIFIED COMMUNITY PARTNERSHIP INTEREST- The term 'qualified community partnership interest' means any interest in a partnership if--

'(A) such interest is acquired by the taxpayer after December 31, 2000, and before January 1, 2008;

'(B) as of the time such interest was acquired, such partnership was a renewal community business (or, in the case of a new partnership, such partnership was being organized for purposes of being a renewal community business); and

'(C) during substantially all of the taxpayer's holding period for such interest, such partnership qualified as a renewal community business.

A rule similar to the rule of paragraph (2)(B) shall apply for purposes of this paragraph.

'(4) QUALIFIED COMMUNITY BUSINESS PROPERTY-

'(A) IN GENERAL- The term 'qualified community business property' means tangible property if--

'(i) such property was acquired by the taxpayer by purchase (as defined in section 179(d)(2)) after December 31, 2000, and before January 1, 2008;

'(ii) the original use of such property in the renewal community commences with the taxpayer; and

'(iii) during substantially all of the taxpayer's holding period for such property, substantially all of the use of such property was in a renewal community business of the taxpayer.

'(B) SPECIAL RULE FOR SUBSTANTIAL IMPROVEMENTS- The requirements of clauses (i) and (ii) of subparagraph (A) shall be treated as satisfied with respect to--

'(i) property which is substantially improved (within the meaning of section 1400B(b)(4)(B)(ii)) by the taxpayer before January 1, 2008; and

'(ii) any land on which such property is located.

'(c) CERTAIN RULES TO APPLY- Rules similar to the rules of paragraphs (5), (6), and (7) of subsection (b), and subsections (e), (f), and (g), of section 1400B shall apply for purposes of this section.

'SEC. 1400G. RENEWAL COMMUNITY BUSINESS DEFINED.

'For purposes of this part, the term 'renewal community business' means any entity or proprietorship which would be a qualified business entity or qualified proprietorship under section 1397B if--

'(1) references to renewal communities were substituted for references to empowerment zones in such section; and

'(2) '80 percent' were substituted for '50 percent' in subsections (b)(2) and (c)(1) of such section.

'PART III--FAMILY DEVELOPMENT ACCOUNTS

'Sec. 1400H. Family development accounts for renewal community EITC recipients.

'SEC. 1400H. FAMILY DEVELOPMENT ACCOUNTS FOR RENEWAL COMMUNITY EITC RECIPIENTS.

'(a) ALLOWANCE OF DEDUCTION-

'(1) IN GENERAL- There shall be allowed as a deduction--

'(A) in the case of a qualified individual, the amount paid in cash for the taxable year by such individual to any family development account for such individual's benefit; and

'(B) in the case of any person other than a qualified individual, the amount paid in cash for the taxable year by such person to any family development account for the benefit of a qualified individual but only if the amount so paid is designated for purposes of this section by such individual.

No deduction shall be allowed under this paragraph for any amount deposited in a family development account under section 1400I (relating to demonstration program to provide matching amounts in renewal communities).

'(2) LIMITATION-

'(A) IN GENERAL- The amount allowable as a deduction to any individual for any taxable year by reason of paragraph (1)(A) shall not exceed the lesser of--

'(i) $2,000, or

'(ii) an amount equal to the compensation includible in the individual's gross income for such taxable year.

'(B) PERSONS DONATING TO FAMILY DEVELOPMENT ACCOUNTS OF OTHERS- The amount which may be designated under paragraph (1)(B) by any qualified individual for any taxable year of such individual shall not exceed $1,000.

'(3) SPECIAL RULES FOR CERTAIN MARRIED INDIVIDUALS- Rules similar to rules of section 219(c) shall apply to the limitation in paragraph (2)(A).

'(4) COORDINATION WITH IRA'S- No deduction shall be allowed under this section to any person by reason of a payment to an account for the benefit of a qualified individual if any amount is paid into an individual retirement account (including a Roth IRA) for the benefit of such individual.

'(5) ROLLOVERS- No deduction shall be allowed under this section with respect to any rollover contribution.

'(b) TAX TREATMENT OF DISTRIBUTIONS-

'(1) INCLUSION OF AMOUNTS IN GROSS INCOME- Except as otherwise provided in this subsection, any amount paid or distributed out of a family development account shall be included in gross income by the payee or distributee, as the case may be.

'(2) EXCLUSION OF QUALIFIED FAMILY DEVELOPMENT DISTRIBUTIONS- Paragraph (1) shall not apply to any qualified family development distribution.

'(c) QUALIFIED FAMILY DEVELOPMENT DISTRIBUTION- For purposes of this section--

'(1) IN GENERAL- The term 'qualified family development distribution' means any amount paid or distributed out of a family development account which would otherwise be includible in gross income, to the extent that such payment or distribution is used exclusively to pay qualified family development expenses for the holder of the account or the spouse or dependent (as defined in section 152) of such holder.

'(2) QUALIFIED FAMILY DEVELOPMENT EXPENSES- The term 'qualified family development expenses' means any of the following:

'(A) Qualified higher education expenses.

'(B) Qualified first-time homebuyer costs.

'(C) Qualified business capitalization costs.

'(D) Qualified medical expenses.

'(E) Qualified rollovers.

'(3) QUALIFIED HIGHER EDUCATION EXPENSES-

'(A) IN GENERAL- The term 'qualified higher education expenses' has the meaning given such term by section 72(t)(7), determined by treating postsecondary vocational educational schools as eligible educational institutions.

'(B) POSTSECONDARY VOCATIONAL EDUCATION SCHOOL- The term 'postsecondary vocational educational school' means an area vocational education school (as defined in subparagraph (C) or (D) of section 521(4) of the Carl D. Perkins Vocational and Applied Technology Education Act (20 U.S.C. 2471(4))) which is in any State (as defined in section 521(33) of such Act), as such sections are in effect on the date of the enactment of this section.

'(C) COORDINATION WITH OTHER BENEFITS- The amount of qualified higher education expenses for any taxable year shall be reduced as provided in section 25A(g)(2).

'(4) QUALIFIED FIRST-TIME HOMEBUYER COSTS- The term 'qualified first-time homebuyer costs' means qualified acquisition costs (as defined in section 72(t)(8) without regard to subparagraph (B) thereof) with respect to a principal residence (within the meaning of section 121) for a qualified first-time homebuyer (as defined in such section).

'(5) QUALIFIED BUSINESS CAPITALIZATION COSTS-

'(A) IN GENERAL- The term 'qualified business capitalization costs' means qualified expenditures for the capitalization of a qualified business pursuant to a qualified plan.

'(B) QUALIFIED EXPENDITURES- The term 'qualified expenditures' means expenditures included in a qualified plan, including capital, plant, equipment, working capital, and inventory expenses.

'(C) QUALIFIED BUSINESS- The term 'qualified business' means any business that does not contravene any law.

'(D) QUALIFIED PLAN- The term 'qualified plan' means a business plan which meets such requirements as the Secretary may specify.

'(6) QUALIFIED MEDICAL EXPENSES- The term 'qualified medical expenses' means any amount paid during the taxable year, not compensated for by insurance or otherwise, for medical care (as defined in section 213(d)) of the taxpayer, his spouse, or his dependent (as defined in section 152).

'(7) QUALIFIED ROLLOVERS- The term 'qualified rollover' means any amount paid from a family development account of a taxpayer into another such account established for the benefit of--

'(A) such taxpayer, or

'(B) any qualified individual who is--

'(i) the spouse of such taxpayer, or

'(ii) any dependent (as defined in section 152) of the taxpayer.

Rules similar to the rules of section 408(d)(3) shall apply for purposes of this paragraph.

'(d) TAX TREATMENT OF ACCOUNTS-

'(1) IN GENERAL- Any family development account is exempt from taxation under this subtitle unless such account has ceased to be a family development account by reason of paragraph (2). Notwithstanding the preceding sentence, any such account is subject to the taxes imposed by section 511 (relating to imposition of tax on unrelated business income of charitable, etc., organizations). Notwithstanding any other provision of this title (including chapters 11 and 12), the basis of any person in such an account is zero.

'(2) LOSS OF EXEMPTION IN CASE OF PROHIBITED TRANSACTIONS- For purposes of this section, rules similar to the rules of section 408(e) shall apply.

'(3) OTHER RULES TO APPLY- Rules similar to the rules of paragraphs (4), (5), and (6) of section 408(d) shall apply for purposes of this section.

'(e) FAMILY DEVELOPMENT ACCOUNT- For purposes of this title, the term 'family development account' means a trust created or organized in the United States for the exclusive benefit of a qualified individual or his beneficiaries, but only if the written governing instrument creating the trust meets the following requirements:

'(1) Except in the case of a qualified rollover (as defined in subsection (c)(7))--

'(A) no contribution will be accepted unless it is in cash; and

'(B) contributions will not be accepted for the taxable year in excess of $3,000 (determined without regard to any contribution made under section 1400I (relating to demonstration program to provide matching amounts in renewal communities)).

'(2) The requirements of paragraphs (2) through (6) of section 408(a) are met.

'(f) QUALIFIED INDIVIDUAL- For purposes of this section, the term 'qualified individual' means, for any taxable year, an individual--

'(1) who is a bona fide resident of a renewal community throughout the taxable year; and

'(2) to whom a credit was allowed under section 32 for the preceding taxable year.

'(g) OTHER DEFINITIONS AND SPECIAL RULES-

'(1) COMPENSATION- The term 'compensation' has the meaning given such term by section 219(f)(1).

'(2) MARRIED INDIVIDUALS- The maximum deduction under subsection (a) shall be computed separately for each individual, and this section shall be applied without regard to any community property laws.

'(3) TIME WHEN CONTRIBUTIONS DEEMED MADE- For purposes of this section, a taxpayer shall be deemed to have made a contribution to a family development account on the last day of the preceding taxable year if the contribution is made on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year (not including extensions thereof).

'(4) EMPLOYER PAYMENTS; CUSTODIAL ACCOUNTS- Rules similar to the rules of sections

219(f)(5) and 408(h) shall apply for purposes of this section.

'(5) REPORTS- The trustee of a family development account shall make such reports regarding such account to the Secretary and to the individual for whom the account is maintained with respect to contributions (and the years to which they relate), distributions, and such other matters as the Secretary may require under regulations. The reports required by this paragraph--

'(A) shall be filed at such time and in such manner as the Secretary prescribes in such regulations; and

'(B) shall be furnished to individuals--

'(i) not later than January 31 of the calendar year following the calendar year to which such reports relate; and

'(ii) in such manner as the Secretary prescribes in such regulations.

'(6) INVESTMENT IN COLLECTIBLES TREATED AS DISTRIBUTIONS- Rules similar to the rules of section 408(m) shall apply for purposes of this section.

'(h) PENALTY FOR DISTRIBUTIONS NOT USED FOR QUALIFIED FAMILY DEVELOPMENT EXPENSES-

'(1) IN GENERAL- If any amount is distributed from a family development account and is not used exclusively to pay qualified family development expenses for the holder of the account or the spouse or dependent (as defined in section 152) of such holder, the tax imposed by this chapter for the taxable year of such distribution shall be increased by the sum of--

'(A) 100 percent of the portion of such amount which is includible in gross income and is attributable to amounts contributed under section 1400I (relating to demonstration program to provide matching amounts in renewal communities); and

'(B) 10 percent of the portion of such amount which is includible in gross income and is not described in subparagraph (A).

For purposes of this subsection, distributions which are includable in gross income shall be treated as attributable to amounts contributed under section 1400I to the extent thereof. For purposes of the preceding sentence, all family development accounts of an individual shall be treated as one account.

'(2) EXCEPTION FOR CERTAIN DISTRIBUTIONS- Paragraph (1) shall not apply to distributions which are--

'(A) made on or after the date on which the account holder attains age 59 1/2 ,

'(B) made to a beneficiary (or the estate of the account holder) on or after the death of the account holder, or

'(C) attributable to the account holder's being disabled within the meaning of section 72(m)(7).

'(i) TERMINATION- No deduction shall be allowed under this section for any amount paid to a family development account for any taxable year beginning after December 31, 2007.

'SEC. 1400I. DEMONSTRATION PROGRAM TO PROVIDE MATCHING CONTRIBUTIONS TO FAMILY DEVELOPMENT ACCOUNTS IN CERTAIN RENEWAL COMMUNITIES.

'(a) Designation-

'(1) DEFINITIONS- For purposes of this section, the term 'FDA matching demonstration area' means any renewal community--

'(A) which is nominated under this section by each of the local governments and States which nominated such community for designation as a renewal community under section 1400E(a)(1)(A); and

'(B) which the Secretary of Housing and Urban Development designates as an FDA matching demonstration area after consultation with--

'(i) the Secretaries of Agriculture, Commerce, Labor, and the Treasury, the Director of the Office of Management and Budget, and the Administrator of the Small Business Administration; and

'(ii) in the case of a community on an Indian reservation, the Secretary of the Interior.

'(2) Number of designations-

'(A) IN GENERAL- The Secretary of Housing and Urban Development may designate not more than 5 communities as FDA matching demonstration areas.

'(B) MINIMUM DESIGNATION IN RURAL AREAS- Of the areas designated under subparagraph (A), at least 2 must be areas described in section 1400E(a)(2)(B).

'(3) Limitations on designations-

'(A) PUBLICATION OF REGULATIONS- The Secretary of Housing and Urban Development shall prescribe by regulation no later than 4 months after the date of the enactment of this section, after consultation with the officials described in paragraph (1)(B)--

'(i) the procedures for nominating a renewal community under paragraph (1)(A) (including procedures for coordinating such nomination with the nomination of an area for designation as a renewal community under section 1400E); and

'(ii) the manner in which nominated renewal communities will be evaluated for purposes of this section.

'(B) TIME LIMITATIONS- The Secretary of Housing and Urban Development may designate renewal communities as FDA matching demonstration areas only during the 24-month period beginning on the first day of the first month following the month in which the regulations described in subparagraph (A) are prescribed.

'(4) DESIGNATION BASED ON DEGREE OF POVERTY, ETC- The rules of section 1400E(a)(3) shall apply for purposes of designations of FDA matching demonstration areas under this section.

'(b) PERIOD FOR WHICH DESIGNATION IS IN EFFECT- Any designation of a renewal community as an FDA matching demonstration area shall remain in effect during the period beginning on the date of such designation and ending on the date on which such area ceases to be a renewal community.

'(c) MATCHING CONTRIBUTIONS TO FAMILY DEVELOPMENT ACCOUNTS-

'(1) IN GENERAL- Not less than once each taxable year, the Secretary shall deposit (to the extent provided in appropriation Acts) into a family development account of each qualified individual (as defined in section 1400H(f))--

'(A) who is a resident throughout the taxable year of an FDA matching demonstration area; and

'(B) who requests (in such form and manner as the Secretary prescribes) such deposit for the taxable year,

an amount equal to the sum of the amounts deposited into all of the family development accounts of such individual during such taxable year (determined without regard to any amount contributed under this section).

'(2) LIMITATIONS-

'(A) ANNUAL LIMIT- The Secretary shall not deposit more than $1000 under paragraph (1) with respect to any individual for any taxable year.

'(B) AGGREGATE LIMIT- The Secretary shall not deposit more than $2000 under paragraph (1) with respect to any individual for all taxable years.

'(3) EXCLUSION FROM INCOME- Except as provided in section 1400H, gross income shall not include any amount deposited into a family development account under paragraph (1).

'(d) NOTICE OF PROGRAM- The Secretary shall provide appropriate notice to residents of FDA matching demonstration areas of the availability of the benefits under this section.

'(e) TERMINATION- No amount may be deposited under this section for any taxable year beginning after December 31, 2007.

'SEC. 1400J. DESIGNATION OF EARNED INCOME TAX CREDIT PAYMENTS FOR DEPOSIT TO FAMILY DEVELOPMENT ACCOUNT.

'(a) IN GENERAL- With respect to the return of any qualified individual (as defined in section 1400H(f)) for the taxable year of the tax imposed by this chapter, such individual may designate that a specified portion (not less than $1) of any overpayment of tax for such taxable year which is attributable to the earned income tax credit shall be deposited by the Secretary into a family development account of such individual. The Secretary shall so deposit such portion designated under this subsection.

'(b) MANNER AND TIME OF DESIGNATION- A designation under subsection (a) may be made with respect to any taxable year--

'(1) at the time of filing the return of the tax imposed by this chapter for such taxable year, or

'(2) at any other time (after the time of filing the return of the tax imposed by this chapter for such taxable year) specified in regulations prescribed by the Secretary.

Such designation shall be made in such manner as the Secretary prescribes by regulations.

'(c) PORTION ATTRIBUTABLE TO EARNED INCOME TAX CREDIT- For purposes of subsection (a), an overpayment for any taxable year shall be treated as attributable to the earned income tax credit to the extent that such overpayment does not exceed the credit allowed to the taxpayer under section 32 for such taxable year.

'(d) OVERPAYMENTS TREATED AS REFUNDED- For purposes of this title, any portion of an overpayment of tax designated under subsection (a) shall be treated as being refunded to the taxpayer as of the last date prescribed for filing the return of tax imposed by this chapter (determined without regard to extensions) or, if later, the date the return is filed.

'(e) TERMINATION- This section shall not apply to any taxable year beginning after December 31, 2007.

'PART IV--ADDITIONAL INCENTIVES

'Sec. 1400K. Commercial revitalization credit.

'Sec. 1400L. Increase in expensing under section 179.

'SEC. 1400K. COMMERCIAL REVITALIZATION CREDIT.

'(a) GENERAL RULE- For purposes of section 46, except as provided in subsection (e), the commercial revitalization credit for any taxable year is an amount equal to the applicable percentage of the qualified revitalization expenditures with respect to any qualified revitalization building.

'(b) APPLICABLE PERCENTAGE- For purposes of this section--

'(1) IN GENERAL- The term 'applicable percentage' means--

'(A) 20 percent for the taxable year in which a qualified revitalization building is placed in service, or

'(B) at the election of the taxpayer, 5 percent for each taxable year in the credit period.

The election under subparagraph (B), once made, shall be irrevocable.

'(2) CREDIT PERIOD-

'(A) IN GENERAL- The term 'credit period' means, with respect to any building, the period of 10 taxable years beginning with the taxable year in which the building is placed in service.

'(B) APPLICABLE RULES- Rules similar to the rules under paragraphs (2) and (4) of section 42(f) shall apply.

'(c) QUALIFIED REVITALIZATION BUILDINGS AND EXPENDITURES- For purposes of this section--

'(1) QUALIFIED REVITALIZATION BUILDING- The term 'qualified revitalization building' means any building (and its structural components) if--

'(A) such building is located in a renewal community and is placed in service after December 31, 2000;

'(B) a commercial revitalization credit amount is allocated to the building under subsection (e); and

'(C) depreciation (or amortization in lieu of depreciation) is allowable with respect to the building.

'(2) QUALIFIED REVITALIZATION EXPENDITURE-

'(A) IN GENERAL- The term 'qualified revitalization expenditure' means any amount properly chargeable to capital account--

'(i) for property for which depreciation is allowable under section 168 and which is--

'(I) nonresidential real property; or

'(II) an addition or improvement to property described in subclause (I); and

'(ii) in connection with the construction of any qualified revitalization building which was not previously placed in service or in connection with the substantial rehabilitation (within the meaning of section 47(c)(1)(C)) of a building which was placed in service before the beginning of such rehabilitation.

'(B) DOLLAR LIMITATION- The aggregate amount which may be treated as qualified revitalization expenditures with respect to any qualified revitalization building for any taxable year shall not exceed the excess of--

'(i) $10,000,000, reduced by

'(ii) any such expenditures with respect to the building taken into account by the taxpayer or any predecessor in determining the amount of the credit under this section for all preceding taxable years.

'(C) CERTAIN EXPENDITURES NOT INCLUDED- The term 'qualified revitalization expenditure' does not include--

'(i) STRAIGHT LINE DEPRECIATION MUST BE USED- Any expenditure (other than with respect to land acquisitions) with respect to which the taxpayer does not use the straight line method over a recovery period determined under subsection (c) or (g) of section 168. The preceding sentence shall not apply to any expenditure to the extent the alternative depreciation system of section 168(g) applies to such expenditure by reason of subparagraph (B) or (C) of section 168(g)(1).

'(ii) ACQUISITION COSTS- The costs of acquiring any building or interest therein and any land in connection with such building to the extent that such costs exceed 30 percent of the qualified revitalization expenditures determined without regard to this clause.

'(iii) OTHER CREDITS- Any expenditure which the taxpayer may take into account in computing any other credit allowable under this title unless the taxpayer elects to take the expenditure into account only for purposes of this section.

'(d) WHEN EXPENDITURES TAKEN INTO ACCOUNT-

'(1) IN GENERAL- Qualified revitalization expenditures with respect to any qualified revitalization building shall be taken into account for the taxable year in which the qualified revitalization building is placed in service. For purposes of the preceding sentence, a substantial rehabilitation of a building shall be treated as a separate building.

