§ 522.1260 [Amended]

■ 2. Section 522.1260 *Lincomycin* is amended in paragraph (b)(2) by removing ''No. 000857'' and by adding in its place ''Nos. 000857 and 059130''.

Dated: March 3, 2004.

Stephen F. Sundlof,

Director, Center for Veterinary Medicine.

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9116]

RIN 1545–BC02

New Markets Tax Credit Amendments

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains amendments to temporary regulations for the new markets tax credit under section 45D. The regulations revise and clarify certain aspects of those regulations and affect a taxpayer making a qualified equity investment in a qualified community development entity that has received a new markets tax credit allocation. The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section in this issue of the **Federal Register**.

DATES: *Effective Date:* These regulations are effective March 11, 2004.

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

FOR FURTHER INFORMATION CONTACT: Paul F. Handleman or Lauren R. Taylor, (202) 622–3040 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document amends 26 CFR part 1 to provide amended rules (the revised regulations) relating to the new markets tax credit under section 45D of the Internal Revenue Code (Code). On December 26, 2001, the IRS published temporary and proposed regulations (the 2001 temporary regulations) in the **Federal Register** (66 FR 66307, 66 FR 66376). Written and electronic comments responding to the 2001 temporary regulations were received. The IRS and Treasury Department have reviewed the comments on the 2001 temporary regulations and decided to revise and clarify certain aspects of those regulations. The IRS and Treasury Department continue to consider comments on the 2001 temporary regulations that are not addressed in the revised regulations.

Explanation of Provisions

General Overview

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

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

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

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

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

Substantially All

As indicated above, a CDE must use substantially all of the cash from a qualified equity investment to make qualified low-income community investments. Section 1.45D–1T(c)(5)(i) provides that the substantially-all requirement is treated as satisfied for an annual period if either the direct-tracing calculation under § 1.45D–1T(c)(5)(ii), or the safe harbor calculation under § 1.45D–1T(c)(5)(iii), is performed every six months and the average of the two calculations for the annual period is at least 85 percent. Commentators have suggested that the use of the direct-tracing calculation (or the safe harbor calculation) for an annual period should not preclude the use of the safe harbor calculation (or the direct-tracing calculation) for another annual period. The revised regulations adopt this suggestion.

Commentators have suggested that, if a CDE makes a qualified low-income community investment from a source of funds other than a qualified equity investment (for example, a line of credit from a bank), and later uses proceeds of an equity investment in the CDE to reimburse or repay the other source of funds, the equity investment should be treated as financing the qualified low-income community investment on a direct-tracing basis. The revised regulations do not adopt this suggestion because, in these circumstances, the proceeds of the equity investment are not ''used . . . to make'' the qualified low-income community investment as required by section 45D(b)(1)(B). However, the revised regulations provide an example demonstrating that, in this situation, the substantially-all requirement may be satisfied under the safe harbor calculation.

Qualified Low-Income Community Investments

Under section 45D(d)(1)(B), a qualified low-income community

investment includes the purchase from another CDE of any loan made by such entity that is a qualified low-income community investment. Commentators have suggested that, for purposes of section 45D(d)(1)(B), a loan by an entity should be treated as made by a CDE, even if the entity is not a CDE at the time it makes the loan, so long as the entity is a CDE at the time it sells the loan. The revised regulations adopt this suggestion, in accordance with Notice 2003–68 (2003–41 I.R.B. 824).

Commentators also have suggested that the phrase ''made by such entity'' for purposes of section 45D(d)(1)(B) should include any loans held or purchased by such entity. The revised regulations do not adopt this suggestion because it would treat loan purchases as qualified low-income community investments even if the originator or a prior seller of the loan were not a CDE. However, the revised regulations do contain a special rule, as set forth in Notice 2003–68, that applies to the purchase of a loan by a CDE (the ultimate CDE) from a second CDE if the loan was made by a third CDE (the originating CDE). Specifically, the revised regulations provide that, for purposes of section 45D(d)(1)(B): (1) The purchase of a loan by the ultimate CDE from a second CDE that purchased the loan from the originating CDE (or from another CDE) is treated as a purchase of the loan by the ultimate CDE from the originating CDE, provided that each entity that sold the loan was a CDE at the time it sold the loan; and (2) a loan purchased by the ultimate CDE from another CDE is a qualified low-income community investment if it qualifies as a qualified low-income community investment either (A) at the time the loan was made or (B) at the time the ultimate CDE purchases the loan.

