

September 1999

COMMUNITY
DEVELOPMENT

Businesses' Use of
Empowerment Zone
Tax Incentives



**Resources, Community, and
Economic Development Division**

B-283591

September 30, 1999

The Honorable John Mica
Chairman, Subcommittee on Criminal Justice,
Drug Policy, and Human Resources
Committee on Government Reform
House of Representatives

The Honorable Christopher Shays
Chairman, Subcommittee on National Security,
Veterans Affairs, and International Relations
Committee on Government Reform
House of Representatives

The Omnibus Budget Reconciliation Act of 1993 established the Empowerment Zone and Enterprise Community program as a comprehensive approach to help designated communities revitalize deteriorating areas. The act also provided three tax incentives that, among other things, were intended to revitalize the distressed areas by lowering the cost of doing business in an empowerment zone. These three tax incentives are (1) an employment credit, (2) a \$20,000 increase in the expensing deduction for depreciable business property, and (3) a tax-exempt facility bond. The estimated cost of these incentives to the government, which is periodically updated, is projected to be about \$2.5 billion over the 10-year life of this program.

As arranged with your offices, this report discusses the extent to which businesses in empowerment zones used the program's three tax incentives, as well as three other tax incentives that are targeted to help businesses, including those in distressed areas—the work opportunity credit; the welfare-to-work credit; and an environmental cleanup tax deduction, also known as the brownfields deduction. This report also discusses, where applicable, why the incentives were not used.

To address these objectives, we mailed a survey to about 2,400 businesses in the nine original empowerment zones, which are located in Atlanta, Georgia; Baltimore, Maryland; Chicago, Illinois; Detroit, Michigan; Philadelphia, Pennsylvania/Camden, New Jersey; New York, New York; the Kentucky Highlands; the Mississippi Mid-Delta; and the Rio Grande Valley, Texas.¹ We asked businesses about their use of the employment

¹The Taxpayer Relief Act of 1997 provided for a second round of this program with revised tax incentives. Consequently, additional empowerment zones were designated in January 1998 and January 1999.

credit and the increased expensing deduction for tax year 1997, which was the most recently completed tax year for which all of the businesses we surveyed would have filed taxes when we initiated our work in January 1999 (see app. I for a copy of the survey). Throughout the report, we provide information separately for large urban businesses, small urban businesses, and rural businesses because we found differences in how they responded to the survey. In some cases, we provide information separately for large rural businesses and small rural businesses.² We also are providing descriptive information on the businesses that responded to the survey (see app. II). Because more than half of the large urban businesses and the rural businesses did not respond to our survey, the survey results only reflect the usage of the incentives by those who responded and may not reflect actual usage of the incentives.³ In addition, the estimates that are based on responses from our random sample of the small urban businesses may be imprecise because of the sampling error associated with the estimate. These estimates reflect the usage of the incentives by the businesses that would have responded to the survey if we had mailed it to all of them. Appendix III contains a complete description of our scope and methodology, as well as the sampling errors for the estimates that we report for small urban businesses.

Results in Brief

Large urban businesses and rural businesses were more likely than small urban businesses to have used at least one of the three tax incentives available to businesses in the empowerment zones. The employment credit was the most frequently used of the three tax incentives. According to the survey's responses, 42 percent of the large urban businesses, an estimated 6 percent of the small urban businesses, and 32 percent of the rural businesses used the employment credit. Large urban businesses and rural businesses reported claiming \$9.1 million for tax year 1997. The majority of the businesses that used the employment credit reported that the credit was at least "somewhat important" to making decisions about hiring employees who live in the zones. The businesses that reported they did not claim the employment credit cited a variety of reasons, which most frequently included that they did not qualify for the credit because their employees lived outside of the zone or they did not know about the credit.

In tax year 1997, the increased expensing deduction was used less than the employment credit. About 9 percent of the large urban businesses, an

²We defined large businesses as those with 50 or more employees and small businesses as those with fewer than 50 employees.

³For example, one survey that was returned too late to be included in our analysis was from a business that reported claiming \$700,000 in employment credits.

estimated 4 percent of the small urban businesses, and 8 percent of the rural businesses used the increased expensing deduction. Of the businesses that used this deduction, large urban businesses reported claiming \$405,534 and rural businesses reported claiming \$480,081. The businesses that reported they did not claim this deduction cited a variety of reasons. The four most frequently cited reasons were (1) a lack of knowledge about the increased deduction, (2) a lack of investment in “qualified zone property,” (3) insufficient business investments to use the deduction, and (4) insufficient income to use the deduction.

Few businesses have used the tax-exempt facility bonds. Ten businesses reported receiving the proceeds from these tax-exempt bonds: seven large urban businesses, one large rural business, and two small rural businesses. Of the businesses that did not use these bonds, the predominant reason was that they did not know about them. Finally, most of the businesses did not use the work opportunity credit, the welfare-to-work credit, or the environmental cleanup tax deduction.

Background

On December 21, 1994, nine empowerment zones—six urban and three rural—were designated. The urban zones are located in Atlanta, Georgia; Baltimore, Maryland; Chicago, Illinois; Detroit, Michigan; Philadelphia, Pennsylvania/Camden, New Jersey; and New York, New York. The rural zones are located in the Kentucky Highlands; the Mississippi Mid-Delta; and the Rio Grande Valley, Texas.³ The businesses in these empowerment zones may be eligible for three tax incentives, which are (1) an employment credit, (2) a \$20,000 increase in the expensing deduction for depreciable business property authorized under section 179 of the Internal Revenue Code, and (3) a tax-exempt facility bond. According to officials in the empowerment zones—including Executive Directors and others familiar with the zones’ efforts to provide information on the tax incentives, they have disseminated information on the three empowerment zone incentives by (1) mailing information to businesses operating in the zones, (2) responding to individual requests for information or assistance on operating in the zones, and/or (3) conducting seminars and other meetings with businesses from the zones.

The empowerment zone employment credit allows a business to claim a credit for up to 20 percent of the first \$15,000 in wages paid to each of its employees that lives and works in the zone—up to a maximum of \$3,000

³An additional 95 communities were designated as enterprise communities in 1994. Empowerment zones receive much larger grants and more tax incentives than enterprise communities and are the subject of this report.

for each employee.⁵ The depreciation incentive increases by up to \$20,000 the limit on expensing deductions for qualified empowerment zone businesses, as authorized by section 179 of the Internal Revenue Code. For example, in 1997, the limit for these businesses was \$38,000 and the limit for other businesses was \$18,000.⁶ This deduction allows businesses to recover the cost of certain depreciable property, such as equipment and machinery, by deducting all or part of the cost in the year that the property is placed in service rather than over several years.

A new category of tax-exempt bonds was authorized for the program to offer businesses lower rates than conventional financing for borrowing money. These bonds can be used by qualified businesses to finance the purchase of business property and land, as well as to finance new facilities or to expand and renovate existing ones. However, these bonds are subject to an annual limit that is established for each state.⁷ Additionally, the aggregate face amount of these bonds for each qualified business cannot exceed \$3 million per zone and \$20 million for the same business in all empowerment zones and enterprise communities nationwide. The authorizing legislation requires, among other things, that each business that benefits from these bonds ensures that at least 35 percent of its employees live in the zone.

At least three additional tax incentives are available to businesses in the empowerment zones, as well as to other businesses. The work opportunity credit provides businesses with an incentive to hire individuals from groups that have a particularly high unemployment rate or other special employment needs. This tax credit allows businesses to claim a credit for wages paid to qualified employees in their first year of employment up to a specified limit per individual. These employees must be certified as being in one of eight groups of people—such as veterans, high-risk youth, and food stamp recipients—that have high unemployment rates or other special employment needs. A second credit, the welfare-to-work credit, is intended to encourage businesses to hire long-term recipients of family assistance to ease the transition from welfare to work by increasing access to employment, as well as providing certain employee benefits to encourage training, health coverage, dependent care, and better job

⁵The credit will be reduced by 5 percentage points per year starting in 2002 for the nine initial empowerment zones.

⁶The limit on this deduction for businesses that are not in empowerment zones will be raised in annual increments until it reaches \$25,000 for the years after 2002.

⁷Under current law, each state has the authority to issue tax-exempt private activity bonds in an amount equal to \$50 per resident. If a state's population results in the authority to issue less than \$150 million, the state's allocation is automatically raised to \$150 million.

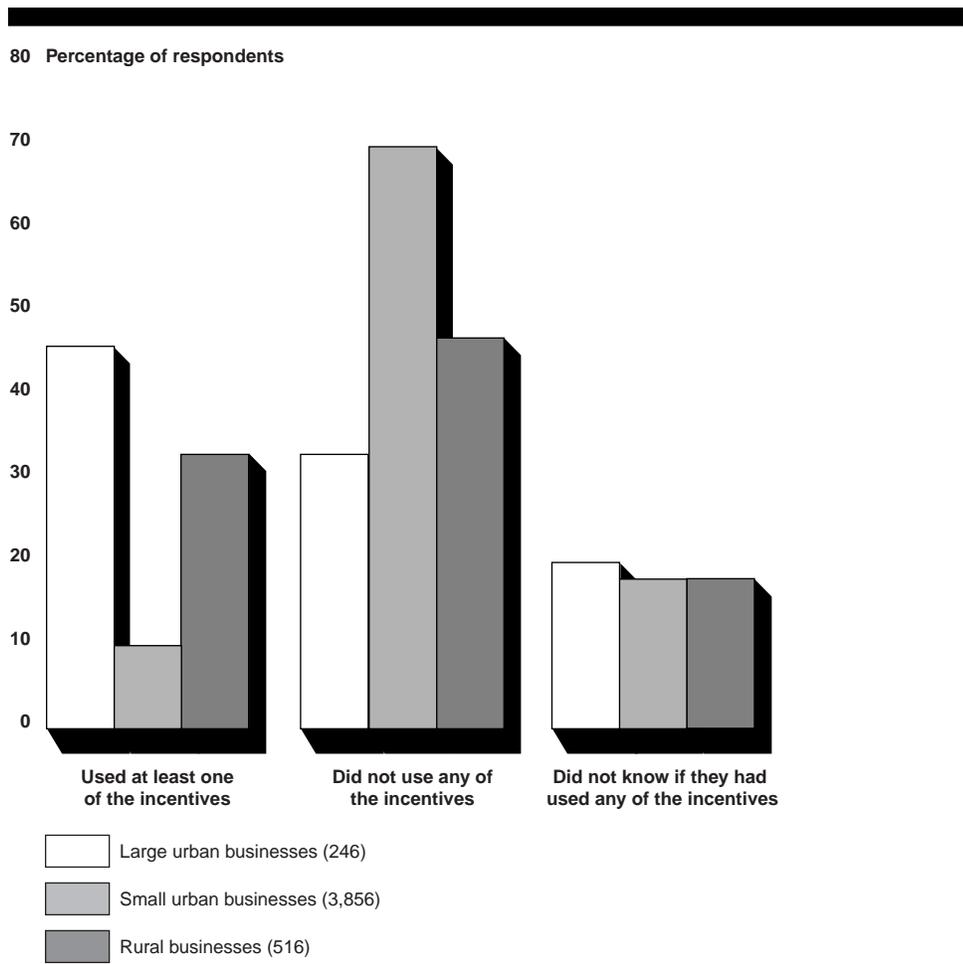
retention. This tax incentive provides a credit for wages paid to qualified employees over the initial 2 years of employment. Finally, the environmental cleanup tax deduction, which is also referred to as the brownfields deduction, allows businesses to deduct the cleanup costs for certain contaminated sites in the tax year they incur these costs. The expenditure must be made in connection with the abatement or control of hazardous substances at a qualified contaminated site, with empowerment zones designated as one of the targeted areas for this tax deduction.