'(2) PROGRESS EXPENDITURE PAYMENTS- Rules similar to the rules of subsections (b)(2) and (d) of section 47 shall apply for purposes of this section.

'(e) LIMITATION ON AGGREGATE CREDITS ALLOWABLE WITH RESPECT TO BUILDINGS LOCATED IN A STATE-

'(1) IN GENERAL- The amount of the credit determined under this section for any taxable year with respect to any building shall not exceed the commercial revitalization credit amount (in the case of an amount determined under subsection (b)(1)(B), the present value of such amount as determined under the rules of section 42(b)(2)(C)) allocated to such building under this subsection by the commercial revitalization credit agency. Such allocation shall be made at the same time and in the same manner as under paragraphs (1) and (7) of section 42(h).

'(2) COMMERCIAL REVITALIZATION CREDIT AMOUNT FOR AGENCIES-

'(A) IN GENERAL- The aggregate commercial revitalization credit amount which a commercial revitalization credit agency may allocate for any calendar year is the amount of the State commercial revitalization credit ceiling determined under this paragraph for such calendar year for such agency.

'(B) STATE COMMERCIAL REVITALIZATION CREDIT CEILING- The State commercial revitalization credit ceiling applicable to any State--

'(i) for each calendar year after 2000 and before 2008 is $2,000,000 for each renewal community in the State; and

'(ii) zero for each calendar year thereafter.

'(C) COMMERCIAL REVITALIZATION CREDIT AGENCY- For purposes of this section, the term 'commercial revitalization credit agency' means any agency authorized by a State to carry out this section.

'(f) RESPONSIBILITIES OF COMMERCIAL REVITALIZATION CREDIT AGENCIES-

'(1) PLANS FOR ALLOCATION- Notwithstanding any other provision of this section, the commercial revitalization credit amount with respect to any building shall be zero unless--

'(A) such amount was allocated pursuant to a qualified allocation plan of the commercial revitalization credit agency which is approved (in accordance with rules similar to the rules of section 147(f)(2) (other than subparagraph (B)(ii) thereof)) by the governmental unit of which such agency is a part; and

'(B) such agency notifies the chief executive officer (or its equivalent) of the local jurisdiction within which the building is located of such allocation and provides such individual a reasonable opportunity to comment on the allocation.

'(2) QUALIFIED ALLOCATION PLAN- For purposes of this subsection, the term 'qualified allocation plan' means any plan--

'(A) which sets forth selection criteria to be used to determine priorities of the commercial revitalization credit agency which are appropriate to local conditions;

'(B) which considers--

'(i) the degree to which a project contributes to the implementation of a strategic plan that is devised for a renewal community through a citizen participation process;

'(ii) the amount of any increase in permanent, full-time employment by reason of any project; and

'(iii) the active involvement of residents and nonprofit groups within the renewal community; and

'(C) which provides a procedure that the agency (or its agent) will follow in monitoring compliance with this section.

'(g) TERMINATION- This section shall not apply to any building placed in service after December 31, 2007.

'SEC. 1400L. INCREASE IN EXPENSING UNDER SECTION 179.

'(a) GENERAL RULE- In the case of a renewal community business (as defined in section 1400G), for purposes of section 179--

'(1) the limitation under section 179(b)(1) shall be increased by the lesser of--

'(A) $35,000; or

'(B) the cost of section 179 property which is qualified renewal property placed in service during the taxable year; and

'(2) the amount taken into account under section 179(b)(2) with respect to any section 179 property which is qualified renewal property shall be 50 percent of the cost thereof.

'(b) RECAPTURE- Rules similar to the rules under section 179(d)(10) shall apply with respect to any qualified renewal property which ceases to be used in a renewal community by a renewal community business.

'(c) QUALIFIED RENEWAL PROPERTY- For purposes of this section--

'(1) IN GENERAL- The term 'qualified renewal property' means any property to which section 168 applies (or would apply but for section 179) if--

'(A) such property was acquired by the taxpayer by purchase (as defined in section 179(d)(2)) after December 31, 2000, and before January 1, 2008; and

'(B) such property would be qualified zone property (as defined in section 1397C) if references to renewal communities were substituted for references to empowerment zones in section 1397C.

'(2) CERTAIN RULES TO APPLY- The rules of subsections (a)(2) and (b) of section 1397C shall apply for purposes of this section.'.

SEC. 102. EXTENSION OF EXPENSING OF ENVIRONMENTAL REMEDIATION COSTS TO RENEWAL COMMUNITIES.

(a) EXTENSION- Paragraph (2) of section 198(c) (defining targeted area) is amended by redesignating subparagraph (C) as subparagraph (D) and by inserting after subparagraph (B) the following new subparagraph:

'(C) RENEWAL COMMUNITIES INCLUDED- Except as provided in subparagraph (B), such term shall include a renewal community (as defined in section 1400E).'.

(b) EXTENSION OF TERMINATION DATE FOR RENEWAL COMMUNITIES- Subsection (h) of section 198 is amended by inserting before the period '(December 31, 2007, in the case of a renewal community, as defined in section 1400E).'.

SEC. 103. EXTENSION OF WORK OPPORTUNITY TAX CREDIT FOR RENEWAL COMMUNITIES.

(a) EXTENSION- Subsection (c) of section 51 (relating to termination) is amended by adding at the end the following new paragraph:

'(5) EXTENSION OF CREDIT FOR RENEWAL COMMUNITIES-

'(A) IN GENERAL- In the case of an individual who begins work for the employer after the date contained in paragraph (4)(B), for purposes of section 38--

'(i) in lieu of applying subsection (a), the amount of the work opportunity credit determined under this section for the taxable year shall be equal to--

'(I) 15 percent of the qualified first-year wages for such year; and

'(II) 30 percent of the qualified second-year wages for such year;

'(ii) subsection (b)(3) shall be applied by substituting '$10,000' for '$6,000';

'(iii) paragraph (4)(B) shall be applied by substituting for the date contained therein the last day for which the designation under section 1400E of the renewal community referred to in subparagraph (B)(i) is in effect; and

'(iv) rules similar to the rules of section 51A(b)(5)(C) shall apply.

'(B) QUALIFIED FIRST- AND SECOND-YEAR WAGES- For purposes of subparagraph (A)--

'(i) IN GENERAL- The term 'qualified wages' means, with respect to each 1-year period referred to in clause (ii) or (iii), as the case may be, the wages paid or incurred by the employer during the taxable year to any individual but only if--

'(I) the employer is engaged in a trade or business in a renewal community throughout such 1-year period;

'(II) the principal place of abode of such individual is in such renewal community throughout such 1-year period; and

'(III) substantially all of the services which such individual performs for the employer during such 1-year period are performed in such renewal community.

'(ii) QUALIFIED FIRST-YEAR WAGES- The term 'qualified first-year wages' means, with respect to any individual, qualified wages attributable to service rendered during the 1-year period beginning with the day the individual begins work for the employer.

'(iii) QUALIFIED SECOND-YEAR WAGES- The term 'qualified second-year wages' means, with respect to any individual, qualified wages attributable to service rendered during the 1-year period beginning on the day after the last day of the 1-year period with respect to such individual determined under clause (ii).'.

(b) CONGRUENT TREATMENT OF RENEWAL COMMUNITIES AND ENTERPRISE ZONES FOR PURPOSES OF YOUTH RESIDENCE REQUIREMENTS-

(1) HIGH-RISK YOUTH- Subparagraphs (A)(ii) and (B) of section 51(d)(5) are each amended by striking 'empowerment zone or enterprise community' and inserting

'empowerment zone, enterprise community, or renewal community'.

(2) QUALIFIED SUMMER YOUTH EMPLOYEE- Clause (iv) of section 51(d)(7)(A) is amended by striking 'empowerment zone or enterprise community' and inserting 'empowerment zone, enterprise community, or renewal community'.

(3) HEADINGS- Paragraphs (5)(B) and (7)(C) of section 51(d) are each amended by inserting 'OR COMMUNITY' in the heading after 'ZONE'.

SEC. 104. CONFORMING AND CLERICAL AMENDMENTS.

(a) DEDUCTION FOR CONTRIBUTIONS TO FAMILY DEVELOPMENT ACCOUNTS ALLOWABLE WHETHER OR NOT TAXPAYER ITEMIZES- Subsection (a) of section 62 (relating to adjusted gross income defined) is amended by inserting after paragraph (17) the following new paragraph:

'(18) FAMILY DEVELOPMENT ACCOUNTS- The deduction allowed by section 1400H(a)(1)(A).'.

(b) TAX ON EXCESS CONTRIBUTIONS-

(1) TAX IMPOSED- Subsection (a) of section 4973 is amended by striking 'or' at the end of paragraph (3), adding 'or' at the end of paragraph (4), and inserting after paragraph (4) the following new paragraph:

'(5) a family development account (within the meaning of section 1400H(e)),'.

(2) EXCESS CONTRIBUTIONS- Section 4973 is amended by adding at the end the following new subsection:

'(g) FAMILY DEVELOPMENT ACCOUNTS- For purposes of this section, in the case of a family development account, the term 'excess contributions' means the sum of--

'(1) the excess (if any) of--

'(A) the amount contributed for the taxable year to the account (other than a qualified rollover, as defined in section 1400H(c)(7), or a contribution under section 1400I), over

'(B) the amount allowable as a deduction under section 1400H for such contributions; and

'(2) the amount determined under this subsection for the preceding taxable year reduced by the sum of--

'(A) the distributions out of the account for the taxable year which were included in the gross income of the payee under section 1400H(b)(1);

'(B) the distributions out of the account for the taxable year to which rules similar to the rules of section 408(d)(5) apply by reason of section 1400H(d)(3); and

'(C) the excess (if any) of the maximum amount allowable as a deduction under section 1400H for the taxable year over the amount contributed to the account for the taxable year (other than a contribution under section 1400I).

For purposes of this subsection, any contribution which is distributed from the family development account in a distribution to which rules similar to the rules of section 408(d)(4) apply by reason of section 1400H(d)(3) shall be treated as an amount not contributed.'.

(c) TAX ON PROHIBITED TRANSACTIONS- Section 4975 is amended--

(1) by adding at the end of subsection (c) the following new paragraph:

'(6) SPECIAL RULE FOR FAMILY DEVELOPMENT ACCOUNTS- An individual for whose benefit a family development account is established and any contributor to such account shall be exempt from the tax imposed by this section with respect to any transaction concerning such account (which would otherwise be taxable under this section) if, with respect to such transaction, the account ceases to be a family development account by reason of the application of section 1400H(d)(2) to such account.'; and

(2) in subsection (e)(1), by striking 'or' at the end of subparagraph (E), by redesignating subparagraph (F) as subparagraph (G), and by inserting after subparagraph (E) the following new subparagraph:

'(F) a family development account described in section 1400H(e), or'.

(d) INFORMATION RELATING TO CERTAIN TRUSTS AND ANNUITY PLANS- Subsection (c) of section 6047 is amended--

(1) by inserting 'or section 1400H' after 'section 219'; and

(2) by inserting ', of any family development account described in section 1400H(e),', after 'section 408(a)'.

(e) INSPECTION OF APPLICATIONS FOR TAX EXEMPTION- Clause (i) of section 6104(a)(1)(B) is amended by inserting 'a family development account described in section 1400H(e),' after 'section 408(a),'.

(f) FAILURE TO PROVIDE REPORTS ON FAMILY DEVELOPMENT ACCOUNTS- Paragraph (2) of section 6693(a) is amended by striking 'and' at the end of subparagraph (C), by striking the period and inserting ', and' at the end of subparagraph (D), and by adding at the end the following new subparagraph:

'(E) section 1400H(g)(6) (relating to family development accounts).'.

(g) CONFORMING AMENDMENTS REGARDING COMMERCIAL REVITALIZATION CREDIT-

(1) Section 46 (relating to investment credit) is amended by striking 'and' at the end of paragraph (2), by striking the period at the end of paragraph (3) and inserting ', and', and by adding at the end the following new paragraph:

'(4) the commercial revitalization credit provided under section 1400K.'.

(2) Section 39(d) is amended by adding at the end the following new paragraph:

'(9) NO CARRYBACK OF SECTION 1400K CREDIT BEFORE DATE OF ENACTMENT- No portion of the unused business credit for any taxable year which is attributable to any commercial revitalization credit determined under section 1400K may be carried back to a taxable year ending before the date of the enactment of section 1400K.'.

(3) Subparagraph (B) of section 48(a)(2) is amended by inserting 'or commercial revitalization' after 'rehabilitation' each place it appears in the text and heading.

(4) Subparagraph (C) of section 49(a)(1) is amended by striking 'and' at the end of clause (ii), by striking the period at the end of clause (iii) and inserting ', and', and by adding at the end the following new clause:

> '(iv) the portion of the basis of any qualified revitalization building attributable to qualified revitalization expenditures.'.

(5) Paragraph (2) of section 50(a) is amended by inserting 'or 1400K(d)(2)' after 'section 47(d)' each place it appears.

(6) Subparagraph (A) of section 50(a)(2) is amended by inserting 'or qualified revitalization building (respectively)' after 'qualified rehabilitated building'.

(7) Subparagraph (B) of section 50(a)(2) is amended by adding at the end the following new sentence: 'A similar rule shall apply for purposes of section 1400K.'.

(8) Paragraph (2) of section 50(b) is amended by striking 'and' at the end of subparagraph (C), by striking the period at the end of subparagraph (D) and inserting '; and', and by adding at the end the following new subparagraph:

> '(E) a qualified revitalization building (as defined in section 1400K) to the extent of the portion of the basis which is attributable to qualified revitalization expenditures (as defined in section 1400K).'.

(9) The last sentence of section 50(b)(3) is amended to read as follows: 'If any qualified rehabilitated building or qualified revitalization building is used by the tax-exempt organization pursuant to a lease, this paragraph shall not apply for purposes of determining the amount of the rehabilitation credit or the commercial revitalization credit.'.

(10) Subparagraph (C) of section 50(b)(4) is amended--

> (A) by inserting 'or commercial revitalization' after 'rehabilitated' in the text and heading; and
>
> (B) by inserting 'or commercial revitalization' after 'rehabilitation'.

(11) Subparagraph (C) of section 469(i)(3) is amended--

(A) by inserting 'or section 1400K' after 'section 42'; and

(B) by striking 'CREDIT' in the heading and inserting 'AND COMMERCIAL REVITALIZATION CREDITS'.

(h) CLERICAL AMENDMENTS- The table of subchapters for chapter 1 is amended by adding at the end the following new item:

'Subchapter X. Renewal Communities.'.

SEC. 105. EVALUATION AND REPORTING REQUIREMENTS.

Not later than the close of the fourth calendar year after the year in which the Secretary of Housing and Urban Development first designates an area as a renewal community under section 1400E of the Internal Revenue

Code of 1986, and at the close of each fourth calendar year thereafter, such Secretary shall prepare and submit to the Congress a report on the effects of such designations in stimulating the creation of new jobs, particularly for disadvantaged workers and long-term unemployed individuals, and promoting the revitalization of economically distressed areas.

SEC. 106. EXCLUSION OF EFFECTS OF THIS ACT FROM PAYGO SCORECARD.

Upon the enactment of this Act, the Director of the Office of Management and Budget shall not make any estimates of changes in receipts under section 252(d) of the Balanced Budget and Emergency Deficit Control Act of 1985 resulting from the enactment of this Act.

TITLE II--ADDITIONAL PROVISIONS

SEC. 201. TRANSFER OF UNOCCUPIED AND SUBSTANDARD HUD-HELD HOUSING IN RENEWAL COMMUNITIES TO LOCAL GOVERNMENTS.

(a) TRANSFER REQUIREMENT- Pursuant to the authority under section 204 of the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1997, the Secretary shall transfer ownership of any qualified HUD property to the unit of general local government having jurisdiction for the area in which the property is located in accordance with this section, but only if the unit of general local government enters into an agreement with the Secretary meeting the requirements of subsection (d).

(b) QUALIFIED HUD PROPERTIES- For purposes of this section, the term 'qualified HUD property' means any unoccupied multifamily housing, project, substandard multifamily housing project, or unoccupied single family property, that is--

(1) owned by the Secretary; and

(2) located within a renewal community.

(c) TIMING OF TRANSFER- Any transfer of ownership required under subsection (a) shall be completed--

(1) with respect to any multifamily housing project or single family property that is acquired by the Secretary before the date on which the area in which property is located is designated as a renewal community and that is substandard or unoccupied (as applicable) upon such date, not later than 1 year after such date; and

(2) with respect to any multifamily housing project or single family property that is acquired by the Secretary on or after the date on which the area in which the property is located is designated as a renewal community, not later than 1 year after--

(A) the date on which the project is determined to be substandard or unoccupied (as applicable), in the case of a property that is not unoccupied or substandard upon acquisition by the Secretary; or

(B) the date on which the project is acquired by the Secretary, in the case of a property that is substandard or unoccupied (as applicable) upon such acquisition.

(d) AGREEMENTS TO SELL PROPERTY TO COMMUNITY DEVELOPMENT CORPORATIONS- An agreement described in this subsection is an agreement that requires a unit of general local government to dispose of the qualified HUD property acquired by the unit of general local government in accordance with the following requirements:

(1) NOTIFICATION TO COMMUNITY DEVELOPMENT CORPORATIONS- Not later than 30 days after the date on which the unit of general local government acquires title to the property under subsection (a), the unit of general local government shall notify each community development corporation located in the State in which the property is located--

(A) of such acquisition of title; and

(B) that, during the 6-month period beginning on the date on which such notification is made, such community development corporations shall have the exclusive right under this subsection to make bona fide offers to purchase the property on a cost recovery basis.

(2) RIGHT OF FIRST REFUSAL- During the 6-month period described in paragraph (1)(B)--

(A) the unit of general local government may not sell or offer to sell the qualified HUD property other than to a party notified under paragraph (1), unless each community development corporation required to be so notified has notified the unit of general local government

that the corporation will not make an offer to purchase the property; and

(B) the unit of general local government shall accept a bona fide offer to purchase the property made during such period if the offer is acceptable to the unit of general local government, except that a unit of general local government may not sell a property to a community development corporation during that 6-month period other than on a cost recovery basis.

(3) OTHER DISPOSITION- During the 6-month period beginning on the expiration of the 6-month period described in paragraph (1)(B), the unit of general local government shall dispose of the property on a negotiated, competitive bid, or other basis, on such terms as the unit of general local government deems appropriate.

(e) SATISFACTION OF INDEBTEDNESS- Before transferring ownership of any qualified HUD property pursuant to subsection (a), the Secretary shall satisfy any indebtedness incurred in connection with the property to be transferred, by--

(1) canceling the indebtedness; or

(2) reimbursing the unit of general local government to which the property is transferred for the amount of the indebtedness.

(f) DETERMINATION OF STATUS OF PROPERTIES- To ensure compliance with the requirements of subsection (c), the Secretary shall take the following actions:

(1) UPON DESIGNATION OF RENEWAL COMMUNITIES- Upon the designation of any renewal community, the Secretary shall promptly assess each residential property owned by the Secretary that is located within such renewal community to determine whether such property is a qualified HUD property.

(2) UPON ACQUISITION- Upon acquiring any residential property that is located with a renewal community, the Secretary shall promptly determine whether the property is a qualified HUD property.

(3) UPDATES- The Secretary shall periodically reassess the residential properties owned by the Secretary to determine whether any such properties have become qualified HUD properties.

(g) TENANT LEASES- This section shall not affect the terms or the enforceability of any contract or lease entered into with respect to any residential property before the date that such property becomes a qualified HUD property.

(h) PROCEDURES- Not later than the expiration of the 6-month period beginning on the date of the enactment of this Act, the Secretary shall establish, by rule, regulation, or order, such procedures as may be necessary to carry out this section.

(i) DEFINITIONS- For purposes of this section, the following definitions shall apply:

(1) COMMUNITY DEVELOPMENT CORPORATION- The term 'community development corporation' means a nonprofit organization whose primary purpose is to promote community development by providing housing opportunities for low-income families.

(2) COST RECOVERY BASIS- The term 'cost recovery basis' means, with respect to any sale of a residential property by a unit of general local government to a community development corporation under subsection (d)(2), that the purchase price paid by the community development corporation is less than or equal to the costs incurred by the unit of general local government in connection with such property during the period beginning on the date on which the unit of general local government acquires title to the property under subsection (a)

and ending on the date on which the sale is consummated.

(3) LOW-INCOME FAMILIES- The term 'low-income families' has the meaning given the term in section 3(b) of the United States Housing Act of 1937.

(4) MULTIFAMILY HOUSING PROJECT- The term 'multifamily housing project' has the meaning given the term in section 203 of the Housing and Community Development Amendments of 1978.

(5) RENEWAL COMMUNITY- The term 'renewal community' means an area designated (under subchapter X of chapter 1 of the Internal Revenue Code of 1986) as a renewal community.