Commentators have suggested that, in certain circumstances in which a CDE purchases a loan from another entity under an advance commitment agreement, the loan should be treated as made by the CDE and therefore eligible to be a qualified low-income community investment. The revised regulations provide that, for these purposes, a loan is treated as made by a CDE to the extent the CDE purchases the loan from the originator (whether or not the originator is a CDE) within 30 days after the date the originator makes the loan if, at the time the loan is made, there is a legally enforceable written agreement between the originator and the CDE which (A) requires the CDE to approve the making of the loan either directly or by imposing specific written loan underwriting criteria and (B) requires the CDE to purchase the loan within 30 days after the date the loan is made.

Section 1.45D–1T(d)(1)(iv) provides that a qualified low-income community investment includes an equity investment in, or loan to, another CDE, but only to the extent that the recipient CDE uses the proceeds: (1) for either an investment in, or a loan to, a qualified active low-income community business, or financial counseling and other services; and (2) in a manner that would constitute a qualified low-income community investment if it were made directly by the CDE making the equity investment or loan. Commentators have suggested that this provision should be amended to permit investments through multiple tiers of CDEs. For example, commentators have indicated that some CDEs have reasons relating to bank regulatory requirements for lending to bank holding company CDEs that invest in bank subsidiary CDEs. The revised regulations amend this provision, in accordance with Notice 2003–64 (2003–39 I.R.B. 646), to permit investments through two additional CDEs.

Qualified Active Low-Income Community Business

Section 45D(d)(2)(A)(i) provides that a corporation (including a nonprofit corporation) or a partnership is a qualified active low-income community business only if, among other things, at least 50 percent of the total gross income of the entity is derived from the active conduct of a qualified business within any low-income community. Commentators have requested clarification of the meaning of ''active conduct''. Some commentators have suggested that the term should include start-up businesses, including the development of commercial rental property. Other commentators have suggested defining active conduct by focusing on the economic effect of a particular business activity. The revised regulations provide a special rule that makes clear that an entity will be treated as engaged in the active conduct of a trade or business if, at the time the CDE makes a capital or equity investment in, or loan to, the entity, the CDE reasonably expects that the entity will generate revenues (or, in the case of a nonprofit corporation, receive donations) within 3 years after the date the investment or loan is made.

Section 45D(d)(2)(A)(iii) provides that a corporation or a partnership is a qualified active low-income community business only if, among other things, a substantial portion of the services performed for such entity by its employees are performed in a low-income community (the services test). Section 1.45D–1T(d)(4)(i)(C) defines substantial portion for this purpose as 40 percent. Commentators have requested guidance on compliance with the services test if an entity has no employees. One commentator has suggested that, if the entity is a partnership and has no employees, the test should be applied to the general partners or managing members. The revised regulations provide that, if an entity has no employees, the entity is deemed to satisfy the services test (as well as the requirement in § 1.45D–1T(d)(4)(i)(A) that at least 50 percent of the total gross income of the entity be derived from the active conduct of a qualified business within a low-income community) if at least 85 percent of the use of the tangible property of the entity (whether owned or leased) is within a low-income community.

Control

Under § 1.45D–1T(d)(6)(i), an entity is treated as a qualified active low-income community business if the CDE reasonably expects, at the time the CDE makes the capital or equity investment in, or loan to, the entity, that the entity will satisfy the requirements to be a qualified active low-income community business throughout the entire period of the investment or loan. However, under § 1.45D–1T(d)(6)(ii)(A), if the CDE controls or obtains control of the entity at any time during the 7-year credit period, the entity will be treated as a qualified active low-income community business only if the entity satisfies the applicable requirements throughout the entire period the CDE controls the entity. Section 1.45D–1T(d)(6)(ii)(B) generally defines control with respect to an entity as direct or indirect ownership (based on value) or control (based on voting or management rights) of 33 percent or more of the entity. Commentators have suggested that this definition should be revised to increase the threshold for control. The revised regulations amend the definition of control to mean direct or indirect ownership (based on value) or control (based on voting or management rights) of more than 50 percent of the entity.