Businesses' Use of the Tax Incentives for Tax Year 1997 Varied Among the Three Respondent Groups

We identified 13,590 for-profit, nonfarming businesses that operated in the original nine empowerment zones. These businesses ranged from single-person operations to companies with hundreds of employees and included manufacturing firms, wholesalers, service providers, construction firms, retailers, and other types of businesses. We surveyed about 2,400 of these businesses on their usage of the three empowerment zone tax incentives and received responses from 48 percent of the large urban businesses, 32 percent of the small urban businesses, and 46 percent of the rural businesses that we surveyed.

According to our survey's respondents, 46 percent of the large urban businesses, an estimated 10 percent of the small urban businesses, and 33 percent of the rural businesses used at least one of the three empowerment zone tax incentives for tax year 1997 (see fig. 1). At the same time, 33 percent of the large urban businesses, an estimated 70 percent of the small urban businesses, and 47 percent of the rural businesses indicated that they did not use any of the three tax incentives that year. The employment credit was the most frequently used of the three tax incentives, followed by the increased expensing deduction for depreciable business property, and the tax-exempt facility bond. For the businesses that did not use the tax incentives, their reasons for not using them included not knowing about them, not qualifying for them, and finding them too complicated to use. Finally, most of the businesses did not use the work opportunity credit, the welfare-to-work credit, or the environmental cleanup tax deduction.

Figure 1: Use of the Three Empowerment Zone Tax Incentives



Notes: These percentages do not include the businesses that did not provide information on their use of these incentives.

The number of small urban businesses is an estimate based on our sample.

Source: GAO's analysis of the responses to the survey.

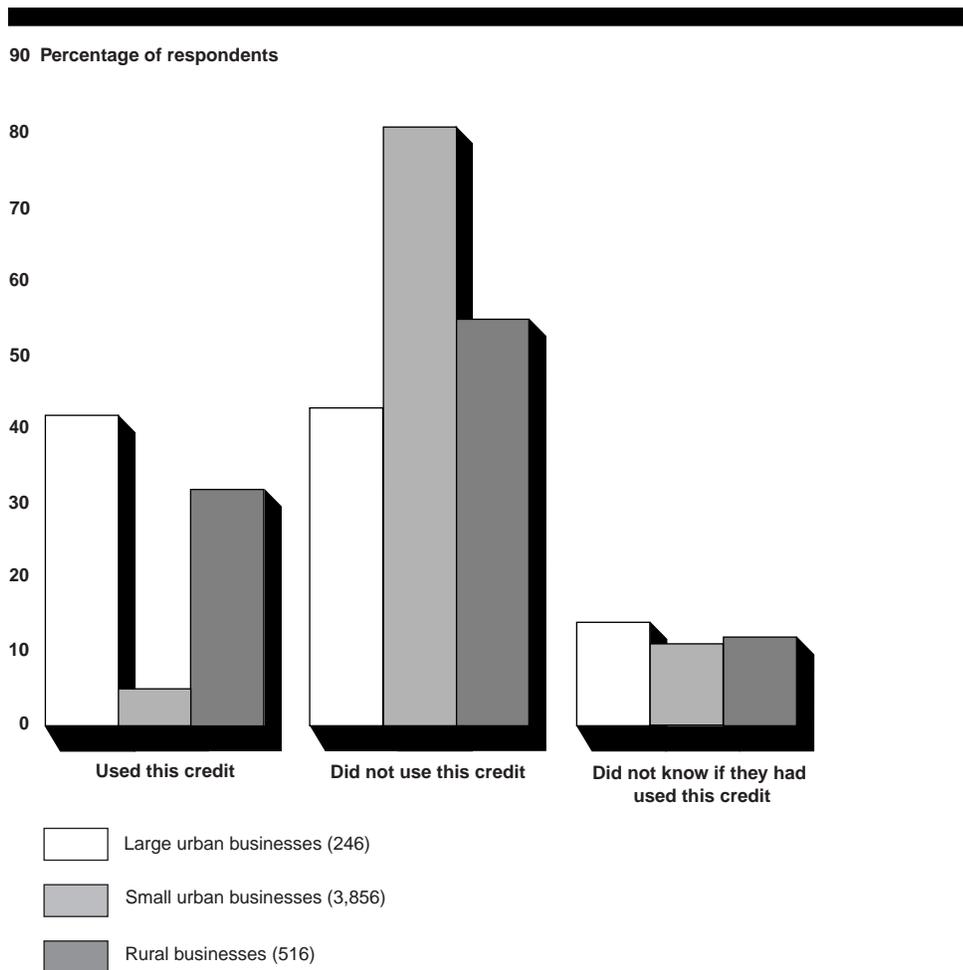
Use of the Empowerment Zone Employment Credit

Large urban businesses were the most likely to use the employment credit and small urban businesses were the least likely to use it, according to the respondents to our survey. As shown in figure 2, this credit was used by 42 percent of the large urban businesses, an estimated 6 percent of the small urban businesses, and 32 percent of the rural businesses. Among rural businesses, about two-thirds of the 28 large businesses and about one-third of the 465 small businesses reported using the employment credit. Large urban businesses and rural businesses reported claiming \$9.1 million for tax year 1997.⁸ Of this amount, 94 large urban businesses claimed \$5.2 million, 15 large rural businesses claimed \$2.9 million, and 107 small rural businesses claimed \$1 million.

While businesses of all types used the employment credit, its use varied depending on the type of business, as shown in figure 3. For the large urban businesses that used the credit, 55 percent were manufacturing firms. For rural businesses, 40 percent of the businesses that used the credit were in retail trade, followed by 22 percent that were involved in providing services. For the small urban businesses, use of the employment credit did not vary by type of business.

⁸We could not estimate the amount claimed by small urban businesses because too few of them provided an amount. Also, the \$9.1 million reported by the survey's respondents may include some credits that were not claimed. For example, while a subchapter S corporation may have reported the amount that the corporation could claim, the individual owners may or may not have claimed their portion of the credit based on their individual tax liability situation.

Figure 2: Use of the Employment Credit, Tax Year 1997

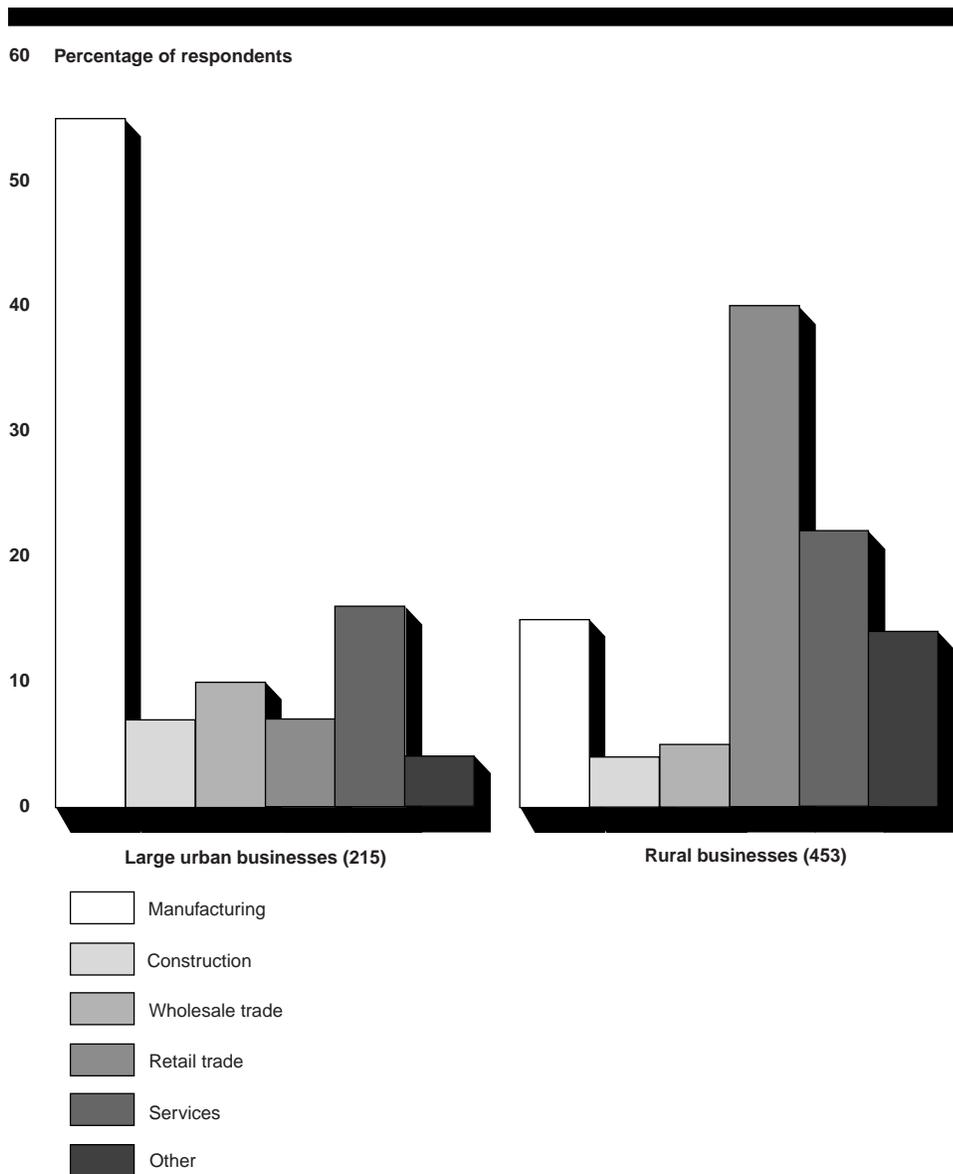


Notes: These percentages do not include the businesses that did not provide information on their use of this credit.