(6) RESIDENTIAL PROPERTY- The term 'residential property' means a property that is a multifamily housing project or a single family property.

(7) SECRETARY- The term 'Secretary' means the Secretary of Housing and Urban Development.

(8) SEVERE PHYSICAL PROBLEMS- The term 'severe physical problems' means, with respect to a dwelling unit, that the unit--

(A) lacks hot or cold piped water, a flush toilet, or both a bathtub and a shower in the unit, for the exclusive use of that unit;

(B) on not less than 3 separate occasions during the preceding winter months, was uncomfortably cold for a period of more than 6 consecutive hours due to a malfunction of the heating system for the unit;

(C) has no functioning electrical service, exposed wiring, any room in which there is not a functioning electrical outlet, or has experienced 3 or more blown fuses or tripped circuit breakers during the preceding 90-day period;

(D) is accessible through a public hallway in which there are no working light fixtures,

loose or missing steps or railings, and no elevator; or

(E) has severe maintenance problems, including water leaks involving the roof, windows, doors, basement, or pipes or plumbing fixtures, holes or open cracks in walls or ceilings, severe paint peeling or broken plaster, and signs of rodent infestation.

(9) SINGLE FAMILY PROPERTY- The term 'single family property' means a 1- to 4-family residence.

(10) SUBSTANDARD- The term 'substandard' means, with respect to a multifamily housing project, that 25 percent or more of the dwelling units in the project have severe physical problems.

(11) UNIT OF GENERAL LOCAL GOVERNMENT- The term 'unit of general local government' has the meaning given the term in section 102(a) of the Housing and Community

Development Act of 1974.

(12) UNOCCUPIED- The term 'unoccupied' means, with respect to a residential property, that the unit of general local government having jurisdiction over the area in which the project is located has certified in writing that the property is not inhabited.

SEC. 202. PREVENTION AND TREATMENT OF SUBSTANCE ABUSE; SERVICES PROVIDED THROUGH RELIGIOUS ORGANIZATIONS.

Title V of the Public Health Service Act (42 U.S.C. 290aa et seq.) is amended by adding at the end the following part:

'Part G--Services Provided Through Religious Organizations

'SEC. 581. APPLICABILITY TO DESIGNATED PROGRAMS.

'(a) DESIGNATED PROGRAMS- Subject to subsection (b), this part applies to each program under this Act that makes awards of Federal financial assistance to public or private entities for the purpose of carrying out activities to prevent or treat substance abuse (in this part referred to as a 'designated program'). Designated programs include the program under subpart II of part B of title XIX (relating to formula grants to the States).

'(b) LIMITATION- This part does not apply to any award of Federal financial assistance under a designated program for a purpose other than the purpose specified in subsection (a).

'(c) DEFINITIONS- For purposes of this part (and subject to subsection (b)):

'(1) The term 'designated award recipient' means a public or private entity that has received an award under a designated program (whether the award is a designated direct award or a designated subaward).

'(2) The term 'designated direct award' means an award under a designated program that is received directly from the Federal Government.

'(3) The term 'designated subaward' means an award of financial assistance made by a non-Federal entity, which award consists in whole or in part of Federal financial assistance provided through an award under a designated program.

'(4) The term 'designated program' has the meaning given such term in subsection (a).

'(5) The term 'financial assistance' means a grant, cooperative agreement, contract, or voucherized assistance.

'(6) The term 'program beneficiary' means an individual who receives program services.

'(7) The term 'program participant' has the meaning given such term in section 582(a)(2).

'(8) The term 'program services' means treatment for substance abuse, or preventive services regarding such abuse, provided pursuant to an award under a designated program.

'(9) The term 'religious organization' means a nonprofit religious organization.

'(10) The term 'voucherized assistance' means--

'(A) a system of selecting and reimbursing program services in which--

'(i) the beneficiary is given a document or other authorization that may be used to pay for program services;

'(ii) the beneficiary chooses the organization that will provide services to him or her according to rules specified by the designated award recipient; and

'(iii) the organization selected by the beneficiary is reimbursed by the designated award recipient for program services provided; or

'(B) any other mode of financial assistance to pay for program services in which the program beneficiary determines the allocation of program funds through his or her selection of one service provider from among alternatives.

'SEC. 582. RELIGIOUS ORGANIZATIONS AS PROGRAM PARTICIPANTS.

'(a) IN GENERAL-

'(1) SCOPE OF AUTHORITY- Notwithstanding any other provision of law, a religious organization--

'(A) may be a designated award recipient;

'(B) may make designated subawards to other public or nonprofit private entities (including other religious organizations);

'(C) may provide for the provision of program services to program beneficiaries through the use of voucherized assistance; and

'(D) may be a provider of services under a designated program, including a provider that accepts voucherized assistance.

'(2) DEFINITION OF PROGRAM PARTICIPANT- For purposes of this part, the term 'program participant' means a public or private entity that has received a designated direct award, or a designated subaward, regardless of whether the entity provides program services. Such term includes an entity whose only participation in a designated program is to provide program services pursuant to the acceptance of voucherized assistance.

'(b) RELIGIOUS ORGANIZATIONS- The purpose of this section is to allow religious organizations to be program participants on the same basis as any other nonprofit private provider without impairing the religious character of such organizations, and without diminishing the religious freedom of program beneficiaries.

'(c) NONDISCRIMINATION AGAINST RELIGIOUS ORGANIZATIONS-

'(1) FINDINGS- The Congress finds that the establishment clause of the first amendment to the Constitution of the United States does not require that--

'(A) social-welfare programs discriminate against faith-based providers of services; or

'(B) faith-based providers of services, as a prerequisite to participation in Federal programs, abandon their religious character and censor their religious expression.

'(2) NONDISCRIMINATION- Religious organizations are eligible to be program participants on the same basis as any other nonprofit private organization. Neither the Federal Government nor a State receiving funds under such programs shall discriminate against an organization that is or applies to be a program participant on the basis that the organization has a religious character.

'(d) RELIGIOUS CHARACTER AND FREEDOM-

'(1) RELIGIOUS ORGANIZATIONS- Except as provided in this section, any religious organization that is a program participant shall retain its independence from Federal, State, and local government, including such organization's control over the definition, development, practice, and expression of its religious beliefs.

'(2) ADDITIONAL SAFEGUARDS- Neither the Federal Government nor a State shall require a religious organization to--

'(A) alter its form of internal governance; or

'(B) remove religious art, icons, scripture, or other symbols;

in order to be a program participant.

'(e) NONDISCRIMINATION IN EMPLOYMENT-

'(1) IN GENERAL- Except as provided in paragraph (2), nothing in this section shall be construed to modify or affect the provisions of any other Federal or State law or regulation that relates to discrimination in employment on the basis of religion.

'(2) EXCEPTION- A religious organization that is a program participant may require that an employee rendering programs services adhere to--

'(A) the religious beliefs and practices of such organization; and

'(B) any rules of the organization regarding the use of drugs or alcohol.

'(f) RIGHTS OF PROGRAM BENEFICIARIES- With respect to an individual who is a program beneficiary or a prospective program beneficiary, if the individual objects to a program participant on the basis that the participant is a religious organization, the following applies:

'(1) If the organization received a designated direct award, the organization shall arrange for the individual to receive program services through an alternative entity.

'(2) If the organization received a designated subaward, the non-Federal entity that made the subaward shall arrange for the individual to receive the program services through an alternative program participant.

'(3) If the organization is providing services pursuant to voucherized assistance, the designated award recipient that operates the voucherized assistance program shall arrange for the individual to receive the program services through an alternative provider.

'(4) Arrangements under any of paragraphs (1) through (3) with an alternative entity shall provide for program services the monetary value of which is not less than the monetary value of the program services that the individual would have received from the religious organization involved.

'(5) NONDISCRIMINATION-

'(A) IN GENERAL- Except as provided in subparagraph (B) or as otherwise provided in law, a religious organization that is a program participant shall not in providing program services discriminate against a program beneficiary on the basis of religion or religious belief.

'(B) LIMITATION- A religious organization that is a program participant may require a program beneficiary who has elected in accordance with paragraph (1) to receive program services from such organization--

'(i) to actively participate in religious practice, worship, and instruction; and

'(ii) to follow rules of behavior devised by the organizations that are religious in content or origin.

'(g) FISCAL ACCOUNTABILITY-

'(1) IN GENERAL- Except as provided in paragraph (2), any religious organization that is a program participant shall be subject to the same regulations as other recipients of awards of Federal financial assistance to account, in accordance with generally accepted auditing principles, for the use of the funds provided under such awards.

'(2) LIMITED AUDIT- With respect to the award involved, if a religious organization that is a program participant maintains the Federal funds in a separate account from non-Federal funds, then only the Federal funds shall be subject to audit.

'(h) COMPLIANCE- With respect to compliance with this section by an agency, a religious organization may obtain judicial review of agency action in accordance with chapter 7 of title 5, United States Code.

'SEC. 583. LIMITATIONS ON USE OF FUNDS FOR CERTAIN PURPOSES.

'(a) IN GENERAL- Except as provided in subsection (b), no funds provided directly to an entity under a designated program shall be expended for sectarian worship or instruction.

'(b) EXCEPTION- Subsection (a) shall not apply to assistance provided to or on behalf of a program beneficiary if the beneficiary may choose where such assistance is redeemed or allocated.

'SEC. 584. ADMINISTRATION OF PROGRAM AND TREATMENT OF FUNDS.

'(a) FUNDS NOT AID TO INSTITUTIONS- Financial assistance under a designated program provided to or on behalf of program beneficiaries is aid to the beneficiary, not to the organization providing program services. The receipt by a program beneficiary of program services at the facilities of the organization shall not constitute Federal financial assistance to the organization involved.

'(b) PROHIBITION ON STATE DISCRIMINATION IN USE OF FUNDS- No provision in any State constitution or State law shall be construed to prohibit the expenditure of Federal funds under a designated program in a religious facility or by a religious organization that is a program participant. If a State law or constitution would prevent the expenditure of State or local public funds in such a facility or by such an organization, then the State or local government shall segregate the Federal funds from State or other public funds for purposes of carrying out the designated program.

'SEC. 585. EDUCATIONAL REQUIREMENTS FOR PERSONNEL IN DRUG TREATMENT PROGRAMS.

'(a) FINDINGS- The Congress finds that--

'(1) establishing formal educational qualification for counselors and other personnel in drug treatment programs may undermine the effectiveness of such programs; and

'(2) such formal educational requirements for counselors and other personnel may hinder or prevent the provision of needed drug treatment services.

'(b) LIMITATION ON EDUCATIONAL REQUIREMENTS OF PERSONNEL-

'(1) TREATMENT OF RELIGIOUS EDUCATION- If any State or local government that is a program participant imposes formal educational qualifications on providers of program services, including religious organizations,

such State or local government shall treat religious education and training of personnel as having a critical and positive role in the delivery of program services. In applying educational qualifications for personnel in religious organizations, such State or local government shall give credit for religious education and training equivalent to credit given for secular course work in drug treatment or any other secular subject that is of similar grade level and duration.

'(2) RESTRICTION OF DISCRIMINATION REQUIREMENTS-

'(A) IN GENERAL- Subject to paragraph (1), a State or local government that is a program participant may establish formal educational qualifications for personnel in organizations providing program services that contribute to success in reducing drug use among program beneficiaries.

'(B) EXCEPTION- The Secretary shall waive the application of any educational qualification imposed under subparagraph (A) for an individual religious organization, if the Secretary determines that--

'(i) the religious organization has a record of prior successful drug treatment for at least the preceding three years;

'(ii) the educational qualifications have effectively barred such religious organization from becoming a program provider;

'(iii) the organization has applied to the Secretary to waive the qualifications; and

'(iv) the State or local government has failed to demonstrate empirically that the educational qualifications in question are necessary to the successful operation of a drug treatment program.'.

SEC. 203. CRA CREDIT FOR INVESTMENTS IN COMMUNITY DEVELOPMENT ORGANIZATIONS LOCATED IN RENEWAL COMMUNITIES.

Section 804 of the Community Reinvestment Act of 1977 (12 U.S.C. 2903) is amended by adding at the end the following new subsection:

'(c) INVESTMENTS IN CERTAIN COMMUNITY DEVELOPMENT ORGANIZATIONS- In assessing and taking into account, under subsection (a), the record of a regulated financial institution, the appropriate Federal financial supervisory agency may consider, as a factor, investments of the institution in, and capital investment, loan participation, and other ventures undertaken by the institution in cooperation with, any community development organization (as defined in section 234 of the Bank Enterprise Act of 1991) which is located in a renewal community (as designated under section 1400E of the Internal Revenue Code of 1986).'.

END

TALENT-WATT BILL - Leg Strategy 5/7/99

BRODERICK

Floyd was very involved last year

- other democrats that didn't realize there were vouchers
  cuz they became more aware of vouchers they dropped off
- charitable choices was in old ad amount

Bingel likes bill

vouchers gone

Ben Sweeney

areas of community - focus on distressed area
lower criteria
capital incentives that have been suggested Brownsfield, expansion, small business, welfare to work tax credit
consistent w/ our position
would be favored: already in our budget - not major differences / drafting issues more than policy

- Family Development Accounts - Lieberman has a similar bill
  heavy lift to get support
  aspects that are consistent some inconsistent
  not like welfare reform

partial refund - administratively impossible to do
new Lieberman bills have been favored

- Commercial Revitalization tax credit - don't like
- Zero capital gains - Secretary does not like
  97 revitalization act - no data yet

Targeting - picking communities / designating

began using Empowerment Zone language - merging w/ zone to get tax place

the old Kemp Enterprise Zones - added WOTC, IDAs

2 core issues
capital gains
revitalization credit

resource debate - new mkts vs. EZs / ECs

PAGO Exemption, how they are paying for it
does not pay out of CDBG$ funds

1st Round no reduction of cost of capital but cost of capital
our approach now is dealing with cost of capital more

Kemp Article cost of capital vs cost of labor

capital gains at back end - so it doesn't make sense

CRTC - difficult to monitor commercial building than through a residential

Competitions - $s going into projects

Transfer of HUD Held owned prop

Putting People First - s

Targeting
strategy to confuse
→ narrow focus
guidance to New Markets Initiative
let private sector & pick neighborhoods
untapped markets = new markets
allow private sector
$ doesn't go not focus
concentrate $s
open to look at other possibilities
unemployment - but pick a limited #
ratchet to a certain threshold
~~[illegible]~~ unemployment would be used
his criteria are additive - leaves you with narrow

rural is included - real need
access to capital
better mechanisms to provide $ capital

their argument Empowerment Zones - did not have enough tax incentives
- wrong mix of taxes, underutilized

ideological issue to get interest
opening for capital gains tax
urban strategy using capital gains

back end gains don't make sense for these communities
strategy of getting people out

Bill Dodson - or Chuck | capital gains

Commercial Revitalization Tax Credit
- an analysis done ... Brea or Weinstein
- Commentator have said this work

- our staff is putting this up - allows for investments into deals
project based / rehab

abandoned buildings what we are offering is more efficient
you could do this

Business
Expensing is big draw in zone already
lesser of 35

Cardfort / Background - largely abolished
last year whole vouchers

Work Opportunity Tax Credit - philosophical no problem

how does ~~this~~ this compare in the tax credit ...

Talent · Watt

Julian Potter
HUD

Housing Policy meeting

redundant / duplicative of SZ
tax issues on housing - capital gains

community development / economic development
savings - homeownership / etc. . .
liveability, etc. . .

Nic Retsinas,
Bruce Katz, Michael
Stegman

Bruce Katz

Smart Growth / Liveability
DeCentralizing trends in cities
Metropolitan Areas - midwest cities only growth has been a figure
*governors & regional gov municipalities have lost middle class
changing rules of game

wealth creating, infrastructure subsidies will be targeted
to built / existing communities

on a federal it may mean new investments
tax credit expenditure changes
premise is existing programs are exacerbating problems

Nic Retsinas

Joint Center Report
what happens when prosperity ends
how do we preserve existing / successful affordable stock
homeownership - no equivalent for rental housing in
capital markets

How is gov't going to be realistic in trends

Pressures on rental housing
governmental empowered entity to start addressing this issue
REITS - an umbrella over REITS linked HFAs and non-profits

5/5/99

Homeownership Tax Credit

limited tax credit program

Treasury feedback - FU, senator has tried drafts

Treasury working w/ Greater Washington Research Center -

Bullet Bill for DC

series of proposals put forward, placed based strategy

could go through EZ/ECs - tax credits focused on areas

Michael Stegman

Robert Weaver - trends started after war

not possible

Leverability - gain leverability for.

You'll get original

LG

Thanks, Talent-Watts ASAP

GS 5/13/99

DRAFT MEMORANDUM TO GENE SPERLING

DATE: May 11, 1999

FROM: LISA GREEN

SUBJECT: THE AMERICAN COMMUNITY RENEWAL ACT OF 1999 (H.R. 815) (The Talent-Watts Bill)

The purpose of this memorandum is to provide an analysis of the Talent-Watts bill referenced above, as it compares to the New Markets Initiative (NMI) and existing community development programs.

Summary of Bill

The American Community Renewal Act would provide for up to 100 renewal communities designated through a competitive process similar to that of the current Empowerment Zone and Enterprise Community (EZ/EC) Programs. Renewal Communities would be eligible for numerous tax incentives including zero percent capital gains, commercial revitalization tax credits, expensing for small businesses and Brownfields, expansion of the work opportunity tax credit, and family development accounts.

Background and History

The current bill has evolved from several earlier proposals to create a Renewal Community Program. Earlier versions include public school vouchers, which made the bill unacceptable to several Democrats, such as former Congressman Floyd Flake, who had expressed an initial interest. The bill outlines some of the same types of programs promoted by then HUD Secretary Jack Kemp's in his proposal for Enterprise Zones. The bill was previously introduced as HR3685 under the same name.

Overall Conclusions

Based on my review of the bill, a meeting with a subset of the New Markets Initiative inter-agency working group (see list attached), and analyses completed by HUD and Treasury, I have reached the following conclusions.

Capital Gains Opening: The Talent-Watts bill is principally a Republican attempt to create an opening for a capital gains tax through a program that addresses ideological and social issues that are of concern to Democrats. **The main objection raised by several agencies to this bill is the zero percent capital gains** provision for the sale of certain business property and assets held for ~~more than 5 years~~. Eligibility includes a requirement that 35% of employees reside in the Renewal Community.

Because it is a back-end solution, a zero percent capital gains tax is not a logical incentive for investment in distressed economic communities. Potential investors in these areas may not be motivated by a benefit that comes only upon the sale of an investment in an area where they are unlikely to experience appreciation in property values. There is a much greater need for upfront and ongoing incentives to draw investment into such communities. This type of tax incentive could have the perverse and presumably unintended consequence of encouraging more disinvestment in distressed areas as owners might flip businesses and properties to receive this tax benefit. Treasury has raised additional, well-founded concerns about a capital gains tax for investment in distressed communities, as outlined in the attached May 5 draft memorandum from Michael Barr.

Incentives for Capital Investment versus Labor Investments: With the exception of the zero capital gains provision, this bill, places more emphasis on investment in labor rather than capital investments. The NMI was designed to encourage capital investment ~~in distressed communities~~, through loan guarantees and tax credits. H.R. 815 provides tax benefits for businesses to locate and operate in distressed areas and to hire individuals living there. The bill also includes provisions to encourage savings by residents of these areas.

Lisa G. I need your ideas on what we could live with not just what is consistent w/ new markets. I imagine more SB expensing + work opp tax credit could be O.K. what else? GS 5/13/99

Just write from you to me -- don't include

Considerations Related to Specific Provisions

Potentially Acceptable Provisions: Some specific provisions of the bill would be acceptable to various agencies if incorporated into the NMI. These provisions include:

- Use of poverty and unemployment rates to target funding, and
- Expansion of the work opportunity tax credit for certain targeted groups

Duplicative Provisions: There are several areas of the bill considered to be duplicative of existing programs or other legislative proposals.

- Designation of distressed communities that would receive special tax treatment coordinated assistance from the local government and the private sector, is an almost **identical concept to the EZ/EC initiative**.
- Some aspects of the **Family Development Account (FDA)** proposal mirror the Administration's Individual Development Account proposal; however the approach proposed by Senator Coats is preferable to that outlined in H.R. 815. In addition, the FDA proposal outlined in this bill would involve a matching program administered by HUD, requiring resources that HUD does not have at this time.
- Expensing for small business and Brownfields was provided for in the Taxpayer Relief Act of 1997.

Areas of Concern and Potentially Unacceptable Provisions: Specific agencies have raised concerns about several issues. These issues are not of equal concern to all agencies.

