

IRS Comment Letters
Community Development Bankers Association Comment on Proposed Regulations
(REG-119436-01) Regarding New Markets Tax Credit

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

Dear Sir/Madam:

Of behalf of the members of Community Development Bankers Association (CDBA), I am writing to submit comments the Advanced Notice of Proposed Rule Making published in the *Federal Register* on May 1, 2001 by the Internal Revenue Service, regarding the New Markets Tax Credit (NMTC) Program.

CDBA is a new national trade association currently in formation. CDBA is being organized to represent the interests of our nations" network of community development banks. Community development banks are Federal Deposit Insurance Corporation-insured banks and thrifts that have a primary mission of promoting community development. Community development banks target urban and rural communities that lack access to credit and are not adequately served by the traditional banking industry. Currently, there are approximately three dozen community development banks across the nation that have been certified by the Treasury Department's Community Development Financial Institutions (CDFI) Fund. As per the guidance issued by the CDFI Fund, all of these institutions would qualify as Community Development Entities (CDEs) under the NMTC Program.

Paperwork and Administrative Burden:

As a representative of private sector institutions, I have significant concerns about the potential administrative and paperwork burdens that may be created by several key aspects of the NMTC program. If the Treasury Department seeks to promote private sector investment in distressed communities, it is essential to minimize paperwork and administrative burden. For example, the guidance specifies that a CDE may not issue any qualified equity investments to its investors until the CDE and the Fund have executed an Allocation Agreement specifying the terms and conditions of the allocation. In the experience of many community development banks that have received assistance through the Fund's CDFI Program, it is not unusual to take more than a year after award notification to receive an executed Assistance Agreement. The Allocation Agreement should be a streamlined boilerplate document that specifies the general terms and conditions – similar to that which is issued under CDFI Fund's Bank Enterprise Award Program. The Fund should make a commitment to execute all Allocation Agreements within two months of an allocation award notice.

"Substantially All" Requirements:

I wish to express concern about the potential difficulties that could be created in implementing the "substantially all" provision discussed in the Advanced Notice of Proposed Rulemaking published by the Internal Revenue Service. The notice states that CDEs are required to use "substantially all" of the cash from a qualified equity investment to make qualified low-income community investments. In order to carry out its mission, a CDE will need to finance its operations, technical

assistance activities, and risk reserves – as well as make loans and investments – out of the capital raised from investors. For example, in the case of a CDE established as a limited partnership or limited liability company, operations are customarily financed through a management fee assessed on the total amount of paid-in capital from investors. It is critical that the Department's final regulations reflect an understanding that the overhead costs that support a CDE's lending and investment functions are an integral part of making qualified loans and investments. Thus, the Department should count all customary and reasonable expenses (i.e. staff salaries, reserves) associated with undertaking this type of activity towards meeting the "substantially all" requirement. In assessing whether or not a CDE has met the "substantially all" requirements, the Department should assess the total operations of the CDE *and* its pool of equity investments. CDEs must operate in a safe and sound manner for the NMTC Program to achieve its public policy goals and protect investors' principal. If the Department does not take these real costs into consideration, a CDE could be forced to operate without adequate reserves or cut back on critical functions such as conducting sufficient due diligence or monitoring its portfolio. Finally, in determining whether individual investors are able to claim the tax credit based upon whether a CDE has met the "substantially all" requirement, I recommend that the Department evaluate how the CDE has deployed resources overall for its operations and pool of investments – rather than on how each individual investor's dollars were deployed. The latter approach would be administratively burdensome and inconsistent with achieving the public policy goals set forth for the program.

Use with Other Federal Programs:

I wish to express concern regarding the prohibition discussed in the CDFI Fund's guidance that would prohibit CDEs that are insured depository institutions from receiving a Bank Enterprise Award for the provision of *"any financial assistance or services that are also Qualified Low-Income Community Investments if such assistance or services were provided with cash proceeds of a Qualified Equity Investment for which the investor received the benefits of NMTCs."* Furthermore, the guidance states, *"A CDE that is an insured depository institution may not receive both a BEA Program award and a NMTC allocation for the same equity investment in a CDE."* I strongly recommend that this provision be eliminated. Financial institutions should be permitted to use the BEA Program in concert with the NMTC. Both programs are targeted to serve distressed communities that suffer from a lack of private sector investment. While the Department may believe it is prudent to discourage "double dipping" into two Federal subsidies to support a particular set of activities, it should be noted that it is very difficult to attract private capital into distressed and dysfunctional markets. The existence of multiple tools that can be used in tandem to make projects financially viable only improves the prospects of success and should not be viewed negatively. Finally, it should be noted that while there is statutory language that prohibits the use of the NMTC with other Federal tax subsidies – Congress specifically omitted any prohibition against using the NMTC with other Federal programs. I strongly believe that prohibiting the use of the NMTC with the BEA Program over-reaches Congressional intent.

I appreciate your consideration of these comments. I look forward to working with you in the future to make the NMTC Program a success.

Sincerely,

Robert M. McGill
President and Chief Executive Officer
Neighborhood National Bank