The number of small urban businesses is an estimate based on our sample.

Source: GAO's analysis of the responses to the survey.

Figure 3: Types of Businesses That Used the Employment Credit



Notes: These percentages do not include the businesses that did not provide information on their type of business.

Other types of businesses include those related to finance, insurance, and real estate; transportation; communications; utilities; agriculture; and mining.

Source: GAO's analysis of the responses to the survey.

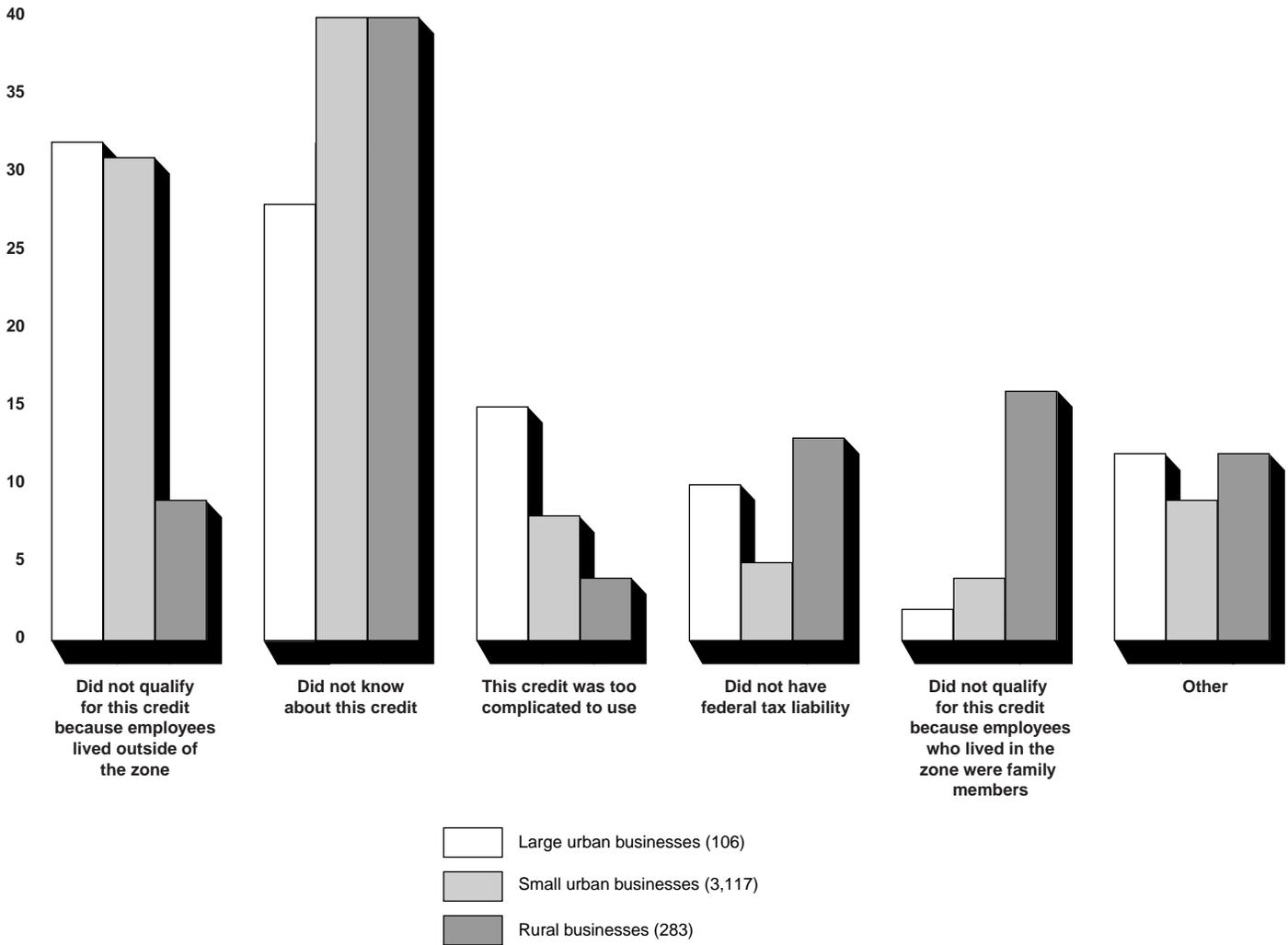
Large urban businesses and rural businesses that used the employment credit for tax year 1997 reported having proportionately more employees living and working in the empowerment zones than other businesses. Specifically, among the large urban businesses, the 42 percent that reported using the credit employed 55 percent of the employees that were reported to be living and working in the zones for large urban businesses. Similarly, among the rural businesses, the 32 percent that reported using the credit employed 68 percent of the employees reported to be living and working in the zones for rural businesses. The number of employees was not significantly different between the small urban businesses that used the credit and those that did not.

The majority of the businesses that used the employment credit reported that it was at least “somewhat important” to making decisions about hiring employees who live in the zones. Specifically, 79 percent of the large urban businesses, an estimated 67 percent of the small urban businesses, and 74 percent of the rural businesses found this credit to be at least “somewhat important” to hiring decisions, with about half of these considering it “very important” or “extremely important.” The remaining businesses considered the credit “hardly or not at all important” to their decision-making.

The businesses that reported they did not claim the employment credit cited a variety of reasons. As shown in figure 4, large urban businesses and small urban businesses most frequently said that they (1) did not qualify for the credit because their employees lived outside of the zone or (2) did not know about the credit. Rural businesses most frequently said that they did not know about the credit. Businesses also reported that the tax credit was too complicated to use, that they did not qualify for the credit because their employees are family members, or that their business did not have federal tax liability against which to claim the credit.

Figure 4: Reasons for Not Claiming the Employment Credit

45 Percentage of respondents



Notes: These percentages do not include the businesses that did not provide a reason.

Other reasons include those provided by individual respondents.

The number of small urban businesses is an estimate based on our sample.

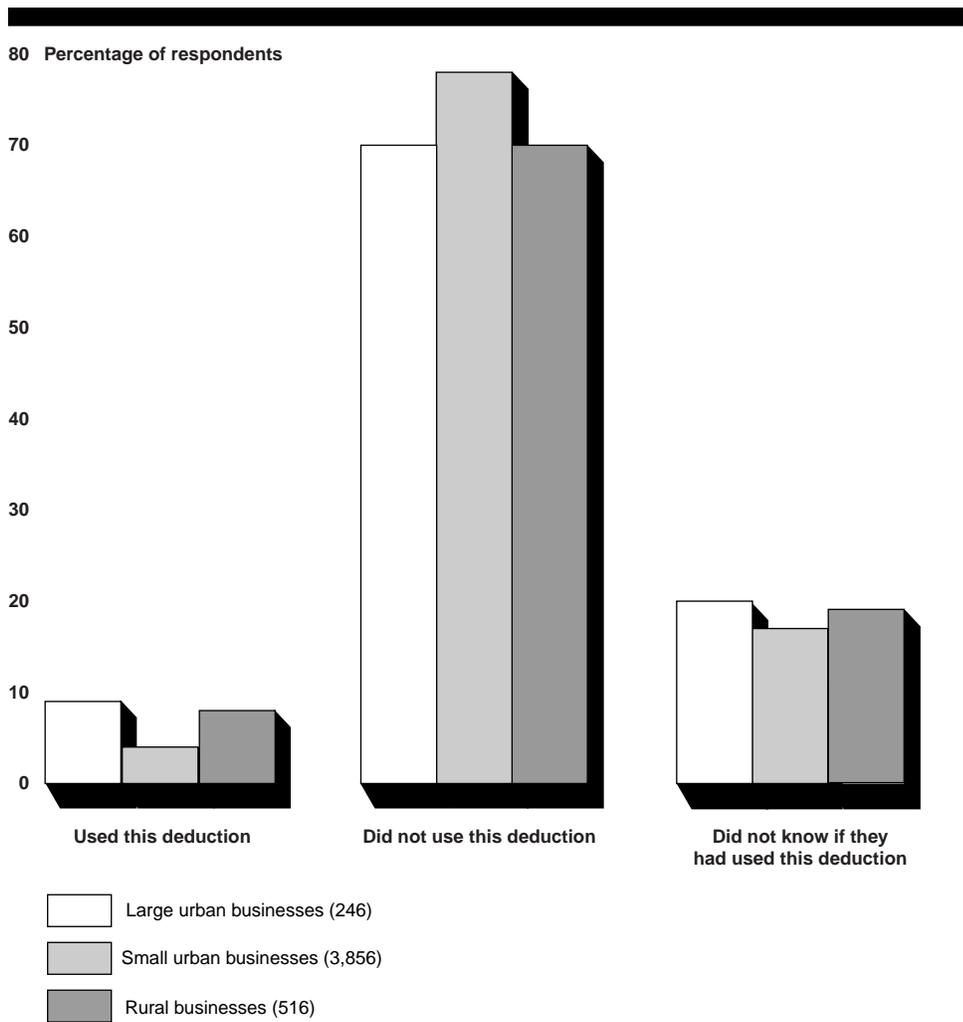
Source: GAO's analysis of the responses to the survey.