- **Funding for the program under PAYGO provisions.** Earlier versions of the Act proposed funding of the program using existing budget authority for CDBG. This proposal was unacceptable to community development interest groups and many Democrats and has since been eliminated. However, the current proposal to fund the program out of the surplus is considered an unreasonable solution by Treasury, particularly given unresolved issues around Social Security.
- **Inclusion of a commercial revitalization tax credit for projects located in Renewal Communities.** Project based tax credits have been used successfully for low-income housing where State Housing Agencies have been able to monitor and administer the program. However it would be very difficult for Treasury to monitor credits for commercial ~~properties~~, as there are no similar state or local entities equipped to ~~provide oversight~~. Treasury has also raised a concern that a commercial revitalization credit could result in negative effective tax rates and cause investors to make purely tax-motivated decisions in order to shelter other income from higher taxes.
- **Requirement for the transfer of any HUD-owned property to the local government.** Both HUD and OMB raised serious objections to this provision which requires HUD to transfer to the local government any substandard multifamily property, or any vacant single family property that is located in a Renewal Community. HUD's position is well outlined in the attached comments from David Kaas.
- **Proposal for charitable choices that allow religious organizations to be treated in the same manner as other non-profit organizations.**

General Comparison with the New Markets Initiative and the Empowerment Zone and Enterprise Community Programs

A detailed comparison of the bill's provisions and requirements to those of the NMI and to the Community Empowerment Program can be found in the attached chart. The following are general observations.

Criteria for Targeting: The criteria for selection as a Renewal Community:

- Is more restrictive than requirements for NMI and less restrictive than those for EZ/ECs;
- Utilizes a place based approach, similar to both NMI and EZ/ECs;
- Incorporates unemployment rates into the selection criteria which is not part of the targeting for NMI or EZ/ECs; and
- Allows for overlap between designations as a Renewal Community and an EZ/EC, which may be confusing for taxpayers.

The logic behind NMI was that targeting should be relatively broad (approximately 40% of the country is eligible) giving investors more choice and flexibility in determining where to place their funds, thereby making the program more attractive to the private sector. This issue has been argued both ways --- there is also benefit to more narrow criteria, which assures that funds reach the most distressed areas. The EZ/EC uses a more targeted approach for this reason.

Expensing Provisions: The bill includes expensing provisions for certain qualified Renewal Community Businesses as well as for Brownfields expensing. Expensing is already available for small businesses; however this Act would increase the phase-out range. In addition it would provide an additional $35,000 per year of expensing for depreciable property. The proposed bill would also extend the period for Brownfields expensing that is currently available.

The Work Opportunity Tax Credit: H.R. 815 would expand the existing law to include Renewal Community residents who work in Renewal Community businesses. The bill would also provide a different tax credit rate and maximum on wages, resulting in a more generous credit for the new target group in the second year of employment. Renewal Community youth, even those who work outside of community would be eligible for the same treatment available to youth under the EZ program which requires that substantially all of the employees' services be provided in the EZ.

Final Considerations

In our meetings with the New Markets working group and legislative subset of the working group, Talent-Watt has never been raised as an alternative proposal to NMI. Although most of the members of the group are familiar with the proposal, they consider this bill to be completely unacceptable, if only because of the zero capital gains tax provision. There is some interest in the Watts-Talent bill from industry groups. It is included on the proposed agenda for a policy workshop in June sponsored in part by the National Congress for Community Economic Development (Roy Priest) and American Association of Enterprise Zones

As outlined in this memorandum there are a few provisions that could, if necessary, be incorporated into our NMI proposal. However, the central provisions of the Talent-Watts Bill --- zero capital gains and incentives for business to locate in distressed areas --- are inconsistent with the thinking behind NMI. As you know the impetus for the NMI was to address inefficiencies in the capital markets. The Talent-Watts bill does not directly address this fundamental issue.

List current sponsors

DRAFT MEMORANDUM TO GENE SPERLING

DATE: May 11, 1999

FROM: LISA GREEN

SUBJECT: THE AMERICAN COMMUNITY RENEWAL ACT OF 1999 (H.R. 815)
(The Talent-Watt Bill)

The purpose of this memorandum is to provide an analysis of the Talent-Watt bill referenced above, as it compares to the New Markets Initiative (NMI) and existing community development programs.

Summary of Bill
The American Community Renewal Act would provide for up to 100 renewal communities designated through a competitive process similar to that of the current Empowerment Zone and Enterprise Community (EZ/EC) Programs. Renewal Communities would be eligible for numerous tax incentives including zero percent capital gains, commercial revitalization tax credits, expensing for small businesses and Brownfields, expansion of the work opportunity tax credit, and family development accounts.

Background and History
The current bill has evolved from several earlier proposals to create a Renewal Community Program. Earlier versions include public school vouchers, which made the bill unacceptable to several Democrats, such as former Congressman Floyd Flake, who had expressed an initial interest. The bill outlines some of the same types of programs promoted by then HUD Secretary Jack Kemp's in his proposal for Enterprise Zones. The bill was previously introduced as HR3685 under the same name.

Overall Conclusions
Based on my review of the bill, a meeting with a subset of the New Markets Initiative inter-agency working group (see list attached), and analyses completed by HUD and Treasury, I have reached the following conclusions.

Capital Gains Opening: The Talent-Watt bill is principally a Republican attempt to create an opening for a capital gains tax through a program that addresses ideological and social issues that are of concern to Democrats. **The main objection raised by several agencies to this bill is the zero percent capital gains** provision for the sale of certain business property and assets held for more than 5 years. Eligibility includes a requirement that 35% of employees reside in the Renewal Community.

Because it is a back-end solution, a zero percent capital gains tax is not a logical incentive for investment in distressed economic communities. Potential investors in these areas may not be motivated by a benefit that comes only upon the sale of an investment in an area where they are unlikely to experience appreciation in property values. There is a much greater need for upfront and ongoing incentives to draw investment into such communities. This type of tax incentive could have the perverse and presumably unintended consequence of encouraging more disinvestment in distressed areas as owners might flip businesses and properties to receive this tax benefit. Treasury has raised additional, well-founded concerns about a capital gains tax for investment in distressed communities, as outlined in the attached May 5 draft memorandum from Michael Barr.

Incentives for Capital Investment versus Labor Investments: With the exception of the zero capital gains provision, this bill, places more emphasis on investment in labor rather than capital investments. The NMI was designed to encourage capital investment in distressed communities, through loan guarantees and tax credits. H.R. 815 provides tax benefits for businesses to locate and operate in distressed areas and to hire individuals living there. The bill also includes provisions to encourage savings by residents of these areas.

Considerations Related to Specific Provisions

Potentially Acceptable Provisions: Some specific provisions of the bill ~~would~~ might be acceptable to various agencies if incorporated into the NMI. These provisions include:

- Use of poverty and unemployment rates to target funding, and
- Expansion of the work opportunity tax credit for certain targeted groups

Duplicative Provisions: There are several areas of the bill considered to be duplicative of existing programs or other legislative proposals. b/c

But criteria less targeted ↓ some overlap end up w/ 150 zones 50 w/ both designations

- Designation of distressed communities that would receive special tax treatment coordinated assistance from the local government and the private sector, is an almost **identical concept to the EZ/EC initiative.** to Treasury no products direct subsidy versus tax subsidy
- Some aspects of the **Family Development Account (FDA)** proposal mirror the Administration's Individual Development Account proposal; however the approach proposed by Senator Coats is preferable to that outlined in H.R. 815. In addition, the FDA proposal outlined in this bill would involve a matching program administered by HUD, requiring resources that HUD does not have at this time.
- Expensing for small business and Brownfields was provided for in the Taxpayer Relief Act of 1997. which this … support, Treasury argues direct subsidy better b/c

Areas of Concern and Potentially Unacceptable Provisions: Specific agencies have raised concerns about several issues. These issues are not of equal concern to all agencies.

not so bad if paid for paying it back

Not fair

- **Funding for the program under PAYGO provisions.** Earlier versions of the Act proposed funding of the program using existing budget authority for CDBG. This proposal was unacceptable to community development interest groups and many Democrats and has since been eliminated. However, the current proposal ~~to~~ fund the program out of the surplus is considered an unreasonable solution by Treasury, particularly given unresolved issues around Social Security. which explicitly
- **Inclusion of a commercial revitalization tax credit for projects located in Renewal Communities.** Project based tax credits have been used successfully for low-income housing where State Housing Agencies have been able to monitor and administer the program. However it would be very difficult for Treasury to monitor credits for commercial properties, as there are no similar state or local entities equipped to provide oversight. Treasury has also raised a concern that a commercial revitalization credit could result in negative effective tax rates and cause investors to make purely tax-motivated decisions in order to shelter other income from higher taxes.
- **Requirement for the transfer of any HUD-owned property to the local government.** Both HUD and OMB raised serious objections to this provision which requires HUD to transfer to the local government any substandard multifamily property, or any vacant single family property that is located in a Renewal Community. HUD's position is well outlined in the attached comments from David Kaas. SF = may lose MF = builders would have a problem

OMB likes it re MF

- **Proposal for charitable choices that allow religious organizations to be treated in the same manner as other non-profit organizations.** that is not related to CD

General Comparison with the New Markets Initiative and the Empowerment Zone and Enterprise Community Programs

A detailed comparison of the bill's provisions and requirements to those of the NMI and to the Community Empowerment Program can be found in the attached chart. The following are general observations.

put EoS in

Criteria for Targeting: The criteria for selection as a Renewal Community:

- Is more restrictive than requirements for NMI and less restrictive than those for EZ/ECs;
- Utilizes a place based approach, similar to both NMI and EZ/ECs;
- Incorporates unemployment rates into the selection criteria which is not part of the targeting for NMI or EZ/ECs; and
- Allows for overlap between designations as a Renewal Community and an EZ/EC, which may be confusing for taxpayers.

approach to cuty cost of program

The logic behind NMI was that targeting should be relatively broad (approximately 40% of the country is eligible) giving investors more choice and flexibility in determining where to place their funds, thereby making the program more attractive to the private sector. This issue has been argued both ways --- there is also benefit to more narrow criteria, which assures that funds reach the most distressed areas. The EZ/EC uses a more targeted approach for this reason.

real issue — important + provide these sorts of standards ~~vs~~ broad targeted program

Expensing Provisions: The bill includes expensing provisions for certain qualified Renewal Community Businesses as well as for Brownfields expensing. Expensing is already available for small businesses; however this Act would increase the phase-out range. In addition it would provide an additional $35,000 per year of expensing for depreciable property. The proposed bill would also extend the period for Brownfields expensing that is currently available.

explain what that is

The Work Opportunity Tax Credit: H.R. 815 would expand the existing law to include Renewal Community residents who work in Renewal Community businesses. The bill would also provide a different tax credit rate and maximum on wages, resulting in a more generous credit for the new target group in the second year of employment. Renewal Community youth, even those who work outside of community would be eligible for the same treatment available to youth under the EZ program which requires that substantially all of the employees' services be provided in the EZ.

Final Considerations

In our meetings with the New Markets working group and legislative subset of the working group, Talent-Watt has never been raised as an alternative proposal to NMI. Although most of the members of the group are familiar with the proposal, they consider this bill to be completely unacceptable, if only because of the zero capital gains tax provision.

As outlined in this memorandum there are a few provisions that could, if necessary, be incorporated into our NMI proposal. However, the central provisions of the Talent-Watt Bill --- zero capital gains and incentives for business to locate in distressed areas --- are inconsistent with the thinking behind NMI. As you know the impetus for the NMI was to address inefficiencies in the capital markets. The Talent-Watt bill does not directly address this fundamental issue. not so definitive

why is this

Wouldn't be so definitive — let them reach own conclusions — ~~to~~ direct him and give recs but he jumps on you if too much certainty

LIST OF THOSE ATTENDING MAY 7 MEETING TO DISCUSS THE TALENT – WATT BILL

Lisa Green, NEC
Carl Haacke, NEC
Sarah Rosen-Wartell, NEC

Michael Barr, Treasury
Xavier Briggs, HUD — Steve Redburn
~~Ed Brigham~~, OMB
Broderick Johnson, EOP/Legislative Affairs (by phone)
David Kass, HUD
Phyliss Love, Community Empowerment Board
Julienn Potter, Community Empowerment Board
Paul Weinstein, DPC

Sarah Rosen Wartell
05/07/99 08:17:57 AM

Record Type: Record

To: Melissa G. Green/OPD/EOP@EOP, Lisa Green/OPD/EOP@EOP

cc: Jonathan A. Kaplan/OPD/EOP@EOP, WEINSTEIN_P@A1@CD@VAXGTWY@VAXGTWY, Michael Deich/OMB/EOP@EOP, Lisa Green/OPD/EOP@EOP

Subject: American Community Renewal Act (HR 815)

Treasury has provided a preliminary draft of a summary/analysis of the tax provisions of the bill. I am not that familiar with EZs, so I hope we can get Weinstein and Deich to take a look at this and give us some guidance. (Copy en route.) The Treasury analysis is pretty damning of each piece, but if we are looking to find common ground between this approach and our new markets approach in order to make political progress, there seem to be some pieces that might be worth exploring.

Targeting/Selection: The hardest nut to crack is that HR 815 proposes that another 100 communities (50 of which are EZs or ECs) be selected and designated to be eligible for the tax treatment. Our approach was to have relatively broad criteria for New Markets (40% of country) and let the market and public spirited CD investment entities decide where in those areas the investment would go. You could imagine a tiered program (where there is the broader targeting AND some number of more targeted areas that get greater benefits (i.e., EZs and ECs)) but it will be expensive.

Capital Gains Tax Credit: Treasury's analysis suggests that we'd have a very hard time swallowing anything here.

Commercial Revitalization Tax Credit: This is an allocated tax credit that goes to the specific project rather than to investment intermediaries. It is targeted to building investment rather than other forms of equity. But there are areas of commonality and we might be able to talk to them about this.

Additional Expensing: Treasury is less negative about compliance aspects of this credit but argues it won't great new jobs for residents of the community.

Extension of Work Opportunity Tax Credit: more generous than extisting tax credit for renewal area residents working in renewal area businesses. Treasury worries about gaming -- using regular credit year one, renewal community year two -- but it doesn't sound like we couldn't do something if we wanted or needed to.

Family Development Accounts: IDAs on the tax side. We like IDAs. Treasury prefers direct subsidy, but sound like we could consider.

Real question is how much of this rhetoric and policy we need to incorporate in order to move forward.

2012-0043-S
DETERMINED TO BE AN
ADMINISTRATIVE MARKING
INITIALS: MA DATE: 12-9-11

DRAFT

CONFIDENTIAL

THE AMERICAN COMMUNITY RENEWAL ACT

I. Summary of the Bill

CONFIDENTIAL

The American Community Renewal Act would provide for up to 100 renewal communities designated through a competitive process similar to that of the current Empowerment Zone and Enterprise Community (EZ/EC) Programs. Renewal Communities would be eligible for numerous tax incentives including zero percent capital gains, commercial revitalization tax credits, expensing for small businesses and Brownfields, expansion of the work opportunity tax credit, and family development accounts. Efforts to create a renewal community program have been underway for several years, and the current bill has evolved from several earlier proposals.

The American Renewal Act contains certain provisions that could not be incorporated into the New Markets Initiative without substantially changing the intent and substance of our proposal for a New Markets Initiative. However, there are a number of other provisions that would be acceptable and could be incorporated into our proposal with little difficult, as outlined herein.

II. Comparison of the American Renewal Act to the New Markets Initiative and the Empowerment Zone and Enterprise Community Programs

Capital Gains Opening: One of the major differences between the President's proposal and the Talent-Watts proposal is that their proposal includes a provision for a Zero Capital Gains. The American Community Renewal Act is principally an attempt to create an opening for a capital gains tax through a program that would attempt to improve conditions in economically distressed communities. Objections and concerns raised about this bill include the zero percent capital gains provision for the sale of certain business property and assets held for more than 5 years. Eligibility includes a requirement that 35% of employees reside in the Renewal Community.

Because it is a back-end solution, a zero percent capital gains tax is not a logical incentive for investment in distressed economic communities. Potential investors in these areas may not be motivated by a benefit that comes only upon the sale of an investment in an area where investors are unlikely to experience appreciation in property values. There is a much greater need in poor communities for upfront and ongoing incentives to draw investment into such communities.

A zero capital gains for distressed communities could have the perverse and presumably unintended consequence of encouraging more disinvestment in distressed areas as owners might flip businesses and properties to receive this tax benefit. Additional and well-founded concerns about a capital gains tax for investment in distressed communities include:

- **Unintended Windfalls:** Certain business with property in the renewal community could earn large one-time "windfall" profits --- for example, from the sale of property near a site chosen for a large public attractions such as a sports arena – without making any new investments related to job growth or spurring the local economy.

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DRAFT

- **Negative Tax Incentives:** The ability of taxpayers to deduct interest on borrowing while entirely excluding the gains from the sale of some property, can create negative tax rates like those associated with the tax shelters of the 1970s and 1980s. For example, ignoring depreciation, a taxpayer in the top tax bracket would make an after-tax profit even if the return on the investment were as low as 5 percent, generating a 3 percent before-tax loss. The attraction for this tax arbitrage could be expected to result in non-productive investment that does not benefit the targeted area.

CONFIDENTIAL

Duplication of the Empowerment Zone and Enterprise Community Program: There are several areas of the bill that are duplicative of existing programs or other legislative proposals. However, our primary concern is related to the duplication and overlap of this program with our existing Community Empowerment program. The designation of distressed communities that would receive special tax treatment and coordinated assistance from the local government and the private sector, is an almost identical concept to the EZ/EC initiative. The Renewal Community program would use a place-based approach, similar to both NMI and EZ/ECs. The proposal also allows for overlap between designations as a Renewal Community and an EZ/EC, which could be confusing for taxpayers.

The American Renewal Act would use poverty and unemployment rates to target funding in contrast to the New Markets Initiative emphasis on income levels as well as poverty. The criteria for selection as a Renewal Community are more restrictive than requirements for NMI and less restrictive than those for EZ/ECs. The logic behind NMI was that targeting should be relatively broad (approximately 37% of the country is eligible) giving investors more choice and flexibility in determining where to place their funds, thereby making the program more attractive to the private sector. This issue has been argued both ways --- there is also a benefit to more narrow criteria, which assures that funds reach the most distressed areas. The EZ/EC uses a more targeted approach for this reason.

DRAFT

DRAFT

DRAFT – VERSION #1

August 3, 1999

Dear Mr. Speaker:

I was very pleased by our meeting last week. I am confident that we can work together effectively to meet the many challenges we face and pass a budget that is fiscally responsible and that meets our key priorities. I was also pleased with our joint sense of commitment to pass meaningful legislation to address the investment needs that our nation's underserved urban rural areas – or New Markets – currently face. While my New Markets proposal differs in several ways from the American Community Renewal Act, I believe that our overarching goals are quite consistent.

There are several provisions of the Talent-Watts bill that we believe could be incorporated into the New Markets Initiative and would be acceptable elements of a compromise proposal. While, there are some aspects of the Talent-Watts legislation, that would be difficult to accept such as the zero capital gains tax, there are other aspects of the Republican proposal upon which we would be willing to negotiate in good faith, such as the Brownfields expensing and Family Development Accounts.

One of the major differences between the New Markets proposal and the Talent-Watts proposal is the provision for a zero capital gains tax, which is of concern to us for several reasons. (1) Because it is a back-end solution, investors may not be motivated by the benefit of a zero percent capital gains tax in distressed economic communities where they are unlikely to experience appreciation in property values or partnership interests. (2) A zero capital gains for distressed communities could have the perverse and presumably unintended consequence of encouraging disinvestment in distressed areas as owners might flip businesses and properties to receive this tax benefit. (3) There could be unintended windfalls with businesses earning large, one-time profits -- for example, from the sale of property near a site chosen for a sports arena -- without making any new investments related to spurring the local economy.

Despite this major difference, there are many other elements of the American Community Renewal Act that we would be willing to discuss and potentially incorporate in the New Markets Initiative. These provisions include commercial revitalization tax credits, the work opportunity tax credit and certain expensing provisions.

It is my hope that we can work together to find common ground in the weeks to come and reach agreement on ways to meet the needs of America's economically distressed communities.

Sincerely Yours,

President William Jefferson Clinton

- 2 versions for the president
- bipartisan support
can't agree on all aspects
- couple of selection of why capital gains is problem

DRAFT

July 21, 1999

Dear Mr. Speaker:

I was very pleased by our meeting last week. I am confident that we can work together effectively to meet the many challenges we face and pass a budget that is fiscally responsible and that meets our key priorities. I was also pleased with our joint sense of commitment to pass meaningful legislation to address the investment needs that our nation's underserved urban rural areas – or New Markets – currently face. While my New Markets proposal differs in several ways from the American Community Renewal Act, I believe that our overarching goals are quite consistent.