Commentators have suggested that if a CDE obtains control of an entity subsequent to making an investment in the entity, the CDE should be granted a reasonable period (such as 12 months) either to cause the entity to satisfy the requirements to be a qualified active low-income community business or to find a replacement investment. The revised regulations provide a 12-month period during which a CDE's acquisition of control of an entity is disregarded if, among other things, the CDE's

investment in the entity met the reasonable expectations test of § 1.45D–1T(d)(6)(i) when initially made and the acquisition of control is due to unforeseen financial difficulties of the entity.

Other Issues

Commentators have suggested that taxpayers should be able to claim the new markets tax credit in the event the CDE in which the qualified equity investment is made becomes bankrupt. The revised regulations adopt this suggestion.

The revised regulations incorporate Notice 2003–9 (2003–5 I.R.B. 369), which permits certain equity investments made on or after April 20, 2001, to be designated as qualified equity investments, and Notice 2003–56 (2003–34 I.R.B. 396), which permits certain equity investments made on or after the date the Treasury Department publishes a Notice of Allocation Availability to be designated as qualified equity investments. The revised regulations also incorporate Notice 2002–64 (2002–41 I.R.B. 690), which provides guidance on Federal tax benefits that do not limit the availability of the new markets tax credit. The IRS and Treasury Department continue to study how the low-income housing credit under section 42 may limit the availability of the new markets tax credit.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. For applicability of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), refer to the cross-reference notice of proposed rulemaking published elsewhere in this issue of the **Federal Register**. Pursuant to section 7805(f) of the Code, these amendments to the 2001 temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

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

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Amendments to the Regulations

■ Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

■ Paragraph 1. The authority citation for part 1 continues to read in part as follows:

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

■ Par. 2. Section 1.45D–1T is amended by:

■ 1. Revising the section heading.

■ 2. Amending paragraph (a) by:

(a) Amending the entry for (c)(3)(ii) by removing the word ''Exception'' and by adding the word ''Exceptions'' in its place.

(b) Adding new entries for (c)(3)(ii)(A) and (B).

(c) Redesignating the entry for (c)(3)(iii) as (c)(3)(iv).

(d) Adding a new entry for (c)(3)(iii).

(e) Adding a new entry for (c)(5)(vi).

(f) Adding new entries for (d)(1)(ii)(A), (d)(1)(ii)(B), (d)(1)(ii)(C), and (d)(1)(ii)(D).

(g) Adding new entries for (d)(1)(iv)(A) and (d)(1)(iv)(B).

(h) Adding new entries for (d)(4)(iv), (d)(4)(iv)(A), and (d)(4)(iv)(B).

(i) Adding a new entry for (d)(6)(ii)(C).

(j) Adding new entries for (d)(8), (d)(8)(i), and (d)(8)(ii).

(k) Adding new entries for (g)(3), (g)(3)(i), (g)(3)(ii), and (g)(4)

(l) Amending the entry for (h) by removing the word ''Date'' and by adding the word ''Dates'' in its place.

(m) Adding new entries for (h)(1) and (h)(2).

■ 3. Amending paragraph (c)(3)(ii) by removing the word ''Exception'' and by adding the word ''Exceptions'' in its place.

■ 4. Revising paragraphs (c)(3)(ii)(A) and (c)(3)(ii)(B).

■ 5. Removing paragraph (c)(3)(ii)(C) and (c)(3)(ii)(D).

■ 6. Redesignating paragraph (c)(3)(iii) as paragraph (c)(3)(iv).

■ 7. Adding a new paragraph (c)(3)(iii), a sentence after the third sentence in paragraph (c)(5)(i), a new paragraph (c)(5)(vi).

■ 8. Revising paragraphs (d)(1)(ii) and (iv).

■ 9. Adding a sentence at the end of paragraph (d)(4)(i)(A), a sentence at the end of paragraph (d)(4)(i)(C), a new paragraph (d)(4)(iv).

■ 10. Revising paragraph (d)(6)(ii)(B)

■ 11. Adding new paragraph (d)(6)(ii)(C), a new paragraph (d)(8), new paragraphs (g)(3) and (g)(4).

■ 12. Revising paragraph (h).

The additions and revisions read as follows:

§ 1.45D–1T New markets tax credit (temporary).