Use of the Increased Expensing Deduction

In tax year 1997, the increased expensing deduction generally was used less than the employment credit. Nine percent of the large urban businesses, an estimated 4 percent of the small urban businesses, and 8 percent of the rural businesses—all of which were small businesses—used the increased expensing deduction (see fig. 5). Of the businesses that used this deduction, 18 large urban businesses reported claiming deductions of \$405,534, and 37 rural businesses reported claiming \$480,081.⁹

⁹We could not estimate the amount claimed by small urban businesses because too few of them provided an amount. Also, we could not determine the portion of the amounts reported that was an increase over that allowed for other businesses; therefore, the amounts reported may include deductions that would have been allowed without the additional expensing deduction for zone businesses.

Figure 5: Use of the Increased Expensing Deduction, Tax Year 1997



Notes: These percentages do not include the businesses that did not provide information on their use of this deduction.

The number of small urban businesses is an estimate based on our sample.

Source: GAO's analysis of the responses to the survey.

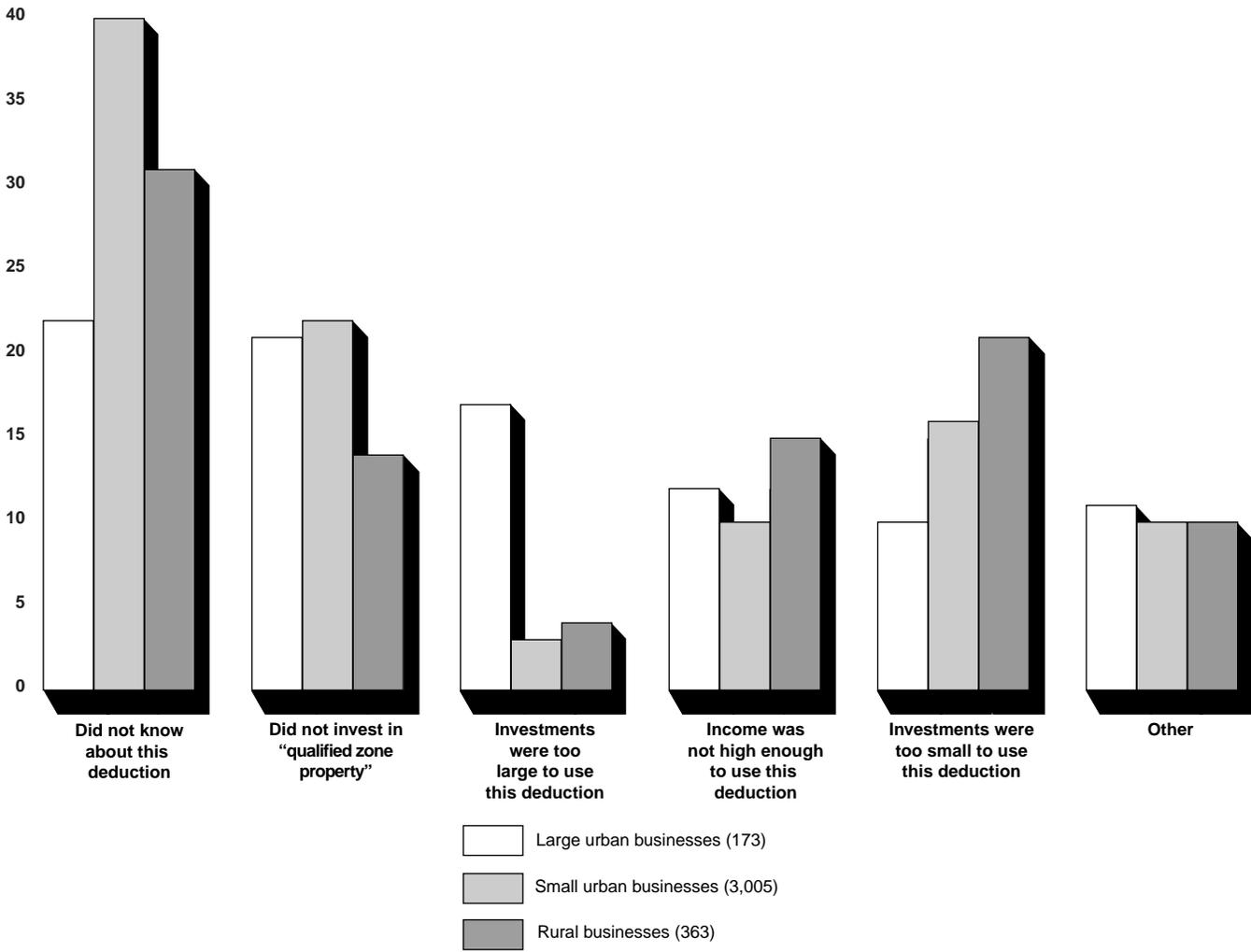
For the businesses that used the increased expensing deduction, 16 large urban businesses and 29 small rural businesses reported that it was at least "somewhat important" in their decision to purchase depreciable

property; while 6 large urban businesses and 10 small rural businesses reported that it was “hardly or not at all important” in those decisions. The responses for small urban businesses were too small to report. No large rural businesses reported using the deduction.

Businesses that reported they did not claim the increased expensing deduction cited a variety of reasons (see fig. 6). Frequently cited reasons included (1) they did not know about the increased deduction, (2) they did not invest in qualified zone property, (3) their business investments were too small or too large to use the deduction, and (4) their income was not high enough to use the deduction.

Figure 6: Reasons for Not Using the Increased Expensing Deduction, Tax Year 1997

45 Percentage of respondents



Notes: These percentages do not include the businesses that did not indicate a reason.

Other includes such reasons as the deduction was too complicated to use, the business did not qualify as an "enterprise zone business," and other reasons that were provided by individual respondents.

The number of small urban businesses is an estimate based on our sample.

Source: GAO's analysis of the responses to the survey.

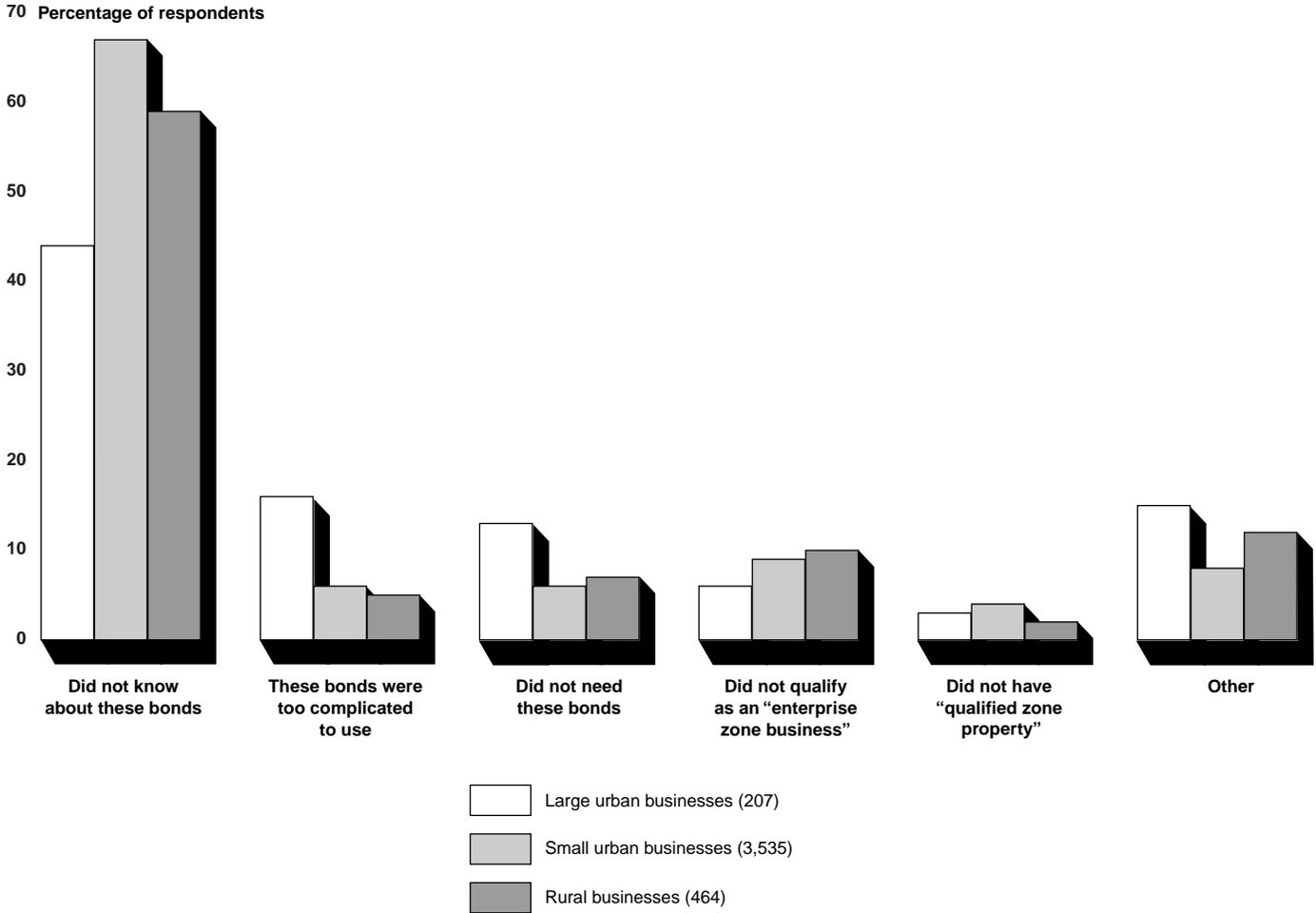
**Use of Tax-Exempt Federal
Enterprise Zone Facility
Bonds**

Few businesses have used the tax-exempt facility bonds. Ten businesses reported receiving proceeds from these tax-exempt bonds: 7 large urban businesses, 1 large rural business, and 2 small rural businesses.⁹ We did not ask these businesses to report the dollar value of the proceeds they received from these bonds.