There are several provisions of the Talent-Watts bill that we believe could be incorporated into the New Markets Initiative and would be acceptable elements of a compromise proposal. However, there are some aspects of the Talent-Watts legislation, including the zero capital gains tax and what we consider a duplication of the Empowerment Zone and the Enterprise Community program, that would be difficult if not impossible for us to accept. The following is a summary of those items which are a part of the New Markets Initiative that we believe are critical to the success of any effort to encourage private sector investment in economically distressed areas. Also outlined below are several of our concerns about the American Community Renewal Act followed by those areas of the Talent-Watts bill which we believe could be incorporated in a compromise proposal.

certainly there are elements in your text we could take; there will be negotiation in good faith

1. Critical Elements of the New Markets Initiatives

Targeting Criteria: The goal of the New Markets Initiative is to encourage private investment in low and moderate-income communities. Accordingly, investments are targeted to areas (as defined by census tract) with poverty levels in excess of 20% or income levels equal to or less than 80% of median income. This targeting results in approximately 37% of the country being eligible for investment under the New Markets Initiative. This also allows the private investor a great deal of discretion, which is critical to the selection of viable investments with secure returns. The Talent-Watts proposal would restrict benefits to only 100 communities.

Structure of Tax Credit: The Tax Credit under the New Markets Initiative provides for a credit to investors in eligible funds and financial institutions that help to finance small businesses in targeted areas. In contrast, the Talent-Watts proposal provides for credits

want intended duplication in so much i.e. or bigger directly to businesses in a finite number of communities. The structure of the New Markets Tax Credit is broader and encourages the creation of new investment funds that will target distressed areas.

Loan Guarantees and Small Business Investment Company (SBIC) Model: The New Markets Initiative would create two new types of government supported investment funds -- APICs (America's Private Investment Companies) and NMVC (New Market Venture Capital) firms -- which are based upon SBA's very successful SBIC program. These programs are fundamental to the goal of the New Markets Initiative because they will encourage the development of investment funds targeted to low and moderate income communities. These areas have not traditionally had access to capital -- a story that was shared over and over again by participants in the President's New Markets Trip. These proposed programs are designed to provide much needed equity capital financing to businesses located in underserved areas. The goal is to provide financing that will support and encourage economic growth in these communities and generate jobs.

2. The Talent-Watts Proposal

A. Areas of Concern

Capital Gains Opening: One of the major differences between the New Markets proposal and the Talent-Watts proposal is that their proposal includes a provision for a zero capital gains tax. Because it is a back-end solution, a zero percent capital gains tax is not a logical incentive for investment in distressed economic communities. Potential investors in these areas may not be motivated by a benefit that comes only upon the sale of an investment in an area where investors are unlikely to experience appreciation in property values. There is a much greater need in poor communities for upfront and ongoing incentives to draw investment into such communities.

A zero capital gains for distressed communities could have the perverse and presumably unintended consequence of encouraging more disinvestment in distressed areas as owners might flip businesses and properties to receive this tax benefit. Additional and well-founded concerns about a capital gains tax for investment in distressed communities include:

- Unintended Windfalls: Certain business with property in the renewal community could earn large one-time "windfall" profits -- for example, from the sale of property near a site chosen for a large public attraction such as a sports arena -- without making any new investments related to job growth or spurring the local economy.

- Negative Tax Incentives: The ability of taxpayers to deduct interest on borrowing while entirely excluding the gains from the sale of some property, can create negative tax rates like those associated with the tax shelters of the 1970s and 1980s. For example, ignoring depreciation, a taxpayer in the top tax bracket would make an after-tax profit even if the return on the investment were as low as 5 percent, generating a 3 percent before-tax loss. The attraction for this tax arbitrage could be expected to result in non-productive investment that does not benefit the targeted area.

Duplication of the Empowerment Zone and Enterprise Community Program: I am concerned that aspects of the bill are duplicative of our existing Community Empowerment program. The designation of distressed communities that would receive special tax treatment and coordinated assistance from the local government and the private sector, is an almost identical concept to the EZ/EC initiative. The Renewal Community program would use a place-based approach, similar to both NMI and EZ/ECs. The proposal also allows for overlap between designations as a Renewal Community and an EZ/EC, which could be confusing for taxpayers.

The American Community Renewal Act would use poverty and unemployment rates to target funding in contrast to the New Markets Initiative emphasis on income levels as well as poverty. The criteria for selection as a Renewal Community are more restrictive than requirements for NMI and less restrictive than those for EZ/ECs. The logic behind NMI was that targeting should be relatively broad (approximately 37% of the country is eligible) giving investors more choice and flexibility in determining where to place their funds, thereby making the program more attractive to the private sector. This issue has been argued both ways --- there is also benefit to more narrow criteria, which assures that funds reach the most distressed areas. The EZ/EC uses a more targeted approach for this reason.

B. Less Objectionable Areas

The following provisions of the American Community Renewal Act are less objectionable than those listed above, and we would be open to discussing some of these as we take steps toward developing a proposal that could pass both Houses.

Family Development Accounts: Some aspects of the Family Development Account (FDA) proposal mirror the Administration's Individual Development Account proposal. However, the FDA proposal outlined in this bill would involve a matching program administered by HUD, requiring resources that HUD does not have at this time.

Brownfields Expensing: Renewal communities would benefit from Brownfields expensing. Expensing for small business and Brownfields was provided for in the Taxpayer Relief Act of 1997. The provision in the American Renewal Community Act is actually a more limited version of the Administration's budget proposal to make Brownfields expensing permanent.

Commercial Revitalization Tax Credit: The American Renewal Act includes a commercial revitalization tax credit for projects located in Renewal Communities. Project based tax credits have been used successfully for low-income housing where State Housing Agencies have been able to monitor and administer the program. However, it would be difficult for Treasury to monitor credits for commercial properties, as there are no similar state or local entities equipped to provide oversight. There is also concern that a commercial revitalization credit could result in negative effective tax rates and cause investors to make purely tax-motivated decisions in order to shelter other income from higher taxes.

The Work Opportunity Tax Credit: H.R. 815 would expand the existing law to include Renewal Community residents who work in Renewal Community businesses. The bill would also provide a different tax credit rate and maximum on wages, resulting in a more generous credit for the new target group in the second year of employment. Renewal Community youth, even those who work outside of community would be eligible for the same treatment available to youth under the EZ program which requires that substantially all of the employees' services be provided in the EZ.

Transfer of HUD-Owned Property: The proposal for American Renewal communities requires the transfer of any HUD-owned property to the local government. HUD and OMB have raised strong objections to this provision which requires HUD to transfer to the local government any substandard multifamily property, or any vacant single family property that is located in a Renewal Community. HUD contends that the FHA single family and multifamily insurance programs depend upon the process of sales of property to reduce costs of the insurance programs. In addition, because there is no limit on the sales prices (for example not greater than the cost recovery basis) there is the potential for fraud and abuse by the local government, which would be the beneficiary of real estate at no cost which could then be sold at a higher price.

Charitable Choices: The proposal includes a provision for charitable choices that allow religious organizations be treated in the same manner as other non-profit organizations.

Expensing Provisions: The bill includes expensing provisions for certain qualified Renewal Community Businesses as well as for Brownfields expensing. Expensing is already available for small businesses; however this Act would increase the phase-out range. In addition it would provide an additional $35,000 per year of expensing for depreciable property. The proposed bill would also extend the period for Brownfields expensing that is currently available. (See description above).

It is my hope that we can work together to find common ground in the weeks to come and reach agreement on ways to meet the needs of America's economically distressed communities.

Sincerely Yours,

President William Jefferson Clinton

DRAFT

July 21, 1999

Dear Mr. Speaker:

I was very pleased by our meeting last week. I am confident that we can work together effectively to meet the many challenges we face and pass a budget that is fiscally responsible and that meets our key priorities. I was also pleased with our joint sense of commitment to pass meaningful legislation to address the investment needs that our nation's underserved urban rural areas – or New Markets – currently face. While my New Markets proposal differs in several ways from the American Community Renewal Act, I believe that our overarching goals are quite consistent.

There are several provisions of the Talent-Watts bill that we believe could be incorporated into the New Markets Initiative and would be acceptable elements of a compromise proposal. However, there are some aspects of the Talent-Watts legislation, including the zero capital gains tax and what we consider a duplication of the Empowerment Zone and the Enterprise Community program, that would be difficult if not impossible for us to accept. The following is a summary of those items which are a part of the New Markets Initiative that we believe are critical to the success of any effort to encourage private sector investment in economically distressed areas. Also outlined below are several of our concerns about the American Community Renewal Act followed by those areas of the Talent-Watts bill which we believe could be incorporated in a compromise proposal.

I. Critical Elements of the New Markets Initiatives

Targeting Criteria: The goal of the New Markets Initiative is to encourage private investment in low and moderate-income communities. Accordingly, investments are targeted to areas (as defined by census tract) with poverty levels in excess of 20% or income levels equal to or less than 80% of median income. This targeting results in approximately 37% of the country being eligible for investment under the New Markets Initiative. This also allows the private investor a great deal of discretion, which is critical to the selection of viable investments with secure returns. The Talent-Watts proposal would restrict benefits to only 100 communities.

Structure of Tax Credit: The Tax Credit under the New Markets Initiative provides for a credit to investors in eligible funds and financial institutions that help to finance small businesses in targeted areas. In contrast, the Talent-Watts proposal provides for credits directly to businesses in a finite number of communities. The structure of the New

Markets Tax Credit is broader and encourages the creation of new investment funds that will target distressed areas.

Loan Guarantees and Small Business Investment Company (SBIC) Model: The New Markets Initiative would create two new types of government supported investment funds -- APICs (America's Private Investment Companies) and NMVC (New Market Venture Capital) firms -- which are based upon SBA's very successful SBIC program. These programs are fundamental to the goal of the New Markets Initiative because they will encourage the development of investment funds targeted to low and moderate income communities. These areas have not traditionally had access to capital -- a story that was shared over and over again by participants in the President's New Markets Trip. These proposed programs are designed to provide much needed equity capital financing to businesses located in underserved areas. The goal is to provide financing that will support and encourage economic growth in these communities and generate jobs.

2. The Talent-Watts Proposal

A. Areas of Concern

Capital Gains Opening: One of the major differences between the New Markets proposal and the Talent-Watts proposal is that their proposal includes a provision for a zero capital gains tax. Because it is a back-end solution, a zero percent capital gains tax is not a logical incentive for investment in distressed economic communities. Potential investors in these areas may not be motivated by a benefit that comes only upon the sale of an investment in an area where investors are unlikely to experience appreciation in property values. There is a much greater need in poor communities for upfront and ongoing incentives to draw investment into such communities.

A zero capital gains for distressed communities could have the perverse and presumably unintended consequence of encouraging more disinvestment in distressed areas as owners might flip businesses and properties to receive this tax benefit. Additional and well-founded concerns about a capital gains tax for investment in distressed communities include:

- Unintended Windfalls: Certain business with property in the renewal community could earn large one-time "windfall" profits -- for example, from the sale of property near a site chosen for a large public attraction such as a sports arena -- without making any new investments related to job growth or spurring the local economy.

- Negative Tax Incentives: The ability of taxpayers to deduct interest on borrowing while entirely excluding the gains from the sale of some property, can create negative tax rates like those associated with the tax shelters of the 1970s and 1980s. For example, ignoring depreciation, a taxpayer in the top tax bracket would make an after-tax profit even if the return on the investment were as low as 5 percent, generating a 3 percent before-tax loss. The attraction for this tax arbitrage could be expected to result in non-productive investment that does not benefit the targeted area.

Duplication of the Empowerment Zone and Enterprise Community Program: I am concerned that aspects of the bill are duplicative of our existing Community Empowerment program. The designation of distressed communities that would receive special tax treatment and coordinated assistance from the local government and the private sector, is an almost identical concept to the EZ/EC initiative. The Renewal Community program would use a place-based approach, similar to both NMI and EZ/ECs. The proposal also allows for overlap between designations as a Renewal Community and an EZ/EC, which could be confusing for taxpayers.

The American Community Renewal Act would use poverty and unemployment rates to target funding in contrast to the New Markets Initiative emphasis on income levels as well as poverty. The criteria for selection as a Renewal Community are more restrictive than requirements for NMI and less restrictive than those for EZ/ECs. The logic behind NMI was that targeting should be relatively broad (approximately 37% of the country is eligible) giving investors more choice and flexibility in determining where to place their funds, thereby making the program more attractive to the private sector. This issue has been argued both ways --- there is also benefit to more narrow criteria, which assures that funds reach the most distressed areas. The EZ/EC uses a more targeted approach for this reason.

B. Less Objectionable Areas

The following provisions of the American Community Renewal Act are less objectionable than those listed above, and we would be open to discussing some of these as we take steps toward developing a proposal that could pass both Houses.

Family Development Accounts: Some aspects of the Family Development Account (FDA) proposal mirror the Administration's Individual Development Account proposal. However, the FDA proposal outlined in this bill would involve a matching program administered by HUD, requiring resources that HUD does not have at this time.

Brownfields Expensing: Renewal communities would benefit from Brownfields expensing. Expensing for small business and Brownfields was provided for in the Taxpayer Relief Act of 1997. The provision in the American Renewal Community Act is actually a more limited version of the Administration's budget proposal to make Brownfields expensing permanent.

Commercial Revitalization Tax Credit: The American Renewal Act includes a commercial revitalization tax credit for projects located in Renewal Communities. Project based tax credits have been used successfully for low-income housing where State Housing Agencies have been able to monitor and administer the program. However, it would be difficult for Treasury to monitor credits for commercial properties, as there are no similar state or local entities equipped to provide oversight. There is also concern that a commercial revitalization credit could result in negative effective tax rates and cause investors to make purely tax-motivated decisions in order to shelter other income from higher taxes.

The Work Opportunity Tax Credit: H.R. 815 would expand the existing law to include Renewal Community residents who work in Renewal Community businesses. The bill would also provide a different tax credit rate and maximum on wages, resulting in a more generous credit for the new target group in the second year of employment. Renewal Community youth, even those who work outside of community would be eligible for the same treatment available to youth under the EZ program which requires that substantially all of the employees' services be provided in the EZ.

Transfer of HUD-Owned Property: The proposal for American Renewal communities requires the transfer of any HUD-owned property to the local government. HUD and OMB have raised strong objections to this provision which requires HUD to transfer to the local government any substandard multifamily property, or any vacant single family property that is located in a Renewal Community. HUD contends that the FHA single family and multifamily insurance programs depend upon the process of sales of property to reduce costs of the insurance programs. In addition, because there is no limit on the sales prices (for example not greater than the cost recovery basis) there is the potential for fraud and abuse by the local government, which would be the beneficiary of real estate at no cost which could then be sold at a higher price.

Charitable Choices: The proposal includes a provision for charitable choices that allow religious organizations be treated in the same manner as other non-profit organizations.

Expensing Provisions: The bill includes expensing provisions for certain qualified Renewal Community Businesses as well as for Brownfields expensing. Expensing is already available for small businesses; however this Act would increase the phase-out range. In addition it would provide an additional $35,000 per year of expensing for depreciable property. The proposed bill would also extend the period for Brownfields expensing that is currently available. (See description above).

It is my hope that we can work together to find common ground in the weeks to come and reach agreement on ways to meet the needs of America's economically distressed communities.

Sincerely Yours,

President William Jefferson Clinton

DRAFT

July 21, 1999

Dear Mr. Speaker:

I was very pleased by our meeting last week. I am confident that we can work together effectively to meet the many challenges we face and pass a budget that is fiscally responsible and that meets our key priorities. I was also pleased with our joint sense of commitment to pass meaningful legislation to address the investment needs that our nation's underserved urban rural areas – or New Markets – currently face. While my New Markets proposal differs in several ways from the American Community Renewal Act, I believe that our overarching goals are quite consistent.

There are several provisions of the Talent-Watts bill that we believe could be incorporated into the New Markets Initiative and would be acceptable elements of a compromise proposal. However, there are some aspects of the Talent-Watts legislation, including the zero capital gains tax and what we consider a duplication of the Empowerment Zone and the Enterprise Community program, that would be difficult if not impossible for us to accept. The following is a summary of those items which are a part of the New Markets Initiative that we believe are critical to the success of any effort to encourage private sector investment in economically distressed areas. Also outlined below are several of our concerns about the American Community Renewal Act followed by those areas of the Talent-Watts bill which we believe could be incorporated in a compromise proposal.

1. Critical Elements of the New Markets Initiatives

Targeting Criteria: The goal of the New Markets Initiative is to encourage private investment in low and moderate-income communities. Accordingly, investments are targeted to areas (as defined by census tract) with poverty levels in excess of 20% or income levels equal to or less than 80% of median income. This targeting results in approximately 37% of the country being eligible for investment under the New Markets Initiative. This also allows the private investor a great deal of discretion, which is critical to the selection of viable investments with secure returns. The Talent-Watts proposal would restrict benefits to only 100 communities.

Structure of Tax Credit: The Tax Credit under the New Markets Initiative provides for a credit to investors in eligible funds and financial institutions that help to finance small businesses in targeted areas. In contrast, the Talent-Watts proposal provides for credits directly to businesses in a finite number of communities. The structure of the New

Markets Tax Credit is broader and encourages the creation of new investment funds that will target distressed areas.

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2. The Talent-Watts Proposal

A. Areas of Concern

Capital Gains Opening: One of the major differences between the New Markets proposal and the Talent-Watts proposal is that their proposal includes a provision for a zero capital gains tax. Because it is a back-end solution, a zero percent capital gains tax is not a logical incentive for investment in distressed economic communities. Potential investors in these areas may not be motivated by a benefit that comes only upon the sale of an investment in an area where investors are unlikely to experience appreciation in property values. There is a much greater need in poor communities for upfront and ongoing incentives to draw investment into such communities.

A zero capital gains for distressed communities could have the perverse and presumably unintended consequence of encouraging more disinvestment in distressed areas as owners might flip businesses and properties to receive this tax benefit. Additional and well-founded concerns about a capital gains tax for investment in distressed communities include:

- Unintended Windfalls: Certain business with property in the renewal community could earn large one-time "windfall" profits -- for example, from the sale of property near a site chosen for a large public attraction such as a sports arena -- without making any new investments related to job growth or spurring the local economy.

- Negative Tax Incentives: The ability of taxpayers to deduct interest on borrowing while entirely excluding the gains from the sale of some property, can create negative tax rates like those associated with the tax shelters of the 1970s and 1980s. For example, ignoring depreciation, a taxpayer in the top tax bracket would make an after-tax profit even if the return on the investment were as low as 5 percent, generating a 3 percent before-tax loss. The attraction for this tax arbitrage could be expected to result in non-productive investment that does not benefit the targeted area.

Duplication of the Empowerment Zone and Enterprise Community Program: I am concerned that aspects of the bill are duplicative of our existing Community Empowerment program. The designation of distressed communities that would receive special tax treatment and coordinated assistance from the local government and the private sector, is an almost identical concept to the EZ/EC initiative. The Renewal Community program would use a place-based approach, similar to both NMI and EZ/ECs. The proposal also allows for overlap between designations as a Renewal Community and an EZ/EC, which could be confusing for taxpayers.

The American Community Renewal Act would use poverty and unemployment rates to target funding in contrast to the New Markets Initiative emphasis on income levels as well as poverty. The criteria for selection as a Renewal Community are more restrictive than requirements for NMI and less restrictive than those for EZ/ECs. The logic behind NMI was that targeting should be relatively broad (approximately 37% of the country is eligible) giving investors more choice and flexibility in determining where to place their funds, thereby making the program more attractive to the private sector. This issue has been argued both ways --- there is also benefit to more narrow criteria, which assures that funds reach the most distressed areas. The EZ/EC uses a more targeted approach for this reason.

B. Less Objectionable Areas

The following provisions of the American Community Renewal Act are less objectionable than those listed above, and we would be open to discussing some of these as we take steps toward developing a proposal that could pass both Houses.

Family Development Accounts: Some aspects of the Family Development Account (FDA) proposal mirror the Administration's Individual Development Account proposal. However, the FDA proposal outlined in this bill would involve a matching program administered by HUD, requiring resources that HUD does not have at this time.

Brownfields Expensing: Renewal communities would benefit from Brownfields expensing. Expensing for small business and Brownfields was provided for in the Taxpayer Relief Act of 1997. The provision in the American Renewal Community Act is actually a more limited version of the Administration's budget proposal to make Brownfields expensing permanent.

Commercial Revitalization Tax Credit: The American Renewal Act includes a commercial revitalization tax credit for projects located in Renewal Communities. Project based tax credits have been used successfully for low-income housing where State Housing Agencies have been able to monitor and administer the program. However, it would be difficult for Treasury to monitor credits for commercial properties, as there are no similar state or local entities equipped to provide oversight. There is also concern that a commercial revitalization credit could result in negative effective tax rates and cause investors to make purely tax-motivated decisions in order to shelter other income from higher taxes.

The Work Opportunity Tax Credit: H.R. 815 would expand the existing law to include Renewal Community residents who work in Renewal Community businesses. The bill would also provide a different tax credit rate and maximum on wages, resulting in a more generous credit for the new target group in the second year of employment. Renewal Community youth, even those who work outside of community would be eligible for the same treatment available to youth under the EZ program which requires that substantially all of the employees' services be provided in the EZ.