(a) * * *

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(c) * * *

(3) * * *

(ii) Exceptions.

(A) Allocation applications submitted by August 29, 2002.

(B) Other allocation applications.

(iii) Failure to receive allocation.

(iv) Initial investment date.

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(5) * * *

(vi) Examples.

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(d) * * *

(1) * * *

(ii) * * *

(A) In general.

(B) Certain loans made before CDE certification.

(C) Intermediary CDEs.

(D) Examples.

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(iv) * * *

(A) In general.

(B) Examples.

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(4) * * *

(iv) Active conduct of a trade or business.

(A) Special rule.

(B) Example.

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(6) * * *

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(ii) * * *

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(C) Disregard of control.

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(8) Special rule for certain loans.

(i) In general.

(ii) Example.

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(g) * * *

(3) Other Federal tax benefits.

(i) In general.

(ii) Low-income housing credit.

(4) Bankruptcy of CDE.

(h) Effective dates.

(1) In general.

(2) Exception for certain provisions.

* * * * *

(c) * * *

(3) * * *

(ii) *Exceptions.* * * *

(A) *Allocation applications submitted by August 29, 2002.*

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

(*2*) The designation of the equity investment as a qualified equity investment is made for a credit

allocation received pursuant to an allocation application submitted to the Secretary no later than August 29, 2002; and

(*3*) The equity investment otherwise satisfies the requirements of section 45D and this section; or

(B) *Other allocation applications.*

(*1*) The equity investment is made on or after the date the Secretary publishes a Notice of Allocation Availability (NOAA) in the **Federal Register**;

(*2*) The designation of the equity investment as a qualified equity investment is made for a credit allocation received pursuant to an allocation application submitted to the Secretary under that NOAA; and

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

(iii) *Failure to receive allocation.* For purposes of paragraph (c)(3)(ii)(A) of this section, if the entity in which the equity investment is made does not receive an allocation pursuant to an allocation application submitted no later than August 29, 2002, the equity investment will not be eligible to be designated as a qualified equity investment. For purposes of paragraph (c)(3)(ii)(B) of this section, if the entity in which the equity investment is made does not receive an allocation under the NOAA described in paragraph (c)(3)(ii)(B)(*1*) of this section, the equity investment will not be eligible to be designated as a qualified equity investment.

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(5) * * *

(i) * * * The use of the direct-tracing calculation under paragraph (c)(5)(ii) of this section (or the safe harbor calculation under paragraph (c)(5)(iii) of this section) for an annual period does not preclude the use of the safe harbor calculation under paragraph (c)(5)(iii) of this section (or the direct-tracing calculation under paragraph (c)(5)(ii) of this section) for another annual period.

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(vi) *Examples.* The following examples illustrate an application of this paragraph (c)(5):

Example 1. X is a partnership and a CDE that has received a $1 million new markets tax credit allocation from the Secretary. On September 1, 2004, X uses a line of credit from a bank to fund a $1 million loan to Y. The loan is a qualified low-income community investment under paragraph (d)(1) of this section. On September 5, 2004, A pays $1 million to acquire a capital interest in X. X uses the proceeds of A's equity investment to pay off the $1 million line of credit that was used to fund the loan to Y. X's aggregate gross assets consist of the $1 million loan to Y and $100,000 in other assets. A's equity investment in X does not satisfy the substantially-all requirement under paragraph (c)(5)(i) of this section using the direct-tracing calculation under paragraph (c)(5)(ii) of this section because the cash from A's equity investment is not used to make X's loan to Y. However, A's equity investment in X satisfies the substantially-all requirement using the safe harbor calculation under paragraph (c)(5)(iii) of this section because at least 85 percent of X's aggregate gross assets are invested in qualified low-income community investments.

