

Local Initiatives Support Corp. Comment on Proposed Regulations
REG-119436-01) Regarding New Markets Tax Credit

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REGULATION: New Markets Tax Credit

July 2, 2001 CC:M&SP:RU (REG-119436-01) Room 5226 Internal Revenue Service POB 7604
Ben Franklin Station Washington, DC 20044

Dear Sir/Madam:

Local Initiatives Support Corporation (LISC) is pleased to comment on the IRS Advance Notice of Proposed Rulemaking concerning the New Markets Tax Credit. About LISC. LISC helps neighbors build whole communities. In 20 years, LISC and its affiliates have raised \$4 billion in private sector investments, loans, and grants, and directly helped 2,000 nonprofit low-income Community Development Corporations (CDCs) across the country to produce 110,000 affordable homes and over 14 million square feet of commercial and industrial space. CDCs have used LISC's funding to leverage an additional \$7 billion from other sources. Among other activities, LISC has raised \$24 million in private equity investments and invested the proceeds in inner-city supermarkets and related shopping centers. In 2000 alone, we committed \$25 million of loans and equity investments for economic development activities in low-income communities. We also invest major resources in jobs and income programs, childcare facilities, youth programs, crime and security initiatives and many other programs that directly benefit low-income neighborhoods and their residents. We believe our perspective may be helpful to the IRS. We have had extensive experience in raising private capital and deploying it in low-income communities, including for economic development. We also are very familiar with the discussions that led to the enactment of the New Market Tax Credits. Finally, we hope to participate in activities involving the New Markets Tax Credits, and therefore have an interest in both their workability and long-term integrity. General comments. LISC is a member of the New Markets Tax Credit Coalition, which has submitted extensive comments with which we are pleased to be associated. However, the Coalition decided not to take a position on two issues that we believe are important to the integrity of the New Markets Tax Credit. Issue 5(a): What restrictions, if any, should apply to the use by a CDE of the proceeds of a qualified low-income community investment received from another CDE? We believe that all qualified low-income community investments (QLICBs) should benefit qualified active low-income community businesses (QALICBs) regardless of whether they are made directly or through another CDE. It should be entirely permissible for a CDE to invest in a second CDE (that is not itself a QALICB), so long as that second CDE in turn uses the proceeds to make QALICBs in QALICBs. To provide otherwise would, in our view, not reflect Congressional intent and would open a broad avenue to abuse. In enacting the New Markets Tax Credit, Congress sought to encourage financing for certain businesses in low-income communities. At no time during the legislative process did we ever hear or understand any policy intent that investments need not benefit QALICBs so long as the funds flowed through a second CDE. Permitting a CDE to invest a second CDE (that is not itself a QALICB) without tracing the proceeds to QALICBs would invite the use of New Markets Tax Credits to support activities outside low-income communities and for businesses that would otherwise be disqualified, such as the rental of residential real estate. Indeed, the second CDE might simply hold the proceeds without reinvesting them in businesses at all. Such loopholes would invite widespread abuse. Virtually any sponsor could set up two CDEs: one to apply for an allocation of New Markets Tax Credits, and a second CDE through which the investments would be funneled in order to avoid meeting the requirement to finance QALICBs. Appropriate tracing should not be problematic. LISC, through our National Equity Fund affiliate, has had extensive experience in marshalling over \$3 billion in investments based on the Low Income Housing Tax Credits. Our investment structure involves two tiers: an investment tier entity

raises equity investments and in turn invests in a series in project-tier entities. In this structure, NEF is responsible to the investors for ensuring that each project-tier entity meets the requirements of the Low Income Housing Tax Credit. This accountability has been fundamental to the effectiveness of the Housing Credit. Issue 8(a): What anti-abuse rules may be necessary for carrying out section 45D? The Credit is intended to benefit economically distressed communities. Since by definition central business district (CBDs) are not primarily residential, residential data are not liable indicators of a CBD's distress. Some portions of CBDs in large cities will meet the income or poverty tests under the law even though they are not truly distressed. For example, we understand that the World Trade Center in New York, the Loop in downtown Chicago, and even the Treasury Department in Washington are in census tracts eligible for New Markets Tax Credit investments. Treasury should use its anti-abuse authority to clarify that credits may not be used to finance business in economically healthy CBDs of cities with populations over 50,000. In general, a CBD should be defined as a downtown area or regional business and commercial center within a city with a least 50,000 residents. A primarily residential or industrial area should not be considered a CBD. No CBD restriction would apply to locality with fewer than 50,000 residents. Many city governments have already delineated a CBD or downtown area, and such designations should apply for purposes of the New Markets Tax Credit. Where no such delineation exists and it is not clear whether a location should be considered within a CBD, a CDE should be permitted to rely on a statement from a city or county government or a regional entity that representative of local governments (such as a regional planning organization or council of governments). Nevertheless, investments within a CBD should be eligible for New Markets Tax Credit financing if the business is located in an area that a state or local government determines to be blighted, distressed, deteriorating, a slum, or of similar character. Federal or state enterprise zones, empowerment zones, and renewal communities should also be eligible even if located within a CBD. In each case, the census tract would still have to meet the census tract income or poverty tests of the New Markets Tax Credit. Conclusion. This concludes our comments. We appreciate your consideration of them.

For further information, please contact me
1825 K Street, NW, Washington, DC 20006 or at 202/785-2908.

Sincerely,

Benson F. Roberts
Vice President for Policy