Transfer of HUD-Owned Property: The proposal for American Renewal communities requires the transfer of any HUD-owned property to the local government. HUD and OMB have raised strong objections to this provision which requires HUD to transfer to the local government any substandard multifamily property, or any vacant single family property that is located in a Renewal Community. HUD contends that the FHA single family and multifamily insurance programs depend upon the process of sales of property to reduce costs of the insurance programs. In addition, because there is no limit on the sales prices (for example not greater than the cost recovery basis) there is the potential for fraud and abuse by the local government, which would be the beneficiary of real estate at no cost which could then be sold at a higher price.

Charitable Choices: The proposal includes a provision for charitable choices that allow religious organizations be treated in the same manner as other non-profit organizations.

Expensing Provisions: The bill includes expensing provisions for certain qualified Renewal Community Businesses as well as for Brownfields expensing. Expensing is already available for small businesses; however this Act would increase the phase-out range. In addition it would provide an additional $35,000 per year of expensing for depreciable property. The proposed bill would also extend the period for Brownfields expensing that is currently available. (See description above).

It is my hope that we can work together to find common ground in the weeks to come and reach agreement on ways to meet the needs of America's economically distressed communities.

Sincerely Yours,

President William Jefferson Clinton

THE AMERICAN COMMUNITY RENEWAL ACT

I. Summary of the Bill

The American Community Renewal Act would provide for up to 100 renewal communities designated through a competitive process similar to that of the current Empowerment Zone and Enterprise Community (EZ/EC) Programs. Renewal Communities would be eligible for numerous tax incentives including zero percent capital gains, commercial revitalization tax credits, expensing for small businesses and Brownfields, expansion of the work opportunity tax credit, and family development accounts. Efforts to create a renewal community program have been underway for several years, and the current bill has evolved from several earlier proposals.

The American Renewal Act contains certain provisions that could not be incorporated into the New Markets Initiative without substantially changing the intent and substance of our proposal for a New Markets Initiative. However, there are a number of other provisions that would be acceptable and could be incorporated into our proposal with little difficult, as outlined herein.

II. Comparison of the American Renewal Act to the New Markets Initiative and the Empowerment Zone and Enterprise Community Programs

CAPITAL GAINS OPENING: One of the major differences between the President's proposal and the Talent-Watts proposal is that their proposal includes a provision for a Zero Capital Gains. The American Community Renewal Act is principally an attempt to create an opening for a capital gains tax through a program that would attempt to improve conditions in economically distressed communities. Objections and concerns raised about this bill include the zero percent capital gains provision for the sale of certain business property and assets held for more than 5 years. Eligibility includes a requirement that 35% of employees reside in the Renewal Community.

Because it is a back-end solution, a zero percent capital gains tax is not a logical incentive for investment in distressed economic communities. Potential investors in these areas may not be motivated by a benefit that comes only upon the sale of an investment in an area where <u>investors are unlikely to experience appreciation in property values</u>. There is a much greater need in poor communities for upfront and ongoing incentives to draw investment into such communities.

A zero capital gains for distressed communities could have the perverse and presumably unintended consequence of encouraging more disinvestment in distressed areas as owners might flip businesses and properties to receive this tax benefit. Additional and well-founded concerns about a capital gains tax for investment in distressed communities include:

- **Unintended Windfalls:** Certain business with property in the renewal community could earn large one-time "windfall" profits --- for example, from the sale of property near a site chosen for a large public attractions such as a sports arena – without making any new investments related to job growth or spurring the local economy.

- **Negative Tax Incentives:** The ability of taxpayers to deduct interest on borrowing while entirely excluding the gains from the sale of some property, can create negative tax rates like those associated with the tax shelters of the 1970s and 1980s. For example, ignoring depreciation, a taxpayer in the top tax bracket would make an after-tax profit even if the return on the investment were as low as 5 percent, generating a 3 percent before-tax loss. The attraction for this tax arbitrage could be expected to result in non-productive investment that does not benefit the targeted area.

Duplication of the Empowerment Zone and Enterprise Community Program: There are several areas of the bill that are duplicative of existing programs or other legislative proposals. However, our primary concern is related to the duplication and overlap of this program with our existing Community Empowerment program. The designation of distressed communities that would receive special tax treatment and coordinated assistance from the local government and the private sector, is an almost identical concept to the EZ/EC initiative. The Renewal Community program would use a place-based approach, similar to both NMI and EZ/ECs. The proposal also allows for overlap between designations as a Renewal Community and an EZ/EC, which could be confusing for taxpayers.

The American Renewal Act would use poverty and unemployment rates to target funding in contrast to the New Markets Initiative emphasis on income levels as well as poverty. The criteria for selection as a Renewal Community are more restrictive than requirements for NMI and less restrictive than those for EZ/ECs. The logic behind NMI was that targeting should be relatively broad (approximately 37% of the country is eligible) giving investors more choice and flexibility in determining where to place their funds, thereby making the program more attractive to the private sector. This issue has been argued both ways --- there is also a benefit to more narrow criteria, which assures that funds reach the most distressed areas. The EZ/EC uses a more targeted approach for this reason.

III. Areas for Agreement and Compromise

While we have problems with some of provisions of the American Renewal Act, the following items are ones that we could certainly discuss and we could accept several of these items into a potential compromise. A major unresolved issue is how this initiative would be paid for. Obviously this would play into the larger Social Security/Medicare/Tax Cut issues debate, but if an agreement on this initiative could be reached I am hopeful we could find a way to fund it.

- **Family Development Accounts:** Some aspects of the Family Development Account (FDA) proposal mirror the Administration's Individual Development Account proposal. Although, the FDA proposal outlined in this bill would involve a matching program administered by HUD, it requires resources that HUD does not have at this time.

- **Brownfields Expensing:** Renewal communities would benefit from Brownfields expensing. Expensing for small business and Brownfields was provided for in the Taxpayer Relief Act of 1997. The provision in the American Renewal Community Act is actually a more limited version of the Administration's budget proposal to make Brownfields expensing permanent.

- **Commercial Revitalization Tax Credit:** The American Renewal Act includes a commercial revitalization tax credit for projects located in Renewal Communities. Project based tax credits have been used successfully for low-income housing where State Housing Agencies have been able to monitor and administer the program. However it would be difficult for Treasury to monitor credits for commercial properties, as there are no similar state or local entities equipped to provide oversight. Treasury has also raised a concern that a commercial revitalization credit could result in negative effective tax rates and cause investors to make purely tax-motivated decisions in order to shelter other income from higher taxes.

- **The Work Opportunity Tax Credit:** H.R. 815 would expand the existing law to include Renewal Community residents who work in Renewal Community businesses. The bill would also provide a different tax credit rate and maximum on wages, resulting in a more generous credit for the new target group in the second year of employment. Renewal Community youth, even those who work outside of community, would be eligible for the same treatment available to youth under the EZ program which requires that substantially all of the employees' services be provided in the EZ.

- **Transfer of HUD-Owned Property:** The proposal for American Renewal communities requires the transfer of any HUD-owned property to the local government. HUD and OMB have raised strong objections to this provision which requires HUD to transfer to the local government any substandard multifamily property, or any vacant single family property that is located in a Renewal Community. HUD contends that the FHA single family and multifamily insurance programs depend upon the process of sales of property to reduce costs of the insurance programs. In addition, because there is no limit on the sales prices (for example not greater than the cost recovery basis) there is the potential for fraud and abuse by the local government, which would be the beneficiary of real estate at no cost which could then be sold at a higher price.

- **Charitable Choices:** The proposal includes a provision for charitable choices that allow religious organizations be treated in the same manner as other non-profit organizations.

- **Expensing Provisions:** The bill includes expensing provisions for certain qualified Renewal Community Businesses as well as for Brownfields expensing. Expensing is already available for small businesses; however this Act would increase the phase-out range. In addition it would provide an additional $35,000 per year of expensing for depreciable property. The proposed bill would also extend the period for Brownfields expensing that is currently available. (See description above).

THE AMERICAN COMMUNITY RENEWAL ACT

Congressmen J.C. Watts, Jim Talent, and Danny Davis

RENEWAL COMMUNITIES: Create 100 Renewal Communities with targeted, pro-growth tax benefits, regulatory relief, savings accounts, brownfields clean-up, and home-ownership opportunities. At least 20 percent of the communities identified must be located in rural areas. Requirements for communities applying for zone status:

- **Poverty Rates:** Area must have a poverty rate of 20 percent or more, an unemployment rate of at least 150 percent the national rate, and in urban areas at least 70 percent of its households must have incomes below 80 percent of the median household income.
- **Local Commitments:** the Renewal Community area must commit to a) reduce local tax rates and fees within zones and to eliminate state and local sales taxes and b) waive local and state occupational licensing regulations and other barriers to entry, except those explicitly needed to protect health and safety.

EXISTING ZONES: OBRA 1993 created 105 Empowerment Zones and Enterprise Communities which qualified for a modest combination of government grants and special tax breaks. The American Community Renewal Act would leave these benefits alone while allowing these communities to apply for the expanded benefits contained in this plan. Ez's and Ec's would be given the first right of refusal to become a Renewal Community for the first 50 designations. The new version of the bill includes a GAO Study identifying the poorest communities in the country. These areas would be given preference in designation as a Renewal Community.

BENEFITS: In return for these commitments, the federal contribution would include a combination of tax, regulatory, and other targeted programs for designated areas including:

- **Tax Benefits:** The tax benefits of Renewal Communities would address the principal hurdles facing small businesses when they are just getting started – raising capital and maintaining cash flow.
  - ◊ **Capital Gains Tax Relief:** Establishes a capital gains rate of zero for the sale of any qualified zone stock, business property, or partnership interest located within the qualified zones that has been held for at least five years.
  - ◊ **Increased Expensing:** Raises the maximum allowable expensing for purchases of plant and equipment in Renewal Communities from $25,000 to $35,000 in 2003.
  - ◊ **Wage Credit:** Businesses located in qualified zones would receive a graduated wage credit starting at 15% for hiring qualified, low-income workers who remain employed for a year. The credit increases to 30% for companies who employ a worker for 2 and 3 years.
  - ◊ **Brownfields Relief:** Permits taxpayers to expense costs incurred in abatement of environmental contaminants within zones.
- **Renewal Community Homeownership:** Provides for the sale of unoccupied or substandard homes and housing projects located within qualified zones and owned by HUD to community development corporations to provide housing opportunities to low-income families.
- **CRA Credit:** Amends section 804 of the Community Reinvestment Act to allow financial institutions to receive their CRA credit for investments in, or loans to, other ventures with community development financial institutions as defined by the Bank Enterprise Act of 1991 and which are located within zones.
- **Commercial Revitalization Tax Credit:** Those renovating and rehabilitating qualified, non-residential buildings located in Renewal Communities will be eligible for a tax credit of up to 20% of the cost of renovation or 5% a year for ten years.
- **Family Development Accounts:** Create Family Development Accounts designed to encourage low-income families to save a portion of their income or their EITC credit refund. Cash donations are deductible, even if the individual does not itemize, while withdrawals are tax-free if used for a qualified purpose. Additionally, 25% of designated Renewal Communities will receive government matched funds to contributions made to accounts.
- **Drug and Alcohol Treatment:** Amends to public Health Service Act to a) permit faith-based substance abuse treatment centers (all centers, not just those located within Renewal Communities) to receive federal assistance b) makes it easier for individuals receiving federally funded drug treatment to select private and religiously oriented treatment, and c) protects the rights of individuals from being required to receive religiously oriented treatment.

For more information, visit the American Community Renewal web page at **http://www.house.gov/talent/renewal.html**.

October 5, 1999

DRAFT

Dear Mr. Speaker:

While we are in the midst of the budget process that necessarily involves a public debate about different approaches, I wanted to discuss with you, in a more personal way, an area where we both agree – the need to spur additional investment in poorer communities.

We have talked in the past about working together on meaningful legislation to address the investment needs in that our nation's underserved rural and areas – or New Markets. I appreciate your interest in this topic and ask you to consider this letter today as a personal request that we explore, before Congress goes out of session, the possibility of passing legislation that meets this objective.

As you know, legislation has been introduced, based upon my New Markets Initiative, by Representatives Rangel and LaFalce and Senators Sarbanes, Rockefeller, and Kerry. I am aware that several members of your party have proposed the American Community Renewal Act, which is designed to accomplish some of the same goals as the New Markets Initiative. I also appreciate last week's Republican introduction of H.R. 2848, the New Markets Initiative Act, by request. We are aware that Representatives Talent, Watts, Leach and Baker have been leaders in the effort to improve conditions in economically-distressed communities.

Let me underscore that I am personally committed to working with you in good faith on possible compromises. I am sure you understand that we may have some disagreement about certain provisions of the American Community Renewal Act (ACRA) such as the zero capital gains tax. However, there are many provisions of the Talent-Watts bill that we believe could be incorporated into a fiscally responsible, paid for New Markets Initiative. Provisions in the Talent-Watts bill that we would be willing to accept are:

- Brownfields Expensing; and
- Work Opportunity Tax Credit;

Furthermore, as currently proposed in the Talent-Watts legislation, Empowerment Zones would be explicitly eligible for benefits provided under the ACRA.

Over the next several weeks, I hope that we can forge a combination of elements from the New Markets Initiative, the American Community Renewal Act, and the strengthening of the existing Empowerment Zone program, to bring true economic and entrepreneurial opportunities to America's underserved markets. We would welcome the opportunity to meet with you or other representatives from the Republican Party to discuss possibilities that might lead to a compromise agreement. I look forward to hearing from you.

Sincerely Yours,

President William Jefferson Clinton

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THE AMERICAN COMMUNITY RENEWAL ACT
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__RENEWAL COMMUNITIES:__ Create 100 Renewal Communities with targeted, pro-growth tax benefits, regulatory relief, savings accounts, brownfields clean-up, and home-ownership opportunities. At least 20 percent of the communities identified must be located in rural areas. Requirements for communities applying for zone status:

- **Poverty Rates:** Area must have a poverty rate of 20 percent or more, an unemployment rate of at least 150 percent the national rate, and in urban areas at least 70 percent of its households must have incomes below 80 percent of the median household income.
- **Local Commitments:** the Renewal Community area must commit to a) reduce local tax rates and fees within zones and to eliminate state and local sales taxes and b) waive local and state occupational licensing regulations and other barriers to entry, except those explicitly needed to protect health and safety.

__EXISTING ZONES:__ OBRA 1993 created 105 Empowerment Zones and Enterprise Communities which qualified for a modest combination of government grants and special tax breaks. The American Community Renewal Act would leave these benefits alone while allowing these communities to apply for the expanded benefits contained in this plan. Ez's and Ec's would be given the first right of refusal to become a Renewal Community for the first 50 designations. The new version of the bill includes a GAO Study identifying the poorest communities in the country. These areas would be given preference in designation as a Renewal Community.

__BENEFITS:__ In return for these commitments, the federal contribution would include a combination of tax, regulatory, and other targeted programs for designated areas including:

- **__Tax Benefits:__** The tax benefits of Renewal Communities would address the principal hurdles facing small businesses when they are just getting started – raising capital and maintaining cash flow.
  - ◊ **Capital Gains Tax Relief:** Establishes a capital gains rate of zero for the sale of any qualified zone stock, business property, or partnership interest located within the qualified zones that has been held for at least five years.
  - ◊ **Increased Expensing:** Raises the maximum allowable expensing for purchases of plant and equipment in Renewal Communities from $25,000 to $35,000 in 2003.
  - ◊ **Wage Credit:** Businesses located in qualified zones would receive a graduated wage credit starting at 15% for hiring qualified, low-income workers who remain employed for a year. The credit increases to 30% for companies who employ a worker for 2 and 3 years.
  - ◊ **Brownfields Relief:** Permits taxpayers to expense costs incurred in abatement of environmental contaminants within zones.
- **__Renewal Community Homeownership:__** Provides for the sale of unoccupied or substandard homes and housing projects located within qualified zones and owned by HUD to community development corporations to provide housing opportunities to low-income families.
- **__CRA Credit:__** Amends section 804 of the Community Reinvestment Act to allow financial institutions to receive their CRA credit for investments in, or loans to, other ventures with community development financial institutions as defined by the Bank Enterprise Act of 1991 and which are located within zones.
- **__Commercial Revitalization Tax Credit:__** Those renovating and rehabilitating qualified, non-residential buildings located in Renewal Communities will be eligible for a tax credit of up to 20% of the cost of renovation or 5% a year for ten years.
- **__Family Development Accounts:__** Create Family Development Accounts designed to encourage low-income families to save a portion of their income or their EITC credit refund. Cash donations are deductible, even if the individual does not itemize, while withdrawals are tax-free if used for a qualified purpose. Additionally, 25% of designated Renewal Communities will receive government matched funds to contributions made to accounts.
- **__Drug and Alcohol Treatment:__** Amends to public Health Service Act to a) permit faith-based substance abuse treatment centers (all centers, not just those located within Renewal Communities) to receive federal assistance b) makes it easier for individuals receiving federally funded drug treatment to select private and religiously oriented treatment, and c) protects the rights of individuals from being required to receive religiously oriented treatment.

For more information, visit the American Community Renewal web page at **http://www.house.gov/talent/renewal.html**.

THE AMERICAN COMMUNITY RENEWAL ACT

I. Summary of the Bill

The American Community Renewal Act would provide for up to 100 renewal communities designated through a competitive process similar to that of the current Empowerment Zone and Enterprise Community (EZ/EC) Programs. Renewal Communities would be eligible for numerous tax incentives including zero percent capital gains, commercial revitalization tax credits, expensing for small businesses and Brownfields, expansion of the work opportunity tax credit, and family development accounts. Efforts to create a renewal community program have been underway for several years, and the current bill has evolved from several earlier proposals.

The American Renewal Act contains certain provisions that could not be incorporated into the New Markets Initiative without substantially changing the intent and substance of our proposal for a New Markets Initiative. However, there are a number of other provisions that would be acceptable and could be incorporated into our proposal with little difficult, as outlined herein.

II. Comparison of the American Renewal Act to the New Markets Initiative and the Empowerment Zone and Enterprise Community Programs

Capital Gains Opening: One of the major differences between the President's proposal and the Talent-Watts proposal is that their proposal includes a provision for a Zero Capital Gains. The American Community Renewal Act is principally an attempt to create an opening for a capital gains tax through a program that would attempt to improve conditions in economically distressed communities. Objections and concerns raised about this bill include the zero percent capital gains provision for the sale of certain business property and assets held for more than 5 years. Eligibility includes a requirement that 35% of employees reside in the Renewal Community.

Because it is a back-end solution, a zero percent capital gains tax is not a logical incentive for investment in distressed economic communities. Potential investors in these areas may not be motivated by a benefit that comes only upon the sale of an investment in an area where investors are unlikely to experience appreciation in property values. There is a much greater need in poor communities for upfront and ongoing incentives to draw investment into such communities.

A zero capital gains for distressed communities could have the perverse and presumably unintended consequence of encouraging more disinvestment in distressed areas as owners might flip businesses and properties to receive this tax benefit. Additional and well-founded concerns about a capital gains tax for investment in distressed communities include:

- **Unintended Windfalls:** Certain business with property in the renewal community could earn large one-time "windfall" profits --- for example, from the sale of property near a site chosen for a large public attractions such as a sports arena – without making any new investments related to job growth or spurring the local economy.

- **Negative Tax Incentives:** The ability of taxpayers to deduct interest on borrowing while entirely excluding the gains from the sale of some property, can create negative tax rates like those associated with the tax shelters of the 1970s and 1980s. For example, ignoring depreciation, a taxpayer in the top tax bracket would make an after-tax profit even if the return on the investment were as low as 5 percent, generating a 3 percent before-tax loss. The attraction for this tax arbitrage could be expected to result in non-productive investment that does not benefit the targeted area.

Duplication of the Empowerment Zone and Enterprise Community Program: There are several areas of the bill that are duplicative of existing programs or other legislative proposals. However, our primary concern is related to the duplication and overlap of this program with our existing Community Empowerment program. The designation of distressed communities that would receive special tax treatment and coordinated assistance from the local government and the private sector, is an almost identical concept to the EZ/EC initiative. The Renewal Community program would use a place-based approach, similar to both NMI and EZ/ECs. The proposal also allows for overlap between designations as a Renewal Community and an EZ/EC, which could be confusing for taxpayers.

The American Renewal Act would use poverty and unemployment rates to target funding in contrast to the New Markets Initiative emphasis on income levels as well as poverty. The criteria for selection as a Renewal Community are more restrictive than requirements for NMI and less restrictive than those for EZ/ECs. The logic behind NMI was that targeting should be relatively broad (approximately 37% of the country is eligible) giving investors more choice and flexibility in determining where to place their funds, thereby making the program more attractive to the private sector. This issue has been argued both ways --- there is also a benefit to more narrow criteria, which assures that funds reach the most distressed areas. The EZ/EC uses a more targeted approach for this reason.