Example 2. X is a partnership and a CDE that has received a new markets tax credit allocation from the Secretary. On August 1, 2004, A pays $100,000 for a capital interest in X. On August 5, 2004, X uses the proceeds of A's equity investment to make an equity investment in Y. X controls Y within the meaning of paragraph (d)(6)(ii)(B) of this section. For the annual period ending July 31, 2005, Y is a qualified active low-income community business (as defined in paragraph (d)(4) of this section). Thus, for that period, A's equity investment satisfies the substantially-all requirement under paragraph (c)(5)(i) of this section using the direct-tracing calculation under paragraph (c)(5)(ii) of this section. For the annual period ending July 31, 2006, Y no longer is a qualified active low-income community business. Thus, for that period, A's equity investment does not satisfy the substantially-all requirement using the direct-tracing calculation. However, during the entire annual period ending July 31, 2006, X's remaining assets are invested in qualified low-income community investments with an aggregate cost basis of $900,000. Consequently, for the annual period ending July 31, 2006, at least 85 percent of X's aggregate gross assets are invested in qualified low-income community investments. Thus, for the annual period ending July 31, 2006, A's equity investment satisfies the substantially-all requirement using the safe harbor calculation under paragraph (c)(5)(iii) of this section.

Example 3. X is a partnership and a CDE that has received a new markets tax credit allocation from the Secretary. On August 1, 2004, A and B each pay $100,000 for a capital interest in X. X does not treat A's and B's equity investments as one qualified equity investment under paragraph (c)(6) of this section. On September 1, 2004, X uses the proceeds of A's equity investment to make an equity investment in Y and X uses the proceeds of B's equity investment to make an equity investment in Z. X has no assets other than its investments in Y and Z. X controls Y and Z within the meaning of paragraph (d)(6)(ii)(B) of this section. For the annual period ending July 31, 2005, Y and Z are qualified active low-income community businesses (as defined in paragraph (d)(4) of this section). Thus, for the annual period ending July 31, 2005, A's and B's equity investments satisfy the substantially-all requirement under paragraph (c)(5)(i) of this section using either the direct-tracing calculation under paragraph (c)(5)(ii) of this section or the safe harbor calculation under paragraph (c)(5)(iii) of this section. For the annual period ending July 31, 2006, Y, but not Z, is a qualified active low-income community business. Thus, for the annual period ending July 31, 2006: (1) X does not satisfy the substantially-all requirement using the safe harbor calculation under paragraph (c)(5)(iii) of this section; (2) A's equity investment satisfies the substantially-all requirement using the direct-tracing calculation because A's equity investment is directly traceable to Y; and (3) B's equity investment does not satisfy the substantially-all requirement because B's equity investment is traceable to Z.

* * * * * *

(d) * * *

(1) * * *

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

(*1*) At the time the loan was made; or

(*2*) At the time the ultimate CDE purchases the loan.

(B) *Certain loans made before CDE certification.* For purposes of paragraph (d)(1)(ii)(A) of this section, a loan by an entity is treated as made by a CDE, notwithstanding that the entity was not a CDE at the time it made the loan, if the entity is a CDE at the time it sells the loan.

(C) *Intermediary CDEs.* For purposes of paragraph (d)(1)(ii)(A) of this section, the purchase of a loan by the ultimate CDE from a CDE that did not make the loan (the second CDE) is treated as a purchase of the loan by the ultimate CDE from the CDE that made the loan (the originating CDE) if—

(*1*) The second CDE purchased the loan from the originating CDE (or from another CDE); and

(*2*) Each entity that sold the loan was a CDE at the time it sold the loan.

(D) *Examples.* The following examples illustrate an application of this paragraph (d)(1)(ii):

Example 1. X is a partnership and a CDE that has received a new markets tax credit allocation from the Secretary. Y, a corporation, made a $500,000 loan to Z in 1999. In January of 2004, Y is certified as a CDE. On September 1, 2004, X purchases the loan from Y. At the time X purchases the loan, Z is a qualified active low-income community business under paragraph (d)(4)(i) of this section. Accordingly, the loan purchased by X from Y is a qualified low-income community investment under

paragraphs (d)(1)(ii)(A) and (B) of this section.

Example 2. The facts are the same as in *Example 1* except that on February 1, 2004, Y sells the loan to W and on September 1, 2004, W sells the loan to X. W is a CDE. Under paragraph (d)(1)(ii)(C) of this section, X's purchase of the loan from W is treated as the purchase of the loan from Y. Accordingly, the loan purchased by X from W is a qualified low-income community investment under paragraphs (d)(1)(ii)(A) and (C) of this section.

Example 3. The facts are the same as in *Example 2* except that W is not a CDE. Because W was not a CDE at the time it sold the loan to X, the purchase of the loan by X from W is not a qualified low-income community investment under paragraphs (d)(1)(ii)(A) and (C) of this section.