The reasons businesses reported for not using these bonds varied (see fig. 7). Of the businesses that did not use these bonds, 44 percent of the large urban businesses, an estimated 67 percent of the small urban businesses, and 59 percent of the rural businesses said that they did not know about them. In addition, 16 percent of the large urban businesses said that these bonds were too complicated to use and another 13 percent said that they did not need them.

⁹In June 1998, we reported that eight businesses had used this bond through April 1998. We did not reconcile this difference. See Community Development: Information on the Use of Empowerment Zone and Enterprise Community Tax Incentives (GAO/RCED-98-203, June 30, 1998).

Figure 7: Reasons for Not Using Enterprise Zone Facility Bonds



Notes: These percentages do not include the businesses that did not provide a reason.

Other includes such reasons as the business needed a bond larger than the \$3-million limit allowed for this type of bond, the state's volume cap had been met when the business applied for a bond, and other answers provided by individual respondents.

The number of small urban businesses is an estimate based on our sample.

Source: GAO's analysis of the responses to the survey.

Use of Work Opportunity
Credits, Welfare-To-Work
Credits, and
Environmental Cleanup
Tax Deductions

Among the other federal tax incentives available to businesses in empowerment zones are the work opportunity credit, the welfare-to-work credit, and the environmental cleanup tax deduction, which are also available to businesses in other areas. Most of the empowerment zone businesses did not use these tax incentives in tax year 1997. Seventy-six percent of the large urban businesses, an estimated 90 percent of the small urban businesses, and 87 percent of the rural businesses reported that they used none of these three tax incentives. Large businesses were more likely than small businesses to use the work opportunity credit. Specifically, 11 percent of the large urban businesses and 14 percent of the large rural businesses indicated that they used this credit, compared with an estimated 1 percent of the small urban businesses and 3 percent of the small rural businesses. Three percent of the large urban businesses, no small urban businesses, and 1 percent of the rural businesses used the welfare-to-work credit; and less than 1 percent of the businesses in all three groups used the environmental cleanup tax deduction.¹⁰ We did not ask the businesses to provide their reasons for not using these incentives.

We are sending copies of this report to the appropriate congressional committees; the Honorable Andrew Cuomo, Secretary of Housing and Urban Development; the Honorable Dan Glickman, Secretary of Agriculture; the Honorable Lawrence H. Summers, Secretary of the Treasury; and the Honorable Charles O. Rossotti, Commissioner of Internal Revenue. We will also make copies available to others on request. If you or your staff have any questions about the material in this report, please call me at (202) 512-7631. Key contributors to this report were Nancy Simmons, Nancy Boardman, and Carolyn Boyce.



Stanley J. Czerwinski
Associate Director, Housing and
Community Development Issues

¹⁰Ten percent of the large urban businesses, an estimated 8 percent of the small urban businesses, and 9 percent of the rural businesses did not provide information on their use of these three tax incentives.

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Survey of the Use of Tax Benefits by Businesses in Empowerment Zones

United States General Accounting Office

GAO

Survey of the Use of Tax Benefits By Businesses in Empowerment Zones

Introduction

The General Accounting Office—an agency that gathers information for the U.S. Congress—is asking you and others who have businesses located in a federal empowerment zone to tell us how you use different tax benefits. We plan to summarize your answers along with others in a report to the Congress.

Please complete this survey, which should only take about 10 minutes, to help us give an accurate report to the Congress. In order to help us avoid costly followup, please return the survey within 2 weeks in the enclosed postage-paid envelope. Our return address is:

Nancy Boardman
U.S. General Accounting Office
441 G Street, NW, Room 1826
Washington, D.C. 20548-0001

Thank you for this important public service. If you have any questions, please call Nancy Boardman toll-free at 1-800-960-6167, (e-mail: boardmann.rced@gao.gov).

Business Location

1. Which of the following best describes how long your business has been in this empowerment zone? *(Check one.)*

1. Was in the empowerment zone before December 21, 1994, the date that the empowerment zones were designated. ⁽⁵⁾
2. Moved or expanded into the empowerment zone on or after December 21, 1994, from another location.
3. Started as a new business in the empowerment zone on or after December 21, 1994.
4. Not located or unsure if located in empowerment zone →Stop. Please call us toll-free at 1-800-960-6167.

2. How many years has your business been located in this neighborhood? *(Check one.)*

1. 3 years or less ⁽⁶⁾
2. 4 to 6 years
3. 7 to 9 years
4. 10 years or more

3. Since December 21, 1994, has this business considered moving out of this empowerment zone? *(Check one.)*

1. Yes →Please continue. ⁽⁷⁾
2. No →Skip to Page 2

4. Which of the following factors have influenced you to consider moving out of this empowerment zone? *(Check all that apply.)*

1. Skilled workers not available ⁽⁸⁻²⁰⁾
2. Low productivity of available employees
3. State and local taxes too high
4. Limited or no access to needed capital/credit
5. Cost of doing business here (e.g., utilities, property, construction, etc.)
6. Insufficient area or land for expansion
7. Inefficient transportation for materials and products
8. State and local controls on environmental impacts too restrictive
9. Insufficient customer base here
10. Inadequate support from empowerment zone projects
11. Other *(Please specify.)*

**Appendix I
Survey of the Use of Tax Benefits by
Businesses in Empowerment Zones**

Use of Federal Tax Benefits

The next three sections focus on federal tax benefits that are available to qualified empowerment zone businesses. Please follow the instructions to skip over questions that do not apply to your situation.

Empowerment zone employment credit.

This federal wage tax credit may reduce your business' taxes each year by up to \$3,000 for each of your employees who lives and works in the empowerment zone. A business computes the credit based on wages—as well as certain training and educational expenses—that it pays to (or for) the employee. It is claimed using IRS Form 8844, line 21.

5. Did your business file an original or amended return that claimed this federal wage tax credit in tax year 1997? (Check one.)

- 1. Yes →Please continue. (21)
- 2. No →Skip to Question 9.
- 3. Don't know →Skip to Question 10.

6. What was the amount of the credit you claimed for this wage tax credit for tax year 1997? This amount is located on line 21 of Form 8844. (Enter number.)

(22-27)

\$ _____

7. About how many employees did you include in your 1997 calculations for this wage tax credit? (Enter estimate.)

_____ employees

8. Overall, how important a benefit to your business is the wage tax credit in your decisions to hire employees who live within the empowerment zone? (Check one.)

(28)

- 1. Hardly or not at all important
- 2. Somewhat important
- 3. Moderately important
- 4. Very important
- 5. Extremely important

9. If your business did not claim this wage tax credit for tax year 1997, which of the following reasons best describes your situation? (Check all that apply.)

(29-36)

- 1. Not applicable/used the credit.
- 2. We did not know about this tax credit.
- 3. Did not qualify because our employees live outside the empowerment zone.
- 4. Did not qualify because our employees who live in the zone are family members.
- 5. Did not have federal taxes against which to use this tax credit immediately. (Do not check this response if your business is a partnership or a Subchapter S corporation.)
- 6. Our partners or shareholders did not have federal taxes against which to use this tax credit immediately. (Do not check this response if your business is a sole proprietorship or a Subchapter C corporation.)
- 7. The tax credit was too complicated to use.
- 8. Other (Please specify.)

**Appendix I
Survey of the Use of Tax Benefits by
Businesses in Empowerment Zones**

Increased Section 179 expensing deduction.

The federal tax code allows businesses to recover all or part of the costs of certain depreciable property, such as equipment and machinery, in one year instead of over several years. Specifically, under section 179 of the Internal Revenue Code, businesses can deduct up to a fixed amount in a given year for the expenses of depreciable property placed in service during the year. In an empowerment zone, businesses that qualify—known as enterprise zone businesses—may deduct an additional \$20,000 for qualified zone property. A business may claim this expensing deduction by using IRS form 4562, line 12.

10. Did your business claim this increased section 179 expensing deduction for tax year 1997? *(Check one.)*

(37)

- 1. Yes →Please continue.
- 2. No →Skip to Question 13.
- 3. Don't know →Skip to Question 14.

11. How much of a section 179 deduction did your business claim for tax year 1997? This amount is located on line 12 of IRS Form 4562. *(Enter amount.)*

\$ _____

12. Overall, how important was this increased section 179 expensing deduction in your decision to purchase depreciable property? *(Check one.)*

(38)

- 1. Hardly or not at all important
- 2. Somewhat important
- 3. Moderately important
- 4. Very important
- 5. Extremely important
- 6. Don't know

13. If you did not use this increased section 179 expensing deduction in tax year 1997, which of the following reasons best describe your situation? *(Check all that apply.)*

(39-47)

- 1. Not applicable/used the deduction.
- 2. We did not know about this increased section 179 expensing deduction.
- 3. Business did not qualify as an "enterprise zone business".
- 4. We made no investment in "qualified zone property".
- 5. Business investments were too **small** to use this deduction.
- 6. Business investments were too **large** to use this deduction.
- 7. Business did not have high enough income to use this deduction.
- 8. The expensing deduction was too complicated to use.
- 9. Other *(Please specify.)*

**Appendix I
Survey of the Use of Tax Benefits by
Businesses in Empowerment Zones**

Tax-exempt federal enterprise zone facility bonds.

An empowerment zone business may qualify to have its state or local government issue this new type of private activity bond. Bond proceeds may be used to finance business property and land, as well as to finance new facilities or support the expansion or renovation of existing facilities. Because tax-exempt bonds generally have lower interest rates than conventional financing, they may lower the costs of financing for a business. Like most private activity bonds they are subject to an annual volume cap for each state. Within an empowerment zone, a qualified business may receive up to \$3 million in bond proceeds. Businesses may contact the local Empowerment Zone for information about bond availability or use in their area.

14. Has your business ever received proceeds from a federal tax-exempt enterprise zone facility bond? *(Check one.)*

- 1. Yes →Skip to Question 16. (48)
- 2. No →Please continue.
- 3. Don't know →Skip to Question 16.