III. Areas for Agreement and Compromise

While we have problems with some of provisions of the American Renewal Act, the following items are ones that we could certainly discuss and we could accept several of these items into a potential compromise. A major unresolved issue is how this initiative would be paid for. Obviously this would play into the larger Social Security/Medicare/Tax Cut issues debate, but if an agreement on this initiative could be reached I am hopeful we could find a way to fund it.

- **Family Development Accounts:** Some aspects of the Family Development Account (FDA) proposal mirror the Administration's Individual Development Account proposal. Although, the FDA proposal outlined in this bill would involve a matching program administered by HUD, it requires resources that HUD does not have at this time.

- **Brownfields Expensing:** Renewal communities would benefit from Brownfields expensing. Expensing for small business and Brownfields was provided for in the Taxpayer Relief Act of 1997. The provision in the American Renewal Community Act is actually a more limited version of the Administration's budget proposal to make Brownfields expensing permanent.

- **Commercial Revitalization Tax Credit:** The American Renewal Act includes a commercial revitalization tax credit for projects located in Renewal Communities. Project based tax credits have been used successfully for low-income housing where State Housing Agencies have been able to monitor and administer the program. However it would be difficult for Treasury to monitor credits for commercial properties, as there are no similar state or local entities equipped to provide oversight. Treasury has also raised a concern that a commercial revitalization credit could result in negative effective tax rates and cause investors to make purely tax-motivated decisions in order to shelter other income from higher taxes.

- **The Work Opportunity Tax Credit:** H.R. 815 would expand the existing law to include Renewal Community residents who work in Renewal Community businesses. The bill would also provide a different tax credit rate and maximum on wages, resulting in a more generous credit for the new target group in the second year of employment. Renewal Community youth, even those who work outside of community, would be eligible for the same treatment available to youth under the EZ program which requires that substantially all of the employees' services be provided in the EZ.

- **Transfer of HUD-Owned Property:** The proposal for American Renewal communities requires the transfer of any HUD-owned property to the local government. HUD and OMB have raised strong objections to this provision which requires HUD to transfer to the local government any substandard multifamily property, or any vacant single family property that is located in a Renewal Community. HUD contends that the FHA single family and multifamily insurance programs depend upon the process of sales of property to reduce costs of the insurance programs. In addition, because there is no limit on the sales prices (for example not greater than the cost recovery basis) there is the potential for fraud and abuse by the local government, which would be the beneficiary of real estate at no cost which could then be sold at a higher price.

- **Charitable Choices:** The proposal includes a provision for charitable choices that allow religious organizations be treated in the same manner as other non-profit organizations.

- **Expensing Provisions:** The bill includes expensing provisions for certain qualified Renewal Community Businesses as well as for Brownfields expensing. Expensing is already available for small businesses; however this Act would increase the phase-out range. In addition it would provide an additional $35,000 per year of expensing for depreciable property. The proposed bill would also extend the period for Brownfields expensing that is currently available. (See description above).

LG Thanks for this — Let's talk ASAP GS 5/13/99

DRAFT MEMORANDUM TO GENE SPERLING

DATE: May 11, 1999

FROM: LISA GREEN

SUBJECT: THE AMERICAN COMMUNITY RENEWAL ACT OF 1999 (H.R. 815) (The Talent-Watts Bill)

The purpose of this memorandum is to provide an analysis of the Talent-Watts bill referenced above, as it compares to the New Markets Initiative (NMI) and existing community development programs.

Summary of Bill

The American Community Renewal Act would provide for up to 100 renewal communities designated through a competitive process similar to that of the current Empowerment Zone and Enterprise Community (EZ/EC) Programs. Renewal Communities would be eligible for numerous tax incentives including zero percent capital gains, commercial revitalization tax credits, expensing for small businesses and Brownfields, expansion of the work opportunity tax credit, and family development accounts.

Background and History

The current bill has evolved from several earlier proposals to create a Renewal Community Program. Earlier versions include public school vouchers, which made the bill unacceptable to several Democrats, such as former Congressman Floyd Flake, who had expressed an initial interest. The bill outlines some of the same types of programs promoted by then HUD Secretary Jack Kemp's in his proposal for Enterprise Zones. The bill was previously introduced as HR3685 under the same name.

Overall Conclusions

Based on my review of the bill, a meeting with a subset of the New Markets Initiative inter-agency working group (see list attached), and analyses completed by HUD and Treasury, I have reached the following conclusions.

Capital Gains Opening: The Talent-Watts bill is principally a Republican attempt to create an opening for a capital gains tax through a program that addresses ideological and social issues that are of concern to Democrats. **The main objection raised by several agencies to this bill is the zero percent capital gains** provision for the sale of certain business property and assets held for ~~more than~~ 5 years. Eligibility includes a requirement that 35% of employees reside in the Renewal Community.

Because it is a back-end solution, a zero percent capital gains tax is not a logical incentive for investment in distressed economic communities. Potential investors in these areas may not be motivated by a benefit that comes only upon the sale of an investment in an area where they are unlikely to experience appreciation in property values. There is a much greater need for upfront and ongoing incentives to draw investment into such communities. This type of tax incentive could have the perverse and presumably unintended consequence of encouraging more disinvestment in distressed areas as owners might flip businesses and properties to receive this tax benefit. Treasury has raised additional, well-founded concerns about a capital gains tax for investment in distressed communities, as outlined in the attached May 5 draft memorandum from Michael Barr.

Incentives for Capital Investment versus Labor Investments: With the exception of the zero capital gains provision, this bill, places more emphasis on investment in labor rather than capital investments. The NMI was designed to encourage capital investment in distressed communities, through loan guarantees and tax credits. H.R. 815 provides tax benefits for businesses to locate and operate in distressed areas and to hire individuals living there. The bill also includes provisions to encourage savings by residents of these areas.

Lisa G. I need your ideas on what we could live with not just what is consistent w/ new markets. I imagine more SB expensing + work opp tax credit could be o.k. what else? GS 5/13/99

Just write from you to me -- don't include

Considerations Related to Specific Provisions

Potentially Acceptable Provisions: Some specific provisions of the bill would be acceptable to various agencies if incorporated into the NMI. These provisions include:

- Use of poverty and unemployment rates to target funding, and
- Expansion of the work opportunity tax credit for certain targeted groups

Duplicative Provisions: There are several areas of the bill considered to be duplicative of existing programs or other legislative proposals.

- Designation of distressed communities that would receive special tax treatment coordinated assistance from the local government and the private sector, is an almost **identical concept to the EZ/EC initiative**.
- Some aspects of the **Family Development Account (FDA)** proposal mirror the Administration's Individual Development Account proposal; however the approach proposed by Senator Coats is preferable to that outlined in H.R. 815. In addition, the FDA proposal outlined in this bill would involve a matching program administered by HUD, requiring resources that HUD does not have at this time.
- Expensing for small business and Brownfields was provided for in the Taxpayer Relief Act of 1997.

Areas of Concern and Potentially Unacceptable Provisions: Specific agencies have raised concerns about several issues. These issues are not of equal concern to all agencies.

- **Funding for the program under PAYGO provisions.** Earlier versions of the Act proposed funding of the program using existing budget authority for CDBG. This proposal was unacceptable to community development interest groups and many Democrats and has since been eliminated. However, the current proposal to fund the program out of the surplus is considered an unreasonable solution by Treasury, particularly given unresolved issues around Social Security.
- **Inclusion of a commercial revitalization tax credit for projects located in Renewal Communities.** Project based tax credits have been used successfully for low-income housing where State Housing Agencies have been able to monitor and administer the program. However it would be very difficult for Treasury to monitor credits for commercial ~~properties~~, as there are no similar state or local entities equipped to ~~provide oversight~~. Treasury has also raised a concern that a commercial revitalization credit could result in negative effective tax rates and cause investors to make purely tax-motivated decisions in order to shelter other income from higher taxes.
- **Requirement for the transfer of any HUD-owned property to the local government.** Both HUD and OMB raised serious objections to this provision which requires HUD to transfer to the local government any substandard multifamily property, or any vacant single family property that is located in a Renewal Community. HUD's position is well outlined in the attached comments from David Kaas.
- **Proposal for charitable choices that allow religious organizations to be treated in the same manner as other non-profit organizations.**

General Comparison with the New Markets Initiative and the Empowerment Zone and Enterprise Community Programs

A detailed comparison of the bill's provisions and requirements to those of the NMI and to the Community Empowerment Program can be found in the attached chart. The following are general observations.

Criteria for Targeting: The criteria for selection as a Renewal Community:

- Is more restrictive ~~than requirements~~ for NMI and less restrictive than those for EZ/ECs;
- Utilizes ~~a~~ place based approach, similar to both NMI and EZ/ECs;
- Incorporates unemployment rates into the selection criteria which is not part of the targeting for NMI ~~or~~ EZ/ECs; and
- Allows for overlap between designations as a Renewal Community and an EZ/EC, which may be confusing for taxpayers.

The logic behind NMI was that targeting should be relatively broad (approximately 40% of the country is eligible) giving investors more choice and flexibility in determining where to place their funds, thereby making the program more attractive to the private sector. This issue has been argued both ways --- there is also benefit to more narrow criteria, which assures that funds reach the most distressed areas. The EZ/EC uses a more targeted approach for this reason.

Expensing Provisions: The bill includes expensing provisions for certain qualified Renewal Community Businesses as well as for Brownfields expensing. Expensing is already available for small businesses; however this Act would increase the phase-out range. In addition it would provide an additional $35,000 ~~per~~ year of expensing for depreciable property. The proposed bill would also extend the period for Brownfields expensing that is currently available.

The Work Opportunity Tax Credit: H.R. 815 would expand the existing law to include Renewal Community residents who work in Renewal Community businesses. The bill would also provide a different tax credit rate and maximum on wages, resulting in a more generous credit for the new target group in the second year of employment. Renewal Community youth, even those who work outside of community would be eligible for the same treatment available to youth under the EZ program which requires that substantially all of the employees' services be provided in the EZ.

Final Considerations

In our meetings with the New Markets working group and legislative subset of the working group, Talent-Watt has never been raised as an alternative proposal to NMI. Although most of the members of the group are familiar with the proposal, they consider this bill to be completely unacceptable, if only because of the zero capital gains tax provision. There is some interest in the Watts-Talent bill from industry groups. It is included on the proposed agenda for a policy workshop in June sponsored in part by the National Congress for Community Economic Development (Roy Priest) and American Association of Enterprise Zones

As outlined in this memorandum there are a few provisions that could, if necessary, be incorporated into our NMI proposal. However, the central provisions of the Talent-Watts Bill --- zero capital gains and incentives for business to locate in distressed areas --- are inconsistent with the thinking behind NMI. As you know the impetus for the NMI was to address inefficiencies in the capital markets. The Talent-Watts bill does not directly address this fundamental issue.

To: Lisa Green
From: Michael Barr

DRAFT / INTERNAL USE ONLY

Draft March 5, 1999

SUBJECT: Comments on American Community Renewal Act of 1999 (H.R. 815)

Summary

This memorandum comments on the tax incentives included in Representative Watts' American Community Renewal Act of 1999. Under this proposal, 100 renewal communities would be designated where the following new tax incentives would be available:

- zero percent capital gains,
- commercial revitalization tax credit,
- additional expensing for small businesses,
- brownfields expensing,
- expansion of the work opportunity tax credit, and
- family development accounts (an IRA-type savings account).

We have a number of policy concerns with the American Community Renewal Act. Specifically, the proposed incentives would be a costly and relatively inefficient mechanism for assisting distressed communities. Many of the tax incentives proposed in this bill were considered and rejected by the Administration during the development in 1993 and 1996 of tax incentives for the first and second rounds of Empowerment Zones (EZs) and Enterprise Communities (ECs). Indeed, the proposed incentives could lose significant revenue while being relatively inefficient in assisting distressed communities. Federal tax relief is not likely to offset the high cost of crime, low quality of schools, and lack of infrastructure in distressed areas that discourage investment. In particular, while the capital gains and revitalization tax credit are likely to shift some economic activity into the targeted areas, most of this activity will be simply displaced from elsewhere, most of the tax incentives will go to existing businesses, and much of the benefits of the investment incentives will go to existing owners of capital and land. In addition, we are concerned about the precedence of making this proposal exempt from the PAYGO provision before dealing with Social Security. However, if additional tax incentives for distressed areas are to be available, we propose extension of the brownfields expensing and more generous incentives for the Cleveland and Los Angeles EZs as was proposed as part of the Administration's budget.

Below is a summary of our concerns with the specific tax provisions proposed in the legislation.

The American Community Renewal Act Proposals

Renewal community selection. The process and criteria for selecting renewal communities would be similar to that of empowerment zones (EZs) and enterprise communities (ECs). For example, in general areas would be nominated by local governments and chosen by the Secretary of Housing and Urban Development based on the extent of distress and the quality of plan for redevelopment. Of the 100 renewal communities, 20 would have to be in rural areas.

In addition, 50 of the renewal communities would have to be EZs or ECs. Areas must have at least 20 percent poverty rates, 1½ times the national unemployment rate, at least 70 percent of households must have incomes below 80 percent of the median income of households in the jurisdiction. Designation would be for 7 years.

While the selection process and criteria is similar to that used with EZs and ECs, tax incentives for renewal communities will not be as targeted. Renewal communities would generally be required to meet more relaxed criteria, particularly with respect to poverty rates, and thus incentives would be less targeted. Less targeted incentives are more likely to be inefficient at encouraging redevelopment of these areas. For example, first round EZs and ECs had at least half of the nominated area consisting of census tracts with poverty rates of 35 percent or more while nominated areas for second round EZs must have at least 90 percent of the census tracts with a poverty rate of 25 percent or more. Similarly, populations are limited in EZs and ECs while renewal communities have minimum population requirements of 4,000 in urban areas and 1,000 in rural areas.

Moreover, the renewal community designation is in addition to EZ and EC designation and is likely to increase administrative and compliance costs of the program. Overlapping designations, such as a renewal community EZ versus an EZ, is likely to make knowing what tax incentives are available in a particular area more difficult than if an area has one designation.

Zero percent rate on certain capital gains. A zero percent rate would apply to capital gains received from the sale of certain business property and assets that are held for more than five years. The assets must consist of property used in, or a partnership interest or stock of, a business that meets certain eligibility requirements during substantially all of the time the taxpayer holds the asset. The eligibility requirements relate to the type of business, where the business operates and who it employs. For example, at least 35 percent of employees must be renewal community residents.

Numerous problems arise from any attempt to use lower capital gains rates as incentives to spur new, meaningful investment in any given geographic area. Generally speaking, a reduction in capital gains rates (even to zero) will not provide an incentive to invest in depreciable property that the business would not otherwise buy since the property is unlikely to increase in value above its original cost. Thus, a zero percent rate on gains is unlikely to prompt the increased investment in machinery or equipment that is so often thought to spur job growth. Nor will there be any benefits to businesses that earn their return through current cash flows that are taxed at ordinary income rates -- whether through sales of inventory or by providing valuable services to their customers. At the same time, however, certain businesses with property in the renewal community could earn large one-time "windfall" profits -- for example, from the sale of property near a site chosen for a large public attraction such as a sports arena -- without making any new investments related to job growth or spurring the local economy.

Finally, the ability of taxpayers to deduct interest on borrowing while entirely excluding the gains from the sale of some property, can create negative tax rates like those associated with the tax shelters of the 1970's and 1980's. For example, ignoring depreciation, a taxpayer in the top tax bracket who borrows $100 at 8 percent and invests in an asset qualifying for the zero rate would make an after-tax profit even if the return on the investment were as low as 5 percent, generating a 3 percent before-tax loss. The attraction of this tax arbitrage could be expected to result in non-productive investments that benefit neither the targeted area nor the country as a whole.

Commercial Revitalization Tax Credit. A commercial revitalization tax credit is an allocated, 20 percent tax credit (or if elected by the taxpayer, 5 percent per year for 10 years) for non-residential building investment in designated areas through 2007. Up to $2 million in credits per State per renewal community (as is done with the low income housing credit) can be allocated in any year with a maximum of $10 million in a specific building expenditure being eligible for the credit.

Investment tax credits can result in significant misallocation of investment within and between industries, particularly since the resulting effective tax rates are likely to be negative. In the extreme, taxpayer investment may be purely tax-motivated in order to shelter other income from higher taxes. These tax shelters tend to benefit higher income taxpayers and would do little for residents in the distressed areas.

Additional expensing. The bill expands the current EZ expensing provision, making an additional $35,000 per year of expensing available for depreciable property used in certain qualified renewal community businesses. This incentive is available to small businesses since the deductible amount phases out as the amount of depreciable property placed in service increases above a fixed amount. The expansion of the amount eligible for expensing includes raising the phase-out range.

Compared to the other tax-based incentives for capital investment, this approach is less likely to be abused. However, capital incentives in general do little to encourage employment of renewal community residents. Moreover, given that some renewal communities will also be EZs, the expensing thresholds will vary among renewal communities and make administrative and compliance costs higher.

Brownfields expensing. The Taxpayer Relief Act of 1997, permits expensing of certain costs incurred in connection with the clean-up of certain qualifying "brownfields" sites. However, renewal communities would benefit from brownfields expensing being available beyond 2000. This provision is a more limited version of the Administration's budget proposal to make brownfields expensing permanent. As a result, we have no objections to extending when brownfields expensing is available, but we do object to its extension to less targeted areas.

Extension of the work opportunity tax credit (WOTC). The bill would create a new target group consisting of renewal community residents who work in a renewal community businesses. The extended credit would be more generous applying to up to $10,000 of wages and have a 15 percent rate for first year wages and 30 percent for second year wages. Requirements would be similar to those of the EZ wage credit in that substantially all the services provided by the employee must be within the renewal community. Under present law, employers are provided a credit of 40 percent of up to $6,000 in wages paid during the first year of employment of members of certain targeted groups, such as persons receiving TANF. In addition, renewal community youth would receive the same treatment under the WOTC as is available to EZ youth. In particular, the wage credit would be available to renewal community youth who work outside the community.

In order to maximize the credit, renewal community businesses have an incentive to use the regular WOTC for the first year of employment, if possible, and then switch to the renewal community version for second year employment of residents. The relatively loose criteria for defining a community suggests that the hiring incentive is likely to lead to "cherry picking" whereby employers will get the credit for renewal community residents who would have been hired without the incentive.

Family Development Accounts (FDAs). An FDA would be a special savings account for renewal community residents who received the earned income tax credit (EITC) in the previous year. Individuals would be able to make up to $2,000 per year in deductible contributions to one of these accounts. Earnings would accumulate in the account tax-free, and could be withdrawn tax-free to pay post-secondary education expenses, first-home purchase costs, expenses from starting a business, medical expenses, and qualified rollovers. In 5 of the renewal communities, a 50 percent match for contributions would be available. Tax would be paid on both the individual's contribution and matching amounts when withdrawn.

While the Administration supports the concept of development accounts, we think the general approach proposed by Senator Coats is preferable. Senator Coats proposes a demonstration project for development accounts where qualified entities, state and local governments and nonprofit organizations, would administer the program and provide matches for the saving accounts from Federal grants. This approach is preferable in that it is designed to be a demonstration project and provides the matching grants directly to the administering organization instead of introducing additional complexity to the tax code.

Comments as of 9/98 on last year's bill

HUD Comments on H.R. 815,
the "American Community Renewal Act of 1999"

HUD opposes this legislation for the following reasons:

1. HUD already has an Empowerment Zone initiative in place. There should not be more than one Empowerment Zone program--regardless of its name--operating at the same time. Not only would the operation of multiple programs be confusing to cities, it would also water down efforts to concentrate resources in very distressed areas which have already been designated or are proposed to be designated under the new Empowerment Zone program.

2. Although the tax incentives for the new round of Empowerment Zones in the Taxpayer Relief Act of 1997 may leave something to be desired, it is difficult, based on current information, to assess the impact and effectiveness of the incentives proposed for this legislation. The bill assumes an independent impact of tax incentives on poverty neighborhoods that is still unproven. The interaction of tax incentives with other practical considerations associated with doing business in such neighborhoods is far from straight-forward. HUD suggests that the effectiveness of the bill in targeting the spending of potential tax revenue would need additional analysis.

3. HUD notes that the community development research of the last twenty years has demonstrated the need for coordinated, continuing, and concentrated activities to achieve measurable long-term impact: it is on those lessons that the Empowerment Zones initiative is building. Few, if any, of the local participants in the Empowerment Zone program believe tax incentives will, by themselves, improve the economic and social conditions of the nation's poorest communities. Thus HUD suggests that if the bill is considered notwithstanding our objections, it should be reviewed to ensure that the programs set forth by this bill are well-coordinated. In this regard, HUD notes that the course of action requirement contained in title I, section 101, setting forth a proposed section 1400E(d), "Required State and Local Commitments," in Chapter 1 of the Internal Revenue Code of 1986, is too vague and weak to ensure coordinated and reinforcing programs.