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(iv) *Investments in other CDEs*—(A) *In general.* Any equity investment in, or loan to, any CDE (the second CDE) by a CDE (the primary CDE), but only to the extent that the second CDE uses the proceeds of the investment or loan—

(*1*) In a manner—

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

(*ii*) That would constitute a qualified low-income community investment if it were made directly by the primary CDE;

(*2*) To make an equity investment in, or loan to, a third CDE that uses such proceeds in a manner described in paragraph (d)(1)(iv)(A)(*1*) of this section; or

(*3*) To make an equity investment in, or loan to, a third CDE that uses such proceeds to make an equity investment in, or loan to, a fourth CDE that uses such proceeds in a manner described in paragraph (d)(1)(iv)(A)(*1*) of this section.

(B) *Examples.* The following examples illustrate an application of paragraph (d)(1)(iv)(A) of this section:

Example 1. X is a partnership and a CDE that has received a new markets tax credit allocation from the Secretary. On September 1, 2004, X uses $975,000 to make an equity investment in Y. Y is a corporation and a CDE. On October 1, 2004, Y uses $950,000 from X's equity investment to make a loan to Z. Z is a qualified active low-income community business under paragraph (d)(4)(i) of this section. Of X's equity investment in Y, $950,000 is a qualified low-income community investment under paragraph (d)(1)(iv)(A)(*1*) of this section.

Example 2. W is a partnership and a CDE that has received a new markets tax credit allocation from the Secretary. On September 1, 2004, W uses $975,000 to make an equity investment in X. On October 1, 2004, X uses $950,000 from W's equity investment to make an equity investment in Y. X and Y are corporations and CDEs. On October 5, 2004, Y uses $925,000 from X's equity investment to make a loan to Z. Z is a qualified active low-income community business under paragraph (d)(4)(i) of this section. Of W's equity investment in X, $925,000 is a qualified low-income community investment under paragraph (d)(1)(iv)(A)(*2*) of this section because X uses proceeds of W's equity investment to make an equity investment in Y, which uses $925,000 of the proceeds in a manner described in paragraph (d)(1)(iv)(A)(*1*) of this section.

Example 3. U is a partnership and a CDE that has received a new markets tax credit allocation from the Secretary. On September 1, 2004, U uses $975,000 to make an equity investment in V. On October 1, 2004, V uses $950,000 from U's equity investment to make an equity investment in W. On October 5, 2004, W uses $925,000 from V's equity investment to make an equity investment in X. On November 1, 2004, X uses $900,000 from W's equity investment to make an equity investment in Y. V, W, X, and Y are corporations and CDEs. On November 5, 2004, Y uses $875,000 from X's equity investment to make a loan to Z. Z is a qualified active low-income community business under paragraph (d)(4)(i) of this section. U's equity investment in V is not a qualified low-income community investment because X does not use proceeds of W's equity investment in a manner described in paragraph (d)(1)(iv)(A)(*1*) of this section.

* * * * *

(4) * * *

(i) * * *

(A) * * * See paragraph (d)(4)(iv) of this section for circumstances in which an entity will be treated as engaged in the active conduct of a trade or business.

* * * * *

(C) * * * If the entity has no employees, the entity is deemed to satisfy this paragraph (d)(4)(i)(C), and paragraph (d)(4)(i)(A) of this section, if the entity meets the requirement of paragraph (d)(4)(i)(B) of this section if ''85 percent'' is applied instead of 40 percent.

* * * * *

(iv) *Active conduct of a trade or business*—(A) *Special rule.* For purposes of paragraph (d)(4)(i)(A) of this section, an entity will be treated as engaged in the active conduct of a trade or business if, at the time the CDE makes a capital or equity investment in, or loan to, the entity, the CDE reasonably expects that the entity will generate revenues (or, in the case of a nonprofit corporation, receive donations) within 3 years after the date the investment or loan is made.

(B) *Example.* The application of paragraph (d)(4)(iv)(A) of this section is illustrated by the following example:

Example. X is a partnership and a CDE that receives a new markets tax credit allocation from the Secretary on July 1, 2004. X makes a ten-year loan to Y. Y is a newly formed entity that will own and operate a shopping center to be constructed in a low-income community. Y has no revenues but X reasonably expects that Y will generate revenues beginning in December 2005. Under paragraph (d)(4)(iv)(A) of this section, Y is treated as engaged in the active conduct of a trade or business for purposes of paragraph (d)(4)(i)(A) of this section.

