

the empowerment zone in a trade or business of the employer.

(3) *Examples.* This paragraph (b) may be illustrated by the following examples. In each example, the following assumptions apply. The employees satisfy the abode requirement at all relevant times and all services performed by the employees for their employer are performed in a trade or business of the employer. The employees are not precluded from being qualified zone employees by section 1396(d)(2) (certain employees ineligible). No portion of the employees' wages is precluded from being qualified zone wages by section 1396(c)(2) (only first \$15,000 of wages taken into account) or section 1396(c)(3) (coordination with targeted jobs credit and work opportunity credit). The examples are as follows:

*Example 1.* (i) Employer X has a weekly pay period for all its employees. Employee A works for X throughout 1997. During each of the first 20 weekly pay periods in 1997, substantially all of A's work for X is performed within the empowerment zone in which A resides. A also works in the zone at various times during the rest of the year, but there is no other pay period in which substantially all of A's work for X is performed within the empowerment zone. Employer X uses the pay period method.

(ii) For each of the first 20 pay periods of 1997, A is a qualified zone employee, all of A's wages from X are qualified zone wages, and X may claim the empowerment zone employment credit with respect to those wages. X cannot claim the credit with respect to any of A's wages for the rest of 1997.

*Example 2.* (i) Employer Y has a weekly pay period for its factory workers and a bi-weekly pay period for its office workers. Employee B works for Y in various factories and Employee C works for Y in various offices. Employer Y uses the pay period method.

(ii) Y must use B's weekly pay periods to determine the periods (if any) in which B is a qualified zone employee. Y may claim the empowerment zone employment credit with respect to B's wages only for the weekly pay periods for which B is a qualified zone employee, because those are B's only wages that are qualified zone wages. Y must use C's bi-weekly pay periods to determine the periods (if any) in which C is a qualified zone employee. Y may claim the credit with respect to C's wages only for the bi-weekly pay periods for which C is a qualified zone employee, because those are C's only wages that are qualified zone wages.

*Example 3.* (i) Employees D and E work for Employer Z throughout 1997. Although some

of D's work for Z in 1997 is performed outside the empowerment zone in which D resides, substantially all of it is performed within that empowerment zone. E's work for Z is performed within the empowerment zone in which E resides for several weeks of 1997 but outside the zone for the rest of the year so that, viewed on an annual basis, E's work is not substantially all performed within the empowerment zone. Employer Z uses the calendar year method.

(ii) D is a qualified zone employee for the entire year, all of D's 1997 wages from Z are qualified zone wages, and Z may claim the empowerment zone employment credit with respect to all of those wages, including the portion attributable to work outside the zone. Under the calendar year method, E is not a qualified zone employee for any part of 1997, none of E's 1997 wages are qualified zone wages, and Z cannot claim any empowerment zone employment credit with respect to E's wages for 1997. Z cannot use the calendar year method for D and the pay period method for E because Z must use the same method for all employees. For 1998, however, Z can switch to the pay period method for E if Z also switches to the pay period method for D and all of Z's other employees.

(c) *Effective date.* This section applies with respect to wages paid or incurred on or after December 21, 1994.

[T.D. 8747, 62 FR 67727, Dec. 30, 1997]

#### § 1.1397E-1 Qualified zone academy bonds.

(a) *Overview.* In general, a qualified zone academy bond is a taxable bond issued by a state or local government the proceeds of which are used to improve certain eligible public schools. An eligible taxpayer that holds a qualified zone academy bond generally is allowed annual Federal income tax credits in lieu of periodic interest payments. These credits compensate the eligible taxpayer for lending money to the issuer and function as payments of interest on the bond. Accordingly, this section generally treats the allowance of a credit as if it were a payment of interest on the bond. In addition, this section provides rules to determine the credit rate, the present value of qualified contributions from private entities, and the maximum term of a qualified zone academy bond.

(b) *Credit rate.* The Secretary shall determine monthly (or more often as deemed necessary by the Secretary) the credit rate the Secretary estimates will generally permit the issuance of a

qualified zone academy bond without discount and without interest cost to the issuer. The manner for ascertaining the credit rate for a qualified zone academy bond as determined by the Secretary shall be set forth in procedures, notices, forms, or instructions prescribed by the Commissioner.

(c) *Private business contribution requirement—(1) Reasonable discount rate.* To determine the present value (as of the issue date) of qualified contributions from private entities under section 1397E(d)(2), the issuer must use a reasonable discount rate. The credit rate determined under paragraph (b) of this section is a reasonable discount rate.

(2) *Definition of private entities.* For purposes of section 1397E(d)(2)(A), the term *private entities* includes any person (as defined in section 7701(a)) other than the United States, a State or local government, or any agency or instrumentality thereof or related party with respect thereto. To determine whether a person is related to the United States or a State or local government under this paragraph (c)(2), rules similar to those for determining whether a person is a related party under § 1.150-1(b) shall apply (treating the United States as a governmental unit for purposes of § 1.150-1(b)).

(3) *Qualified contribution.* For purposes of section 1397E(d)(2)(A), the term *qualified contribution* means any contribution (of a type and quality acceptable to the eligible local education agency) of any property or service described in section 1397E(d)(2)(B)(i), (ii), (iii), (iv) or (v). In addition, cash received with respect to a qualified zone academy from a private entity (other than cash received indirectly from a person that is not a private entity as part of a plan to avoid the requirements of section 1397E) constitutes a qualified contribution if it is to be used to purchase any property or service described in section 1397E(d)(2)(B)(i), (ii), (iii), (iv) or (v). Services of employees of the eligible local education agency do not constitute qualified contributions.