15. If your business has not used this type of tax-exempt bond, which of the following reasons best describes your situation? *(Check all that apply.)*

- 1. We did not know about these federal tax-exempt enterprise zone facility bonds. (49-55)
- 2. Business does not qualify as an "enterprise zone business".
- 3. Our property was not "qualified zone property".
- 4. The state volume cap for private activity bonds had been met when we applied.
- 5. We needed a bond larger than the \$3 million limit allowed in this program.
- 6. The bond was too complicated to use.
- 7. Other *(Please specify.)*

Related Questions

16. Which of the following factors are most important to you in deciding where to locate your business? *(Check all that apply.)* (56-72)

- 1. Availability of federal empowerment zone tax benefits
- 2. Availability of skilled workers
- 3. Productivity of workers
- 4. State and local taxes on business and industry
- 5. Access to capital/credit
- 6. Cost of doing business here (e.g., utilities, property, construction, etc.)
- 7. Ample area or land for future expansion
- 8. Efficient transportation for materials and products
- 9. State and local controls on environmental impacts associated with your business
- 10. Presence of specific target markets; customer base
- 11. Personal and/or business history in a particular location
- 12. Empowerment zone projects that support business development
- 13. Other *(Please specify.)*

17. Overall, how important are these three federal tax benefits (empowerment zone employment credit, increased section 179 expensing deduction, and tax-exempt federal enterprise zone facility bonds) in keeping your business located within the empowerment zone? *(Check one.)* (73)

- 1. Hardly or not at all important
- 2. Somewhat important
- 3. Moderately important
- 4. Very important
- 5. Extremely important
- 6. Not familiar with them

**Appendix I
Survey of the Use of Tax Benefits by
Businesses in Empowerment Zones**

18. Which of the following federal tax benefits did your business use in tax year 1997? *(Check all that apply.)*

(74-77)

1. Work opportunity credit—This tax credit is for employers who hire individuals from among eight groups with high unemployment rates or other special employment needs. A business uses IRS Form 5884 to claim this tax credit.
2. Welfare-to-work credit—This tax credit is for businesses that hire long-term recipients of family (welfare) assistance. A business uses IRS Form 8861 to calculate this credit.
3. Environmental Cleanup Tax Deduction—This deduction is for businesses that clean up certain sites—called “brownfields”—that are contaminated with hazardous substances.
4. None of the above

19. Please describe your primary type of business. *(2(3-6))*

20. Including working owners and operators, how many employees (fulltime and part-time) does your business currently have working within this empowerment zone? *(Enter number.)*

_____ Employees working in zone

21. About how many of the employees you identified in Question 20 also live in the empowerment zone? *(Enter estimate.)*

_____ Employees living in zone

22. Including working owners and operators, about how many employees (fulltime and part-time) did your business have working within this empowerment zone in December 1994? *(Enter estimate or check “not applicable.”)*

_____ Employees in December 1994

_____ Not applicable; business was not in this empower zone in December 1994.

23. When you file federal income taxes for this business, under which of the following categories do you file? *(Check all that apply.)*

(7-12)

1. Sole proprietor
2. Partnership
3. Subchapter S corporation (limited number of owners; not taxed as a corporate entity.)
4. Subchapter C corporation (a “normal” corporation; taxed as a corporate entity.)
5. Farming operation
6. Don’t know

Information on Businesses That Responded to the Survey

The businesses that responded to the survey

- represented various types of work;
- were mostly corporations;
- mostly were already located in the zone before its designation;
- employed, in total, thousands of people;
- considered multiple factors as important in deciding where to locate the business; and
- mostly had not considered moving out of the zone.

Also, for the respondents that had been in their zones since their designation, the number of employees working there has generally increased.

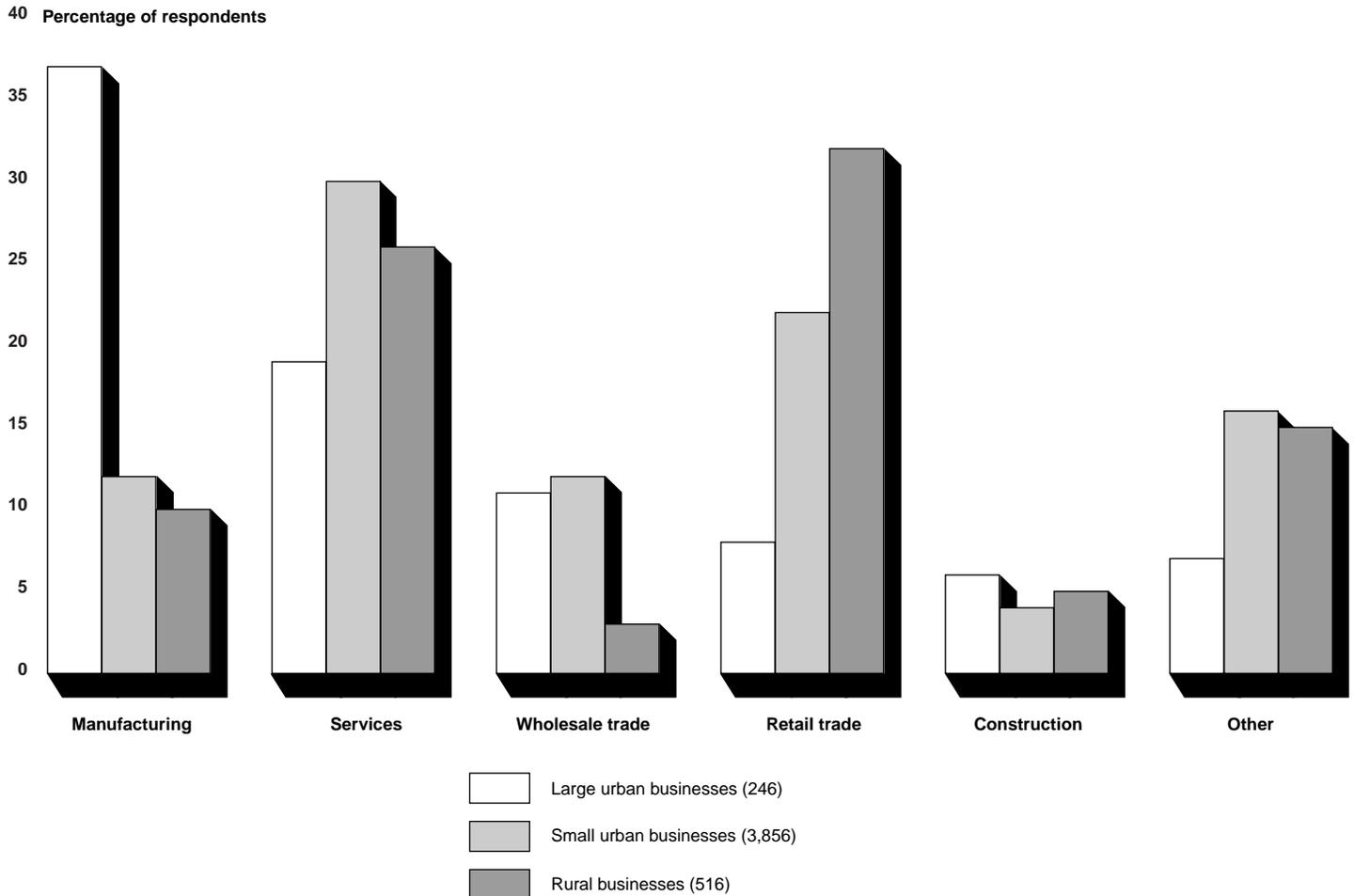
The following sections provide additional information on each of these categories for the businesses that responded to the survey.

Businesses Differed by Type of Work

The businesses that responded to our survey provided descriptions of their type of business. We coded this information into categories using standardized industrial classifications. More than half of the large urban businesses were in the manufacturing business or were service providers, while more than half of the respondents representing small urban businesses and rural businesses were service providers or retailers (see fig. II.1). The remaining businesses in each group included those involved in wholesale trade; construction; finance, insurance, and real estate; transportation; communications; utilities; agriculture; and mining.

**Appendix II
Information on Businesses That Responded
to the Survey**

Figure II.1: Types of Businesses That Responded to the Survey



Notes: These percentages do not include the businesses that did not provide their type of work.

Other types of businesses include those related to finance, insurance, and real estate; transportation; communications; utilities; agriculture; and mining.

The number of small urban businesses is an estimate based on our sample.

Source: GAO's analysis of the responses to the survey.

Respondents Were Mostly Corporations

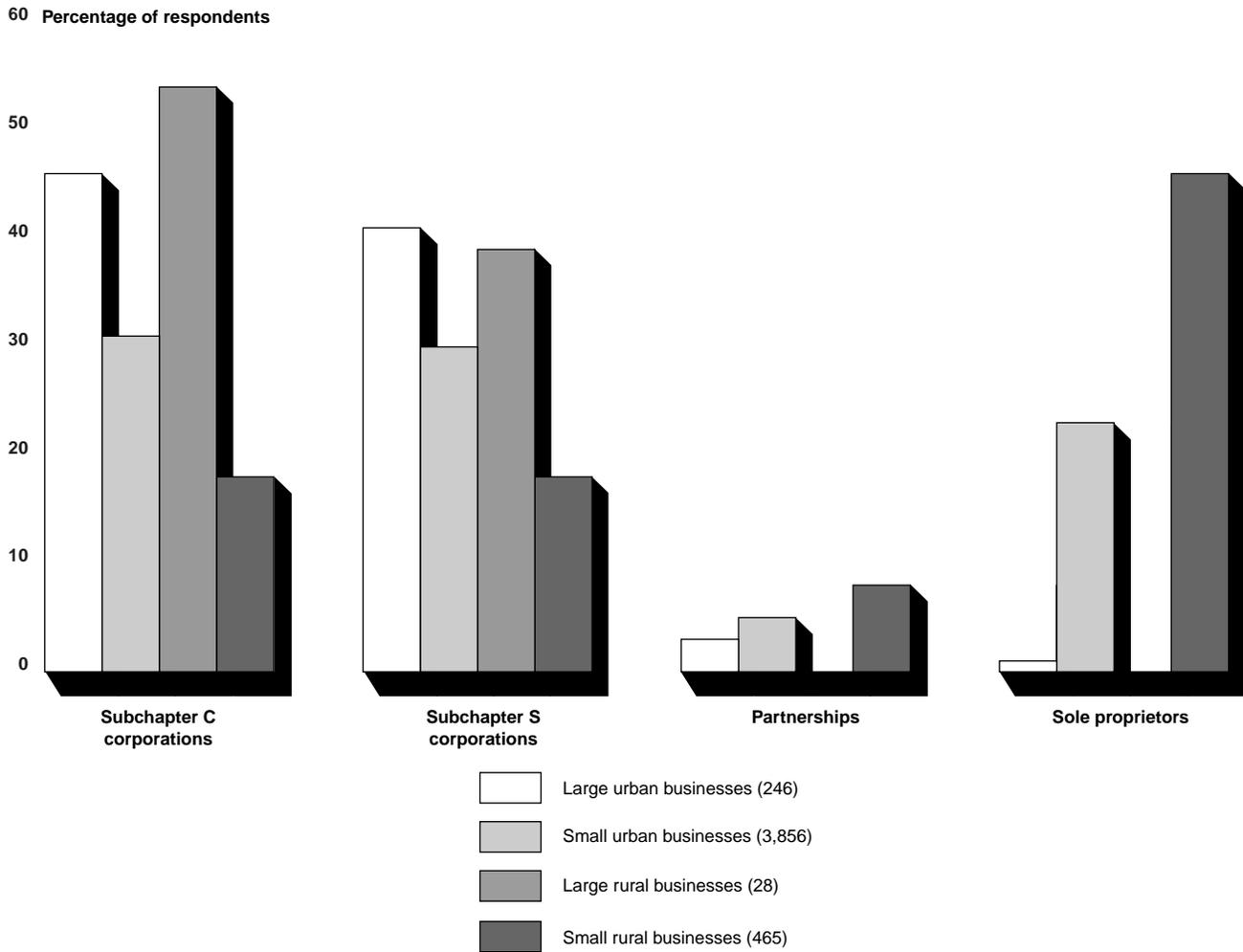
We asked businesses to identify the category in which they filed their federal income taxes. Most of the businesses that responded to our survey