* * * * *

(6) * * *

(ii) * * *

(B) *Definition of control.* Control means, with respect to an entity, direct or indirect ownership (based on value) or control (based on voting or management rights) of more than 50 percent of the entity.

(C) *Disregard of control.* For purposes of paragraph (d)(6)(ii)(A) of this section, the acquisition of control of an entity by a CDE is disregarded during the 12-month period following such acquisition of control (the 12-month period) if—

(*1*) The CDE's capital or equity investment in, or loan to, the entity met the requirements of paragraph (d)(6)(i) of this section when initially made;

(*2*) The CDE's acquisition of control of the entity is due to financial difficulties of the entity that were unforeseen at the time the investment or loan described in paragraph (d)(6)(ii)(C)(1) of this section was made; and

(*3*) If the acquisition of control occurs before the seventh year of the 7-year credit period (as defined in paragraph (c)(5)(i) of this section), either—

(*i*) The entity satisfies the requirements of paragraph (d)(4) of this section by the end of the 12-month period; or

(*ii*) The CDE sells or causes to be redeemed the entire amount of the investment or loan described in paragraph (d)(6)(ii)(C)(1) of this section and, by the end of the 12-month period, reinvests the amount received in respect of the sale or redemption in a qualified low-income community investment under paragraph (d)(1) of this section. For this purpose, the amount treated as continuously invested in a qualified low-income community investment is determined under paragraphs (d)(2)(i) and (ii) of this section.

* * * * *

(8) *Special rule for certain loans*—(i) *In general.* For purposes of paragraphs (d)(1)(i), (ii), and (iv) of this section, a loan is treated as made by a CDE to the extent the CDE purchases the loan from the originator (whether or not the originator is a CDE) within 30 days after the date the originator makes the loan if, at the time the loan is made, there is a legally enforceable written agreement between the originator and the CDE which—

(A) Requires the CDE to approve the making of the loan either directly or by

imposing specific written loan underwriting criteria; and

(B) Requires the CDE to purchase the loan within 30 days after the date the loan is made.

(ii) *Example.* The application of paragraph (d)(8)(i) of this section is illustrated by the following example:

Example. (i) X is a partnership and a CDE that has received a new markets tax credit allocation from the Secretary. On October 1, 2004, Y enters into a legally enforceable written agreement with W. Y and W are corporations but only Y is a CDE. The agreement between Y and W provides that Y will purchase loans (or portions thereof) from W within 30 days after the date the loan is made by W, and that Y will approve the making of the loans.

(ii) On November 1, 2004, W makes a $825,000 loan to Z pursuant to the agreement between Y and W. Z is a qualified active low-income community business under paragraph (d)(4) of this section. On November 15, 2004, Y purchases the loan from W for $840,000. On December 31, 2004, X purchases the loan from Y for $850,000.

(iii) Under paragraph (d)(8)(i) of this section, the loan to Z is treated as made by Y. Y's loan to Z is a qualified low-income community investment under paragraph (d)(1)(i) of this section. Accordingly, under paragraph (d)(1)(ii)(A) of this section, X's purchase of the loan from Y is a qualified low-income community investment in the amount of $850,000.

* * * * *

(g) * * *

(3) *Other Federal tax benefits*—(i) *In general.* Except as provided in paragraph (g)(3)(ii) of this section, the availability of Federal tax benefits does not limit the availability of the new markets tax credit. Federal tax benefits that do not limit the availability of the new markets tax credit include, for example:

(A) The rehabilitation credit under section 47;

(B) All depreciation deductions under sections 167 and 168, including the additional first-year depreciation under section 168(k), and the expense deduction for certain depreciable property under section 179; and

(C) All tax benefits relating to certain designated areas such as empowerment zones and enterprise communities under sections 1391 through 1397D, the District of Columbia Enterprise Zone under sections 1400 through 1400B, renewal communities under sections 1400E through 1400J, and the New York Liberty Zone under section 1400L.

(ii) *Low-income housing credit.* This paragraph (g)(3) does not apply to the low-income housing credit under section 42.

