

Message

From: Siggy Tesfaye [siggy@rapoza.org]

Sent: Friday, June 20, 2003 12:43 PM

To: eric.solomon@do.treas.gov

Cc: davenportl@odfi.treas.gov; Tony Brown (Brown, Tony); Paul F Handleman@IRSCOUNSEL.TREAS.GOV; josephsm@cdfi.treas.gov

Subject: NMTC Coalition Issue letter

Attached please find a letter discussing a number of regulatory and implementation issues that are of concern to members of the NMTC Coalition and we look forward to working with you to resolve these issues in the near future.

Alison Feighan  
Rapoza Associates  
siggy@rapoza.org

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New Markets Tax Credit Coalition (NMTCC)  
June 19, 2003

Eric Solomon  
Deputy Assistant Secretary for Regulatory Affairs  
Office of Tax Policy  
Internal Revenue Service  
1500 Pennsylvania Avenue,

NW Washington, DC 20220

Dear Eric:

I am writing to follow up on the meeting that you and your colleagues had with members of the New Markets Tax Credit Coalition (NMTC Coalition) Steering Committee last month. We appreciated the opportunity to discuss a number of regulatory and implementation issues that are of concern to members of the NMTC Coalition and we look forward to working with you to resolve these issues in the near future.

Internal Revenue Code (IRC) Section 183

The Coalition recommends that the New Markets Tax Credit Coalition (NMTC) be treated like the Low-Income Housing Tax Credit (LIHTC) as it relates to Section 183. Such a ruling would be consistent with Revenue Ruling 2003-20 issued by the Treasury Department in January of this year which permits an investment partnership, financed with both equity and non recourse debt, to finance the purchase of a Qualified Equity Investment in a Community Development Entity (CDE). If an exemption from IRC 183 is not provided for NMTC, CDEs will not be able to take advantage of leverage.

## Implementing the Qualified Active Low-Income Community Business Test Real Estate

Businesses We recommend any real estate project in a qualified low-income community be deemed a Qualified Active Low-Income Community Business. Though one of the intended purposes of the NMTC was clearly to facilitate investments in real estate, we are concerned that real estate projects, which in many cases are structured as trusts or LLCs without employees, will be unable to satisfy the requirements of a Qualified Active Low-Income Community Business. Separately Incorporated The Coalition recommends that Treasury issue additional guidance on the 'separately incorporated' language in the temporary rule (26 C.R.F. 1.45D-1T (d)(4)(E) (iii)). We recommend that CDEs be required to submit substantial documentation to support their contention that a trade or business would qualify as a qualified active low-income business if it was separately incorporated. The test used to identify a Qualified Active Low-Income Community Business, including the gross income, tangible property, and services test, must be satisfied by the 'separately incorporated business entity as though it was a stand-alone entity.

### Control

The Coalition recommends that the threshold for control, which is set at 33% in the temporary regulation, be amended to read 60% of management voting control (whether through holding membership, partnership or stock interest(s)). This higher threshold is a more accurate measure of control and only if a CDE can truly exercise control over a business' actions should they be held to a higher standard in terms of keeping the business in compliance. The current control threshold prevents CDEs operating as community development venture capital funds from taking advantage of the 'reasonable expectations' test and therefore puts them at a greater risk of recapture as compared to other CDEs.

### Defined Cure Period

The Coalition recommends that a one-year cure period be provided in the regulations. We suggest that a CDE would only apply for a waiver if after 12 months they were unable to cure the noncompliance for one reason or another. The temporary rule does not include any cure period and the Allocation Agreement includes a 60 day cure period which we have commented is too short. Recapture penalties under the NMTC are severe and a defined and reasonable cure period is something that both investors and CDEs recommend putting in place.

### Lower Tier CDEs

The Coalition opposes the language in the temporary rule that limits the activities of lower tier CDEs by prohibiting them from investing in or lending to CDEs or from purchasing loans from other CDEs - both of which are Qualified Low-Income Community Investments for upper tier CDEs. The limitation on lower tier CDEs will hinder the activity of CDE intermediaries that intend to use the credit to help non-allocattee CDEs access capital. In terms of safeguards, the 'substantially all' requirement is in place to ensure that at least 85% of a CDE's Qualified Equity Investments is put into Qualified Low-income Community Investments within 12 months

and Allocatees operating as intermediaries will be required to trace those investments to meet the 85% test.

### Multiple Loan Sales and Utilizing a Warehouse Line of Credit

Related to the issue of allowable activities for lower tier CDEs is the issue of multiple loan purchases and the ability of a CDE to use a warehouse line of credit to facilitate the transaction. The Coalition requests clarification as to whether a chain of purchase transactions among several CDEs is allowed. The Coalition believes that such a chain of purchase transactions is clearly within the legislative intent and reflects the reality of practices used within established capital markets and we do not see any opportunity for abuse, as long as each entity in the chain of transactions is a CDE and Qualified Equity Investments are deployed for Qualified Low-Income Community Investments.

We also request that Treasury clarify the ability of a CDE to use a warehouse line of credit to facilitate the chain of purchase transactions. A CDE would use a warehouse line of credit to assemble loans in advance of calling for capital from qualified equity investors. The Qualified Equity Investment would be used as the permanent source of funding for the Qualified Low-Income Community Investment. Since the investor cannot claim tax credits until the equity investment is actually made in the CDE, the use of a warehouse line actually results in a later triggering of the credits, which is, presumably, a more conservative use of the credits.

I have attached a chart that illustrates the various transactions involved in the multiple loan sale including the use of a warehouse line of credit.

### Related Entity Test

In determining whether a CDE is investing in a related business the Coalition recommends that the CDFI Fund look at the operating agreement between the equity investor and the CDE rather than merely considering the relationship between the CDE and the Qualified Low-Income Community Business. If the CDE's operating agreement or partnership agreement stipulate that the equity investor has final decision making power over all investment decisions of the CDE, and then the Fund should look to the relationship between the investor and the Qualified Active Low-Income Community Business in determining whether they are related. Since the statute intended CDEs to make investments in businesses they own, we caution the Fund not to use the related business entity test to discourage CDEs from investing in businesses in which they or a parent or subsidiary have an interest.

### Allocatees Investing in CDE Allocatees

The Coalition agrees with Treasury that there should be a prohibition against Allocatees using a Qualified Equity Investment to make a Qualified Equity Investment in another CDE Allocatee. However, the temporary rule (26 C.R.F. 1.45D-1T(c)(4)(i)(B)) and the Allocation Agreement (Section 3.3(f)), both include language that could be interpreted as prohibiting Allocatees from co-investing with other Allocatees or from using funds not derived from Qualified Equity Investments to invest in a CDE Allocatee. We recommend that the language in

the temporary rule be amended to simply prohibit double dipping of the same Qualified Equity investment.

I appreciate your efforts, and the efforts of your colleagues, in working to resolve these issues. Please let me know if you have any questions or if the NMTC Coalition can be of any help as you move forward.

Sincerely,

Robert A. Rapoza

cc: Tony Brown Linda Davenport Matt Josephs Paul Handleman