4. There are serious flaws with section 201, which would require HUD to transfer to the local government any vacant multifamily property, any substandard multifamily property, or any vacant single family property that (1) is owned by the Secretary; and (2) is located in a renewal community. For example:

- The proposal does not take into account that the FHA single family and multifamily insurance programs depend upon the proceeds of sales of property to reduce the overall costs of the insurance programs. Single family housing, under the Mutual Mortgage Insurance Fund, is a self-sustaining program; multifamily housing, under the General Insurance Fund, requires annual appropriations to cover losses and to provide credit subsidy for new insurance obligations. Should this proposal be enacted, the budget costs of these programs would increase (since losses could not be offset by sales of the property), which could necessitate an increase in premiums.

- With regard to single family properties, HUD already possesses the authority to sell HUD-owned properties to governmental entities and non-profits. In addition, because almost all of the HUD inventory of single family properties are vacant (they are delivered unoccupied) and because of the apparent ease in establishing a locality as a renewal community, HUD might not be able to recover any proceeds of sale on substantial numbers of its inventory. Average sales price on single family properties was about $55,000 over the last twelve months; interest foregone on such properties would be about $8.50 per day.

- With regard to multifamily properties, current law and regulations provide a right of first refusal to States, localities, and PHAs. This bill would complicate this process and detract from the flexibility given under the Multifamily Housing Disposition Reform Act of 1994. HUD is able to sell or transfer projects to community development corporations now, but is NOT under a mandate to give assets away. It is conceivable that, to reduce holding costs, HUD would want to get vacant and substandard properties off the market quickly. The proposed bill could hinder this effort.

- In all cases the local government would be the beneficiary of real estate at no cost, which it could then sell at a higher price (to both community development corporations and to private purchasers, under certain conditions). Although there is a requirement for the sale price to be limited to a cost recovery basis (from the date upon which the local government takes title to the property), HUD notes that the potential for fraud and abuse of this scheme is substantial.

- The proposed legislation (section 201(e)) would make HUD responsible for all indebtedness on the properties before transferring them to local governments. This provision would place an unnecessary restriction on HUD's authority, and should be included in the contracts entered with local governments rather than in the statute.

- The proposed legislation would limit the Department's discretion with regard to establishing the terms of sales under the Community Renewal program. Community development

Jean — mye at eop.gov.

corporations, to which the properties can be sold by the municipalities during a 6 month window, would have the right to pick and choose which properties they would purchase, a procedure which could lessen the effectiveness and impede the purpose of the program.

There are also numerous technical deficiencies in this section. For example:

- The provisions of section 201 are written pursuant to the authority of section 204 of the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1997, which only applies to multifamily property. Thus references to single family properties in sections 201(b), (c), and (i)(6) should be deleted, and section 201(i)(9) should be deleted in its entirety.

- The last phrase of section 201(c)(1) refers to "1 year after such date". It is unclear as to whether "such date" refers to the date of acquisition by the Secretary or the date on which the area was designated as a renewal community. Therefore, clarifying language should be added to the phrase.

- Section 201(d)(2) requires a six-month right of first refusal period during which the local government cannot sell to anyone other than a CDC (unless notified by all CDCs that they are not interested in the property). HUD recommends a shorter period of time for two reasons. First, community groups generally are aware of the status of projects in their area and are capable of making decisions regarding acquisition more quickly than six months. Second, during the six-month period, the local government must pay for property upkeep, security, and other costly items associated with ownership of substandard or unoccupied property. Shortening the period would force the CDC to acquire title more quickly and, thus, renovate, demolish or take other appropriate action to revitalize the community more quickly.

- Section 201(e) states that the Secretary shall "satisfy" any indebtedness on the property before transferring ownership to the local government. Subsection (e)(1) states that the Secretary may "cancel" the indebtedness. Reference to the "cancellation" of indebtedness suggests that the debt is a Secretary-held debt--which would not be the case with HUD-owned property. Thus, HUD presumes that reference is to outstanding taxes, sewer charges, the cost of repairs and other costs that might be associated with the property, other than a mortgage indebtedness. Therefore, HUD recommends that in subsection (e)(1) the word "paying" be used in lieu of "canceling".

- There is no language in section 201 which directs how the CDC should develop the property it acquires or ensure that such property is available as an affordable housing resource. The fact that the CDC is defined in section 201(i)(1) as an entity which provides housing to low-income families does not bind the CDC to doing so. HUD recommends that section 201 include a description of how the property may be used by the CDC.

5. The legislation has a number of technical deficiencies when compared with the previously enacted authority for a second round of Empowerment Zone designations under the Taxpayer Relief Act of 1997.

- First, the criteria for selection of renewal communities would be less stringent with regard to poverty than the criteria set by the 1997 Act for the designation of new Empowerment Zones (the poverty rate for census tracts would be a minimum of 20%, as opposed to 25% for 90% of the census tracts under the 1997 Act). Thus even though half of the first 50 areas (i.e. 25%) to be designated as renewal communities under this bill would be chosen from areas which are Enterprise Communities or Empowerment Zones, and thus would have to meet HUD's higher EC/EZ standards, the remaining communities would only be held to the lower renewal community standards. In addition, there would be no apparent limitation on the area size of renewal communities.

- Second, HUD is not set up to administer a direct entitlement program.

  This bill would provide for "Family Development Accounts," where up to $2,000 in any fiscal year contributed by an individual to a Family Development Account would be tax deductible. The family development account could be used for home purchase expenses by a first time home-buyer, to start a business, for post-secondary education or for qualified medical expenses.

  It also contains a demonstration program, to be run by HUD, which would provide matching contributions to Family Development Accounts in certain renewal communities. Five communities could participate in this demonstration. The Secretary would match the deposits made to the Family Development Accounts of each "qualified individual" in the renewal community. In this time of declining resources, it is not clear how HUD could administer this program.

David Kass
708-3794

Testimony to the House Committee on Small Business
105th Congress

on

HR3865: The American Community Renewal Act

Presented by

Avis C. Vidal
Principal Research Associate
The Urban Institute

May 19, 1998

THE AMERICAN COMMUNITY RENEWAL ACT:

Testimony by Avis C. Vidal[1]

May 19, 1998

Mr. Chairman and Members of the Committee:

I am pleased to have the opportunity to share with you my analysis of the American Community Renewal Act. Since my experience and expertise lie in the area of urban policy, I will focus my comments on how the proposed legislation will affect cities, especially the areas that would be targeted under this legislation. Specifically, I want to make the case that:

- The core of the proposal, which seeks to increase the level of economic activity in Renewal Communities, is structured in ways that make it highly unlikely to meet its stated objectives;

- Unless the bill makes provision for additional housing subsidy dollars, its housing component will do nothing to increase the nation's total supply of affordable housing; to the extent that the bill yields any housing at all, it is likely to have the effect of increasing the concentration of households in poverty; and

- The provision of Family Development Accounts would have much greater impact if coupled with affirmative outreach and education efforts to link poor households into the mainstream banking system, from which many are currently isolated.

Tax Benefits for Business

Geographically targeted tax benefits have become a very popular economic development tool. In addition to the federal tax benefits provided to firms in Empowerment Zones, more than 35 states have enacted their own enterprise zone programs, all of which extend one or more types of tax relief to business establishments in designated zones. The experience of state enterprise zones has been studied extensively by academic researchers and other evaluators, including myself and the GAO.[2] The results are not encouraging: they show that these tax relief programs generally induce

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[1] Avis Vidal is a Principal Research Associate at the Urban Institute in Washington, D.C. The views expressed here are her own, and do not necessarily represent the views of the Urban Institute or any of its sponsors.

[2] Although the evaluations of state enterprise zones are the best available evidence on the efficacy of geographically targeted tax benefits for businesses, they do suffer from important methodological shortcomings. These are discussed in detail in Franklin J. James, "The Evaluation of Enterprise Zone Programs," in Roy E. Green (ed.) *Enterprise Zones: New Directions in Economic Development*. Sage Publications, Newbury Park CA, 1991.

little new economic activity, and that even in zones where employment does increase, job gains for zone residents are quite modest.[3]

The most comprehensive analysis of state programs, conducted by Erickson and Friedman,[4] confirms the findings of numerous less ambitious assessments. They report that, "there are relatively few successful zones that stand in sharp contrast to a multitude in which little growth has occurred since designation" (p. 175). Equally important are the findings from the GAO's analysis of Maryland's program[5] and Bishop and Kang's analysis of the targeted job tax credit[6] (which resembles the wage credit in this bill). Both interviewed participating employers, who generally reported that the tax benefits had had no impact on their behavior. They claimed the credit, often learning about it after the fact, but their investment and hiring decisions were motivated by other factors.

What, then, accounts for the limited number of successful zones pointed to by Erickson and Friedman and others? The weight of the available evidence indicates that "successful" zones have two characteristics:

- *Successful zones are good places to do business.* Although the zones designated under state programs include residential areas that are experiencing some level of distress (most commonly measured in terms of high unemployment, high poverty rates, and low median income), they also include areas with *genuine development potential,* including a *labor pool with good basic skills.*

- *Successful zones are actively managed* by individuals with entrepreneurial skills--people who (a) reach out to business owners in the zone to keep them informed about the benefits available to them and provide them with tax forms and specific information about exactly how to take advantage of the benefits; (b) market the zone and its advantages to firms outside the zone that seek new locations; and (c) represent zone businesses in seeking improvements, such as new infrastructure, to the zone.

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[3] The analysis on which these comments are based is detailed in the author's article "Reintegrating Disadvantaged Communities into the Fabric of Urban Life: The Role of Community Development," *Housing Policy Debate*, vol. 6, no. 1, 1995. A copy is attached for the record.

[4] Rodney A. Erickson and Susan W. Friedman, "Comparative Dimensions of State Enterprise Zone Policy," in Roy E. Green (ed.) *Enterprise Zones: New Directions in Economic Development*, Sage Publications, Newbury Park CA, 1991.

[5] U.S. General Accounting Office, *Enterprise Zones: Lessons Learned from the Maryland Experience*, Washington, D.C., 1988

[6] John H. Bishop and Suk Kang, "Applying for Entitlements: Employers and the Targeted Jobs Tax Credit," *Journal of Policy Analysis and Management*, Vol. 10, No. 1, 1991.

The proposed legislation misses the mark on both of these counts. First, it neither seeks to select zones that are already good business locations nor takes affirmative steps to help distressed communities become better places to do business. I am a co-principal investigator of the Empowerment Zone and Enterprise Community program. A review of the applications filed by localities seeking designation under that program makes clear that these communities need substantial direct financial assistance to improve the local business climate and improve the local labor force. The need for improved safety is a consistent theme throughout the applications, and many localities cite the importance of helping firms gain access to affordable capital, rehabilitating blighted properties, and improving local infrastructure. Most importantly, jurisdictions that are serious about improving residents' access to jobs that pay family-supporting wages stress that *major investments in improving residents' job readiness and upgrading their job skills are critical.* Funds for this purpose, and for the related purposes of providing trainees with placement assistance and the post-placement follow-up that good placement entities like America Works find is the key to long-term labor force attachment, are absent here.

Second, the bill makes no provision for managing Renewal Communities--and good, entrepreneurial management costs money. This would not be a problem for Renewal Communities that are also Empowerment Zones, because they have Title XX funds (or local matching funds) to support the management entities they already have in place. It would be a problem for newly-designated zones, and for Renewal Communities that are also Enterprise Communities, since many will have no federal funding to support their zone management entities after the current fiscal year.

Finally, stimulating investment in Renewal Community businesses would not necessarily do much to increase employment among zone residents. Again the experience of state enterprise zones is instructive. Indiana is generally thought to have one of the most effective state programs since it provides a number of tax benefits; requires that the city, representatives of zone businesses and selected zone residents set policy for the zone; and provides a funding mechanism to support zone management staff. Yet Rubin and Wilder[7] reported that less than one-third of the total new zone jobs went to zone residents; Papke,[8] analyzing Indiana data for a different year, found that only 11 percent of new zone jobs went to zone residents.

In short, in the absence of provisions to improve the employability of the local labor force and link that labor force to zone employers, the proposed legislation will do little to strengthen the economies of Renewal Communities.

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[7] Barry M. Rubin and Margaret G. Wilder, "Urban Enterprise Zones: Employment Impacts and Fiscal Incentives," *Journal of the American Planning Association*, Vol. 55, No. 4, 1989.

[8] James A. Papke, *The Indiana Enterprise Zone Experiment: Concepts, Issues, and Impact*, Indianapolis Department of Commerce, Indianapolis, 1988.

Affordable Housing

The need for more housing affordable to low-income households is well-documented, and CDCs and other nonprofit housing organizations have a well-earned track record as important contributors to meeting this need. However, the most important constraint facing CDCs and others working to increase the supply of affordable housing is the *scarcity of subsidy dollars*, especially subsidies deep enough to make dwellings affordable to very low-income families. Since the bill does nothing to relax this fundamental constraint, it will not increase the supply of affordable housing.[9]

Cities could choose to use existing CDBG and HOME funding to subsidize the redevelopment of properties in Renewal Communities now owned by HUD. The subsidies allocated to these developments would, of course, leave other prospective assisted developments without support. This makes it likely that subsidies used in this fashion would have the effect of *increasing the concentration of low-income households* in neighborhoods selected precisely because they are already very poor.

If CDCs are to mount such projects successfully, they will need more time than the bill currently allows. Few CDCs have cash reserves that can be used to acquire property quickly, and most find it financially prudent to purchase properties only when they have identified likely sources of construction and long-term financing. For their part, relatively few local jurisdictions have themselves developed the capacity to manage a property disposition process in a way that facilitates purchase and redevelopment by CDCs. Given these facts, it is clear that the six month time limit on CDC purchases is much too short. At least one year should be allowed, and even then provision needs to be made for extensions, since this process could easily take up to two years in a significant number of cases.

On balance, experience suggests that this basic approach to affordable housing production is ineffective. The HOPE 3 program, which was enacted under the Bush administration and which I helped to evaluate for HUD, had a similar structure. It sought to use partnerships between local governments and nonprofit housing organizations to move publicly owned dwellings into the hands of low-income families. It accomplished little, despite the fact that federal subsidies (to be matched locally) were made available: the average program improved and sold fewer than 35 units over two years. HOPE 3 was terminated; its approach was flawed. CDCs do not necessarily serve the neighborhoods in which federally-owned properties are located, and properties currently in the HUD inventory are not necessarily attractive (or even viable) for redevelopment. HOPE 3 was defunded.

Finally, I note that although the short bill summary describes the housing provisions as promoting

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[9] Since the properties the bill makes eligible for transfer will require substantial rehabilitation to make them habitable and marketable, they will not be affordable to low income households in the absence of subsidies--even if HUD and the cities make them available at nominal charge.

home ownership, nothing in the bill requires that CDCs (or other purchasers in those cases where nonprofit purchasers are not found) use the properties for this purpose; in fact, the multifamily units are likely to be more suitable, and much more readily marketable, for use as rental units.

Family Development Accounts

Family Development Accounts, more commonly known as Individual Development Accounts (IDAs), are a fine mechanism to help low income households accumulate assets. However, best practices in the filed suggest that the proposed legislation needs a pro-active mechanism to connect eligible households to the mainstream banking system.

Poor households can take advantage of these types of accounts only if they have access to depository institutions. The types of neighborhoods targeted by the legislation are widely acknowledged to be under-served by mainstream financial services institutions. Branch banks, and even automatic teller machines (ATMs), are in short supply, and the minimum deposit and fee requirements imposed on checking accounts by many banks mean that many low income households have no ties to these institutions. They are obliged to rely instead on more informal mechanisms such as store-front check cashing establishments. In addition, the hand-to-mouth nature of life in poverty means that many poor households have not had the opportunity to acquire the kinds of financial management skills that middle class families take for granted. Financial support for community organizations to engage in outreach, to provide education in household budgeting and financial management, and to help families negotiate their initial contacts with the banking system would help to address this problem. This type of proactive support is a common accompaniment to IDA programs, and provision for it should be added here.. Additionally, there is no reason to limit access to these accounts to households that receive the Earned Income Tax Credit (EITC) rather than making them available to all low-income families.

Conclusion

In sum, participating localities can reasonably expect benefits from this legislation as currently written that are modest, at best. Given this fact, the only cities that will find it advantageous to participate are those whose *pre-existing commitments* as participants in Empowerment Zones or Enterprise Communities are extensive enough to constitute "a course of action" as required by the bill and thereby make them automatically eligible. The bill offers other city governments the "opportunity" to assume substantial new--and completely unfunded--obligations, possibly coupled with foregone revenues from local taxes and/or user charges, in exchange for very limited and uncertain benefits to the distressed community and its economy. It's a poor bargain.

COMPARISON OF PROPOSED "NEW MARKETS TAX CREDIT" WITH TAX PROVISIONS OF THE "RENEWAL COMMUNITIES" PROPOSAL

Both the Administration's proposal for a New Markets Tax Credit (contained in the President's FY 2000 Budget request) and the tax provisions of the proposed American Community Renewal Act of 1999 (H.R. 815, by Reps. Watts, Davis, Talent and more than 80 others) would direct tax benefits to individuals and enterprises to promote desirable activities in economically distressed communities.

NEW MARKETS TAX CREDIT:

The Administration's proposal would encourage $6 billion in new investments into low- and moderate-income communities over 5 years. It would do that by providing tax credits for investments of $1.2 billion annually. The investments would be made by banks, foundations, companies or individuals. These investors would acquire stock or other equity interests in selected community economic development entities whose primary mission is serving distressed communities. In other words, the investments that are encouraged by the tax credit are investments in the entities (CDCs, CDFIs, venture funds, SBICs, others) whose mission is to carry out economic development in distressed communities and whose record of doing so warrants their selection by Treasury. Urban and rural communities with high poverty and low median income would be targeted.

The tax credits would be issued by Treasury to the selected entities. These entities in turn would sell or syndicate the credit to investors. The tax credit ultimately delivered to the investor would be in the amount of 6 percent annually of the amount of the investment, for an approximate aggregate value to the investor of 25 percent of the "present value" of the original investment over the 5 years. A "qualified investment" by an investor would be a cash purchase of stock or other equity in a selected entity, which must be held for at least 5 years. Substantially all of the investment would be required to be used by the community development entity to make "qualified low-income community investments," which would be equity investments in, or loans to, qualified active businesses in the low-income communities. "Qualified active businesses" would be businesses with, among other requirements, at least half their activities in low-income communities.

RENEWAL COMMUNITIES TAX PROVISIONS:

The tax portion of the Watts-et-al bill would direct a range of tax benefits to individuals and businesses operating in "renewal communities." Renewal communities (RCs) would be up to 100 newly designated areas (50 of which would be in EZs or ECs) with pervasive poverty, unemployment and general distress. HUD would designate the RCs based on criteria similar to those in the Administration's New Markets proposal. For designation, state and local governments would also have to agree to certain tax reduction, crime prevention, regulatory relief and privatization of social services measures.

The bill would provide to individual investors an exclusion from gross income of any capital gain from a stock, business property, or partnership interest newly acquired in a renewal community business and held more than five years. It would allow a deduction to qualified individuals for amounts paid in cash to a family development account (used for postsecondary education, first home purchase, business capitalization, medical expenses and qualified rollovers). Qualified individuals would be those who resided in an RC and were allowed an earned income credit for the preceding taxable year. Such accounts would be excluded from taxation.

The bill would create a "work opportunity" tax credit to businesses to help offset costs of hiring people on welfare, high-risk youth or individuals in need of vocational rehabilitation. The credit would be worth 15 of employee's wages, up to $10,000. It would establish a tax credit of 20 to 50 percent of the commercial revitalization expenditures regarding a revitalization building. It would increase, for an RC business, the dollar limit on expensing certain depreciable business assets. It would permit taxpayers to treat RC environmental remediation costs as not chargeable to a capital account and as a deduction.

COMPARISON:

Whereas the aim of the two proposals is similar, the New Markets Tax Credit would target tax credits in a more focused way. The credits would be for private equity capital delivered to and through specific economic development entities with a primary mission and record of promoting job and wealth creation in distressed communities. The New Markets Tax Credit presumes that already successful community development entities can succeed in delivering additional economic benefits to the communities where they currently operate. In these communities, there is both urgent need and great opportunity for new, private equity capital. However, the needed private dollars currently are lacking due to market dysfunction. With modest government incentive, the New Markets Tax Credit can help attract such new investment capital to viable enterprises in economically distressed communities.

The renewal communities proposal would also provide tax benefits for a number of economic activities in distressed communities. And many of the activities would likely have some of the same positive economic effects in those communities as activities encouraged by the New Markets proposal. However, because a broader range of individuals and firms would receive tax benefits, it could be much more difficult to determine which of the activities might have taken place without the tax incentives.

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