(4) *Bankruptcy of CDE.* The bankruptcy of a CDE does not preclude a taxpayer from continuing to claim the new markets tax credit on the remaining credit allowance dates under paragraph (b)(2) of this section.

(h) *Effective dates*—(1) *In general.* Except as provided in paragraph (h)(2) of this section, this section applies on or after December 26, 2001, and expires on December 23, 2004.

(2) *Exception for certain provisions.* Paragraphs (c)(3)(ii), (c)(3)(iii), (c)(5)(vi), (d)(1)(ii), (d)(1)(iv), (d)(4)(iv), (d)(6)(ii)(B), (d)(6)(ii)(C), (d)(8), (g)(3), and (g)(4) of this section, the fourth sentence in paragraph (c)(5)(i) of this section, the last sentence in paragraph (d)(4)(i)(A) of this section, and the last sentence in paragraph (d)(4)(i)(C) of this section apply on or after March 11, 2004, and may be applied by taxpayers before March 11, 2004. The paragraphs of this section that apply before March 11, 2004 are contained in § 1.45D–1T as in effect before March 11, 2004 (see 26 CFR part 1 revised as of April 1, 2003).

Mark E. Matthews,

Deputy Commissioner for Services and Enforcement.

Approved: March 3, 2004.

Gregory F. Jenner,

Acting Assistant Secretary of the Treasury.

[FR Doc. 04–5560 Filed 3–10–04; 8:45 am]

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DEPARTMENT OF THE INTERIOR

Office of Surface Mining Reclamation and Enforcement

30 CFR Part 920

[MD–051–FOR]

Maryland Regulatory Program

AGENCY: Office of Surface Mining Reclamation and Enforcement, Interior.

ACTION: Final rule; approval of amendment.

SUMMARY: We, the Office of Surface Mining Reclamation and Enforcement (OSM), are approving an amendment to the Maryland regulatory program (the ''Maryland program'') under the Surface Mining Control and Reclamation Act of 1977 (SMCRA or the Act). The program amendment includes changes to the Code of Maryland Regulations (COMAR) to incorporate various revisions related to: augering, lands eligible for remining, required written findings, and topsoil handling.

EFFECTIVE DATE: March 11, 2004.

FOR FURTHER INFORMATION CONTACT: George Rieger, Telephone: 412–937–2153. Internet: *grieger@osmre.gov.*

SUPPLEMENTARY INFORMATION:

I. Background on the Maryland Program

Section 503(a) of the Act permits a State to assume primacy for the regulation of surface coal mining and reclamation operations on non-Federal and non-Indian lands within its borders by demonstrating that its State program includes, among other things, ''a State law which provides for the regulation of surface coal mining and reclamation operations in accordance with the requirements of the Act * * *; and rules and regulations consistent with regulations issued by the Secretary pursuant to the Act.'' See 30 U.S.C. 1253(a)(1) and (7). On the basis of these criteria, the Secretary of the Interior conditionally approved the Maryland program on December 1, 1980. You can find background information on the Maryland program, including the Secretary's findings, the disposition of comments, and conditions of approval in the December 1, 1980, **Federal Register** (45 FR 79430). You can also find later actions concerning Maryland's program and program amendments at 30 CFR 920.12, 920.15 and 920.16.

II. Submission of the Proposed Amendment

By letter dated September 16, 2003, Maryland sent us a proposed amendment to its program (Administrative Record No. MD–585–00) under SMCRA (30 U.S.C. 1201 *et seq.*). Maryland sent the amendment to include changes made at its own initiative.

The provisions of COMAR that Maryland proposes to revise are as follows: COMAR, 26.20.03.07 Augering, A and B; 26.20.03.11 Lands Eligible for Remining, A, B, (1), (2), C, and D; 26.20.05.01 Required Written Findings, A, B, C, L, (1), (2), and (3), and 26.20.25.02 Topsoil Handling, D. The specific amendments to COMAR are identified below in the ''OSM Findings'' section.

We announced receipt of the proposed amendment in the October 27, 2003, **Federal Register** (68 FR 61172). In the same document, we opened the public comment period and provided an opportunity for a public hearing or meeting on the amendment's adequacy. We did not hold a public hearing or meeting because no one requested one. The public comment period ended on