(d) *Maximum term.* The maximum term for a qualified zone academy bond is determined under section 1397E(d)(3) by using a discount rate equal to 110

percent of the long-term adjusted AFR, compounded semi-annually, for the month in which the bond is issued. The Internal Revenue Service publishes this figure each month in a revenue ruling that is published in the Internal Revenue Bulletin. See § 601.601(d)(2)(ii)(b) of this chapter.

(e) *Tax credit—(1) Eligible taxpayer.* An eligible taxpayer (within the meaning of section 1397E(d)(6)) that holds a qualified zone academy bond on a credit allowance date is allowed a tax credit against the Federal income tax imposed on the taxpayer for the taxable year that includes the credit allowance date. The amount of the credit is equal to the product of the credit rate and the outstanding principal amount of the bond on the credit allowance date. The credit is subject to a limitation based on the eligible taxpayer's income tax liability. See section 1397E(c).

(2) *Ineligible taxpayer.* A taxpayer that is not an eligible taxpayer is not allowed a credit.

(f) *Treatment of the allowance of the credit as a payment of interest—(1) General rule.* The holder of a qualified zone academy bond must treat the bond as if it pays qualified stated interest (within the meaning of § 1.1273-1(c)) on each credit allowance date. The amount of the deemed payment of interest on each credit allowance date is equal to the product of the credit rate and the outstanding principal amount of the bond on that date. Thus, for example, if the holder uses an accrual method of accounting, the holder must accrue as interest income the amount of the credit over the one-year accrual period that ends on the credit allowance date.

(2) *Adjustment if the holder cannot use the credit to offset a tax liability.* If a holder holds a qualified zone academy bond on the credit allowance date but cannot use all or a portion of the credit to reduce its income tax liability (for example, because the holder is not an eligible taxpayer or because the limitation in section 1397E(c) applies), the holder is allowed a deduction for the taxable year that includes the credit allowance date (or, at the option of the holder, the next succeeding taxable year). The amount of the deduction is equal to the amount of the unused

credit deemed paid on the credit allowance date.

(g) *Not a tax-exempt obligation.* A qualified zone academy bond is not an obligation the interest on which is excluded from gross income under section 103(a).

(h) *Reimbursement.* An expenditure for a qualified purpose may be reimbursed with proceeds of a qualified zone academy bond. For this purpose, rules similar to those in § 1.150-2 shall apply.

(i) and (j) [Reserved] For further guidance, see § 1.1397E-1T(i) and (j).

(k) *State or local government—(1) In general.* For purposes of section 1397E(d)(1)(B), the term *State or local government* means a State or political subdivision as defined for purposes of section 103(c).

(2) *On behalf of issuer.* A qualified zone academy bond may be issued on behalf of a State or local government under rules similar to those for determining whether a bond issued on behalf of a State or political subdivision constitutes an obligation of that State or political subdivision for purposes of section 103.

(l) *Cross-references.* See section 171 and the regulations thereunder for rules relating to amortizable bond premium. See § 1.61-7(d) for the seller's treatment of a bond sold between interest payment dates (credit allowance dates) and § 1.61-7(c) for the buyer's treatment of a bond purchased between interest payment dates (credit allowance dates).

(m) *Effective/applicability dates.* Except as provided in this paragraph (m), this section applies to bonds sold on or after September 26, 2000. Each of paragraphs (c) and (k) of this section may be applied by issuers to bonds that are sold before September 26, 2000.

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#### § 1.1397E-1T Qualified zone academy bonds (temporary).

(a) *In general—(1) Overview.* In general, a qualified zone academy bond (QZAB or QZABs) is a taxable bond issued by a state or local government the proceeds of which are used to im-

prove certain eligible public schools. An eligible taxpayer that holds a QZAB generally is allowed annual Federal income tax credits in lieu of periodic interest payments. These credits compensate the eligible taxpayer for lending money to the issuer and function as payments of interest on the bond. Accordingly, this section generally treats the allowance of a credit as if it were a payment of interest on the bond. This section also provides other rules for QZABs, including rules governing the credit rate, the private business contribution requirement, the maximum term, use and expenditure of proceeds, remedial actions, eligible issuers, arbitrage investment restrictions, and information reporting.

(2) *Certain definitions—(i) In general.* For purposes of this section, except as otherwise provided in this section, the following definitions apply: the definitions set forth in this section; the definitions used for general tax-exempt bond purposes in § 1.150-1; and the definitions used for purposes of the arbitrage investment restrictions on tax-exempt bonds in § 1.148-1(b).

(ii) *Applicable definition of proceeds—(A) Use and expenditure provisions.* Except as provided in paragraphs (a)(2)(ii)(B) and (a)(2)(ii)(C) of this section, for purposes of all applicable requirements regarding use and expenditure of proceeds of QZABs under section 1397E and this section, proceeds means "sale proceeds," as defined in § 1.148-1(b), plus "investment proceeds," as defined in § 1.148-1(b).

(B) *Private business contribution requirement.* For purposes of the private business contribution requirement of section 1397E(d)(2), proceeds means "sale proceeds," as defined in § 1.148-1(b).

(C) *Arbitrage investment restrictions.* For purposes of the scope of application of the arbitrage investment restrictions under section 1397E(g) and paragraph (i) of this section, proceeds generally means gross proceeds, as defined in § 1.148-1(b). In addition, in applying the arbitrage investment restrictions under paragraph (i) of this section and section 148, the various applicable definitions of the various types of proceeds of tax-exempt bonds under § 1.148-1(b) shall apply.