Appendix II
Information on Businesses That Responded
to the Survey

were corporations (see fig. II.2). Large urban businesses mainly were subchapter C corporations (corporations that pay taxes as a corporate entity) and subchapter S corporations (corporations that are not taxed as a corporate entity and that have a limited number of owners who file taxes separately). Small urban businesses included nearly equal numbers of subchapter C corporations and subchapter S corporations, but they had a greater percentage of sole proprietors than the large urban businesses. The large rural businesses were mostly subchapter C corporations, followed by subchapter S corporations. Finally, almost half of the small rural businesses were sole proprietorships.

**Appendix II
Information on Businesses That Responded
to the Survey**

Figure II.2: Federal Income Tax Category for Businesses That Responded to Our Survey



(Figure notes on next page)

**Appendix II
Information on Businesses That Responded
to the Survey**

Notes: These percentages do not include the businesses that did not provide their federal income tax category.

We classified rural businesses as large if they reported having 50 or more employees and small if they reported having fewer than 50 employees. Consequently, the percentages for rural businesses exclude businesses that did not report their number of employees.

Of the businesses that responded to the survey, 1 percent of the large rural businesses and 3 percent of the small rural businesses reported that they were farming operations. Also, 7 percent of the large urban businesses, 6 percent of the small urban businesses, 1 percent of the large rural businesses, and 6 percent of the small rural businesses reported that they did not know their federal income tax category.

The number of small urban businesses is an estimate based on our sample.

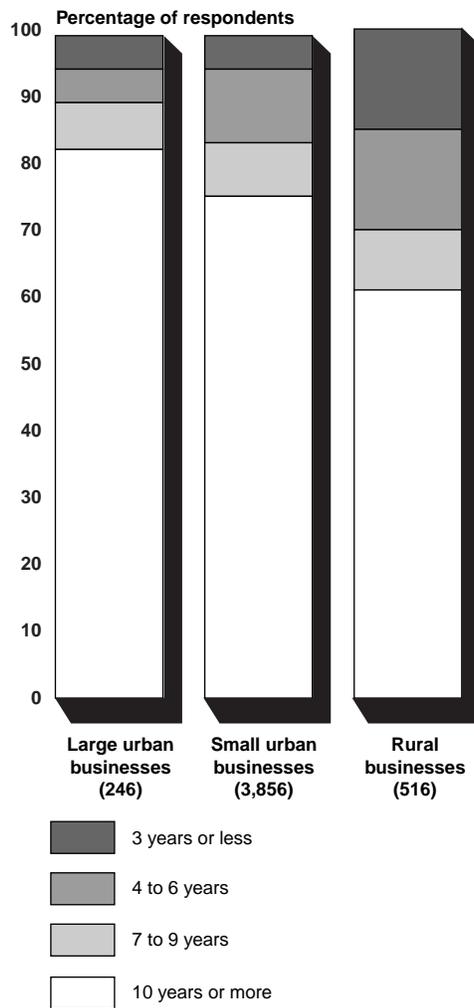
Source: GAO's analysis of the responses to the survey.

Most Respondents Were Already in the Zone Before Designation

According to the survey's respondents, the majority of the businesses were already located in their zones on or before December 21, 1994, the date those areas were designated as empowerment zones. Specifically, 90 percent of the large urban businesses, an estimated 90 percent of the small urban businesses, and 78 percent of the rural businesses were already located in an area that was designated as an empowerment zone. Another 7 percent of the large urban businesses, an estimated 3 percent of the small urban businesses, and 3 percent of the rural businesses reported that they had moved or expanded into the empowerment zones after December 21, 1994. Also, 2 percent of the large urban businesses, an estimated 5 percent of the small urban businesses, and 17 percent of the rural businesses started as a new business in the zones on or after December 21, 1994. In response to a related question, 82 percent of the large urban businesses, an estimated 75 percent of the small urban businesses, and 61 percent of the rural businesses indicated that they had been located in their neighborhoods 10 years or more. Figure II.3 shows the percentage of the respondents by the number of years they had been in business.

**Appendix II
Information on Businesses That Responded
to the Survey**

**Figure II.3: Number of Years
Businesses Had Been Located in Their
Neighborhoods**



Notes: These percentages do not include businesses that did not provide information on how long they had been in their neighborhoods.

The number of small urban businesses is an estimate based on our sample.

Source: GAO's analysis of the responses to the survey.

Businesses Reported Employing Thousands of People

We asked businesses how many full-time and part-time employees (including owners) their businesses had that were currently working in the empowerment zone. The large urban businesses that answered this question reported having a total of 29,849 employees. Based on the answers provided by the respondents from our sample of the small urban businesses, we estimated that 48,797 employees are working within the zones for small businesses that are similar to those responding to our survey. The rural businesses reported a total of 6,533 current employees.

Respondents Indicated That Multiple Factors Were Important in Deciding Where to Locate

Respondents most often included the cost of doing business, the availability of skilled workers, the presence of specific target markets and/or customer base, and their personal and/or business history in a particular location as the factors that were most important in deciding where to locate their businesses. Other location factors that were often selected were the state and local taxes on business and industry, the productivity of workers, and the efficient transportation for materials and products. Such factors as the availability of federal empowerment zone tax benefits and the existence of empowerment zone projects to support business development generally were selected less often than other factors. However, large urban businesses were more likely than other businesses to select these as factors in deciding where to locate. Table II.1 lists the percentage of the respondents that selected each factor.

**Appendix II
Information on Businesses That Responded
to the Survey**

**Table II.1: Most Important Factors for
Selecting a Business Location**

Percentage of respondents			
Location factor	Large urban businesses (246)	Small urban businesses (3,856)	Rural businesses (516)
Cost of doing business at this location (e.g., utilities, property, and/or construction)	56	41	26
Availability of skilled workers	55	25	20
State and local taxes on business and industry	43	22	13
Productivity of workers	39	19	15
Efficient transportation for materials and products	38	18	8
Presence of specific target markets and/or customer base	34	40	30
Ample area or land for future expansion	26	12	12
Personal and/or business history in a location	25	39	40
Availability of federal empowerment zone tax benefits	21	13	15
Empowerment zone projects that support business development	20	13	14
Access to capital and/or credit	16	14	10
State and local controls on environmental impacts associated with the business	16	7	5
Other	8	7	10
Information not provided	4	6	9

Note: The number of small urban businesses is an estimate based on our sample.

Source: GAO's analysis of the responses to the survey.

**Most Respondents
Have Not Considered
Moving Out of Their
Zones**

Most businesses reported that they had not considered moving out of their zones. Specifically, 65 percent of the large urban businesses, an estimated 74 percent of the small urban businesses, and 90 percent of the rural businesses had not considered moving out of their zones. On the other hand, 34 percent of the large urban businesses, an estimated 25 percent of the small urban businesses, and 9 percent of the rural businesses had considered such a move. The survey's respondents indicated a variety of factors, including high state and local taxes, an insufficient customer base,

**Appendix II
Information on Businesses That Responded
to the Survey**

and the cost of doing business, influenced them to consider moving. Table II.2 lists the percentage of the respondents that selected each factor.

Table II.2: Factors Influencing Some Respondents to Consider Moving Out of an Empowerment Zone Percentage of Respondents

Percentage of respondents			
Relocation factor	Large urban businesses (84)	Small urban businesses (980)	Rural businesses (48)
State and local taxes too high	55	38	27
Cost of doing business at this location (e.g., utilities, property, and/or construction) too high	45	36	25
Insufficient area or land for expansion	35	18	6
Skilled workers not available	27	20	19
State and local controls on environmental impacts too restrictive	26	10	6
Low productivity of available employees	25	15	19
Inadequate support from empowerment zone projects	23	33	17
Limited or no access to needed capital and/or credit	12	26	19
Insufficient customer base	8	33	44
Inefficient transportation for materials and products	2	0	8
Other	21	28	29

Note: The number of small urban businesses is an estimate based on our sample.

Source: GAO's analysis of the responses to the survey.

The Number of Employees Working in Empowerment Zones Has Increased for Respondents That Had Been There Since Their Designation

We asked businesses to tell us the number of employees that were working in their zones currently and in December 1994. When we compared these answers, we found that large urban businesses that had been in an empowerment zone since its designation reported an average increase of 7.6 employees since 1994. The average increase in employees was higher for the large urban businesses that were involved in construction (an average increase of 19.8 employees), wholesale trade (an average increase of 19.6 employees), or providing services (an average increase of 14 employees). The small urban businesses reported an average increase of 4.1 employees; the large rural business reported an

Appendix II
Information on Businesses That Responded
to the Survey

average increase of 50.7 employees; and the small rural businesses reported an average increase of 0.9 employees. While the majority of the respondents that had been in an empowerment zone since 1994 reported increases in the number of employees, large urban businesses involved in manufacturing reported an average decrease of 5.5 employees.

Scope and Methodology

We conducted a mail survey of 2,380 businesses located in nine federal empowerment zones that were designated on December 21, 1994. To identify businesses in the six urban zones—Atlanta, Baltimore, Chicago, Detroit, New York and Philadelphia/Camden—we obtained the list of the businesses that the Department of Housing and Urban Development had used for a fall 1997 to winter 1998 telephone survey. The list was developed by Dun and Bradstreet in August 1997 and refined by Abt Associates to include for-profit businesses that were potentially able to use the tax incentives for empowerment zones. The information provided by the Department of Housing and Urban Development included the number of employees for each business. We used this information to sort the businesses into two groups: those with fewer than 50 employees or an unrecorded number of employees (small urban businesses) and those with 50 or more employees (large urban businesses). We identified 585 large urban businesses and 12,854 small urban businesses. The list underestimates the actual number of new businesses in the zones because it does not include businesses that started in the zones between Dun and Bradstreet's data preparation and our survey in 1999. For our survey, we eliminated as ineligible all known duplicates, government and nonprofit businesses, firms that had gone out of business, and businesses that told us they were not located in one of the empowerment zones and surveyed all the remaining 513 large urban businesses. In addition, from our initial random sample of 800 of the small urban businesses, we identified 7 percent (56) that were in the ineligible categories. Thus, we estimate that there are 11,954 small urban businesses that were potentially eligible for our survey, and we included 744 of them.

To identify businesses (excluding farming operations) in the three rural zones, we contacted program officials in the Kentucky Highlands; Mississippi Mid-Delta; and Rio Grande Valley, Texas, empowerment zones. These organizations provided us with lists of the businesses in their respective zones—a total of 1,204 rural businesses—from which, we eliminated businesses that were in the ineligible categories. We surveyed all of the remaining 1,123 eligible rural businesses. In total, we included 2,380 businesses in the survey. We were unable to locate mailing addresses for 235 businesses or about 10 percent of the businesses.

In developing the questionnaire for our survey, we conducted pretests with businesses in the Baltimore, Philadelphia, Atlanta, and Kentucky Highlands zones. We interviewed business owners to help ensure that our questions were clear, unbiased, and precise and that responding to the survey did not place an undue burden on businesses. We also obtained

reviews of our questionnaire from managers at the departments of Treasury, Agriculture, and Housing and Urban Development, as well as the Internal Revenue Service.

To maximize the number of responses to our survey, we mailed a letter to all the businesses in the survey about 1 week before we mailed the questionnaires. We also sent a reminder letter and replacement questionnaire to the businesses that had not responded about a month after mailing the questionnaires and a second follow-up letter with another replacement questionnaire about a month after that. We received completed questionnaires from 48 percent of the 513 large urban businesses, 32 percent of the 744 small urban businesses, and 46 percent of the 1,123 rural businesses (29 percent of the Rio Grande, 54 percent of the Mid-Delta and 67 percent of the Kentucky Highlands businesses).

Because we used a sample (called a probability sample) to develop our estimates for small urban businesses, each estimate has a measurable precision, or sampling error, which may be expressed as a plus/minus figure. A sampling error indicates how closely we can reproduce from a sample the results that we would obtain if we were to take a complete count of the universe using the same measurement methods. By adding the sampling error to and subtracting it from the estimate, we can develop upper and lower bounds for each estimate. This range is called a "confidence interval." Sampling errors and confidence intervals are stated at a certain confidence level. For example, a confidence interval at the 95-percent confidence level means that in 95 out of 100 instances, the sampling procedure we used would produce a confidence interval containing the universe value we are estimating. Table III.1 lists the sampling errors and confidence intervals at the 95-percent confidence level for estimates we developed for the small urban businesses.

We also contacted officials at the nine empowerment zone offices to discuss their efforts to inform businesses of the three empowerment zone tax incentives. We conducted our work from January through September 1999 in accordance with generally accepted government auditing standards.

**Appendix III
Scope and Methodology**

Table III.1: Sampling Errors and Confidence Intervals of Estimates for Small Urban Businesses

Description	Estimate	Sampling error	Confidence interval	
			From	To
Percentage of the businesses that used at least one of the three empowerment zone tax incentives	10	4	6	14
Percentage of the businesses that used none of the empowerment zone tax incentives	70	6	64	76
Percentage of the businesses that did not know if they had used any of the empowerment zone tax incentives	18	5	13	23
Percentage of the businesses that claimed the employment credit in 1997	6	3	3	9
Percentage of the businesses that did not claim the employment credit in 1997	81	5	76	86
Percentage of the businesses that did not know if they had claimed the employment credit in 1997	11	4	7	15
Of the businesses that claimed the employment credit, the percentage that rated it as at least "somewhat important" in their decisions to hire employees who lived within their zones	67	26	41	93
Of the businesses that rated the employment credit as at least "somewhat important," the percentage that rated it as "very important" or "extremely important"	50	33	17	83
Of the businesses that did not claim the employment credit in 1997, the percentage that reported the following reasons:				
did not qualify for the credit because employees lived outside the zone	31	7	24	38
did not know about this credit	40	7	33	47
this credit was too complicated to use	8	4	4	12
did not have federal taxes or their partners and shareholders had no federal taxes	5	3	2	8
did not qualify for this credit because employees are family members	4	3	1	7
other reasons	9	4	5	13
Percentage of the businesses that used the increased expensing deduction for 1997	4	2	2	6
Percentage of the businesses that did not use the increased expensing deduction for 1997	78	5	73	83
Percentage of the businesses that did not know if they had used the increased expensing deduction for 1997	17	5	12	22
Of the businesses that did not use the increased expensing deduction for 1997, the percentage that reported the following reasons:				
did not know about this deduction	40	7	33	47
made no investment in qualified zone property	22	6	16	28
investments were too large	3	2	1	5
did not have high enough income	10	4	6	14
investments were too small	16	5	11	21
this deduction was too complicated to use, did not qualify as a zone business, or other reasons	10	4	6	14

(continued)

**Appendix III
Scope and Methodology**

Description	Estimate	Sampling error	Confidence interval	
			From	To
Of the businesses that had never received proceeds from an empowerment zone facility bond, the percentage that reported the following reasons:				
did not know about this type of bond	67	6	61	73
this bond was too complicated to use	6	3	3	9
did not need this bond	6	3	3	9
did not qualify as a zone business	9	4	5	13
property was not qualified zone property	4	3	1	7
state volume cap had been met when business applied, needed a larger bond than allowed, or other reasons	8	4	4	12
Percentage of the businesses that used the work opportunity credit	1	1	0	2
Percentage of the businesses that used the welfare-to-work credit	0	0	0	0
Percentage of the businesses that used none of the three additional credits	90	4	86	94
Percentage of the businesses in				
manufacturing	12	4	8	16
services	30	6	24	36
wholesale trade	12	4	8	16
retail trade	22	5	17	27
construction	4	2	2	6
other industries	16	5	11	21
Percentage of the businesses that filed incomes taxes as				
subchapter C corporation	31	6	25	37
subchapter S corporation	30	6	24	36
partnership	5	3	2	8
sole proprietor	23	5	18	28
Percentage of the businesses that did not know how they had filed taxes	6	3	3	9
Percentage of the businesses in the zones before December 21, 1994	90	4	86	94
Percentage of the businesses that moved or expanded into the zones on or after December 21, 1994	3	2	1	5
Percentage of the businesses that started as new businesses in the zones on or after December 21, 1994	5	3	2	8
Percentage of the businesses located in their neighborhoods for				
3 years or less	5	3	2	8
4 to 6 years	11	4	7	15
7 to 9 years	8	3	5	11
10 years or more	75	5	70	80
Estimated number of employees working within the zone, including owners and operators	48,797	14,741	34,056	63,538

(continued)

**Appendix III
Scope and Methodology**

Description	Estimate	Sampling error	Confidence interval	
			From	To
Percentage of the businesses that selected the following factors as most important to them in deciding where to locate their businesses:				
cost of doing business	41	6	35	47
availability of skilled workers	25	5	20	30
state and local taxes on business and industry	22	5	17	27
productivity of workers	19	5	14	24
efficient transportation for materials and products	18	5	13	23
presence of specific target markets and/or customer base	40	6	34	46
ample area or land for future expansion	12	4	8	16
personal and/or business history in location	39	6	33	45
availability of federal empowerment zone tax benefits	13	4	9	17
empowerment zone projects that support business development	13	4	9	17
access to capital and/or credit	14	3	10	18
state and local controls on environmental impacts	7	3	4	10
other reasons	7	3	4	10
Percentage of the businesses that have considered moving out of their zones since December 21, 1994	25	5	20	30
Percentage of the businesses that have not considered moving out of their zones since December 21, 1994	74	6	68	80
Of the businesses that have considered moving out of their zones, the percentage that reported the following factors influenced them:				
state and local taxes too high	38	12	26	50
cost of doing business at this location	36	12	24	48
insufficient area or land for expansion	18	10	8	28
skilled workers not available	20	10	10	30
state and local controls on environmental impacts	10	8	2	18
low productivity of available employees	15	9	6	24
inadequate support from empowerment zone projects	33	12	21	45
limited or no access to needed capital and/or credit	26	11	15	37
insufficient customer base	33	12	21	45
inefficient transportation for materials and products	0	1	0	0
other factors	28	11	17	39
Average increase in the number of employees since December 1994 for businesses that had employees working in the zones then	4.1	2.5	1.6	6.6
Percentage of the businesses that reported having fewer than 50 employees	91	4	87	95
Percentage of the businesses that reported having 50 or more employees	5	3	2	8

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