



CC:PA:LPD:PR (REG-101826-11)
Room 5203
Internal Revenue Service
PO Box 7604
Ben Franklyn Station
Washington, DC 20040

Dear Madam/Sir:

We are writing with comments on the regulations proposed by the Internal Revenue Service (IRS) modifying the existing New Markets Tax Credit (NMTC) regulations (IRC Section 45D) in an effort to facilitate and encourage investment in non-real estate businesses in low income communities.

Cohen & Company, Ltd and Ariel Ventures, LLC (Cohen-Ariel) is a joint venture full service tax credit syndication and consulting firm. We have been consulting QALICBs, CDEs, and investors since the NMTC program originated in 2001 and have provided CPA tax and audit services, deal structuring, financial and compliance advisory services for over \$1.5 billion in NMTC, historic tax credits (HTCs), renewable energy credits, and other public-private financing transactions. In addition to our consulting services, we jointly own a CDE that has received \$95 million in NMTC allocation, so we are particularly interested in this new proposed regulation.

In our response to the proposed regulation, below we have addressed the specific questions posed by the IRS and the Department of Treasury. We also offer recommendations of our own.

Specific Questions:

1. Will the proposed rules allowing a payment from a non-real estate qualified active low-income community business to be invested in a certified CDFI facilitate loans to, or equity investments in, non-real estate businesses? Should the rule take into account whether a loan to the non-real estate business is an amortizing or nonamortizing loan, the loan period, and the loan repayment schedule?

Unlike other tax credits that incentivize business owners to invest in their own businesses, the NMTC is designed to provide outside investors with incentives to invest in low-income communities. Inherent in this distinction is a return on investment that an investor expects to receive as a result of his or her investment.

The leveraged model, taking debt and combining it with investor capital to produce larger NMTCs to the investor, generally allows the investor's return to be competitive with other available investments. The use of third party loans as leverage requires the QALICB to provide the CDE with interest payments that can be distributed to the investment fund and used to satisfy the interest incurred on the leveraged financing.

The new proposed regulations provide the ability for the CDE to continue to satisfy the substantially-all requirements under Treas. Reg. §1.45D-1(c)(5) by allowing for any return of capital to be reinvested in a qualified CDFI.

What this provision does not provide is the ability to use the leveraged model for non-real estate NMTC. This is due to the fact that if the CDE invests any returns of capital into a qualified CDFI, there will be an imbalance in the amount of interest earned by the CDE from the qualified CDFI deposit account that is distributed to the investment fund and the interest to be paid by the investment fund to the leveraged lender.

This provision also does not address investor risk. The proposed regulation attempts to reduce the risk of recapture by allowing the CDE to reinvest returns of capital into certified CDFIs. However, the investor still needs to rely on the CDE to make that reinvestment and continue to satisfy the substantially-all test for the entire seven-year period.

The lack of investor certainty surrounding the CDE will create burdensome fees caused by documenting restrictions of the CDE as well as monitoring during the seven-year period for non-real estate loans.

2. Will the proposed rules encourage venture capital investments in non-real estate businesses? If not, how can the proposed rules be modified to accomplish that goal?

The proposed regulation would not encourage venture capital investments in non-real estate businesses through the use of the NMTC, because NMTC does not offset the Alternative Minimum Tax (AMT). Typically, venture capital firms are structured as an LLC or a partnership for tax purposes. This provides investors with greater flexibility regarding allocations and allows losses to flow through to the investors. Traditionally, investors in venture capital entities are individuals or specific types of tax-exempt entities, such as pension plans and foundations.

Currently, NMTC cannot reduce AMT, which could result in an unusable credit during some tax years. This will make investors' calculations of ROI uncertain, burdensome, and doubtful. In addition, in cases where the venture capital investors are tax-exempt entities, the NMTC credit in certain circumstances are of little value in calculating the investors' ROI.

In order to encourage venture capital investments in NMTC, an amendment would need to be made to allow the NMTC to reduce AMT.

3. Is the definition of a non-real estate qualified active low-income community business sufficient for CDEs and investors to rely on? Are the “more than 50 percent gross income” requirement and activity limitation the appropriate ways to define a non-real estate qualified active low-income community business?

The definition appears to be sufficient to ensure the intended purpose of this provision.

4. Will CDEs be able to determine whether an entity satisfies the requirements to be a non-real estate qualified active low-income community business without incurring unduly burdensome costs?

It is our opinion that the CDEs would be able to determine whether an entity satisfies this requirement without incurring unduly burdensome costs. However, safe harbor provisions should be put in place, similar to the existing safe-harbors, such that the CDE and investors can make a reasonable determination at the beginning of the credit period and rely on that determination throughout the seven-year credit period. This will alleviate the burden and risk to the CDE (and thus reduce corresponding costs) of monitoring a QALICB’s activities after the investment is made.

5. Should a payment from a non-real estate qualified active low-income community business be permitted to be invested in entities other than a certified CDFI (or qualified low-income community investments)?

In order to provide the CDEs with more flexibility in use of the leveraged model, a CDE should be permitted to invest returns of capital into entities other than a certified CDFI. These entities can include organizations such as non-profits and for-profits focused on economic and community development and creating jobs, funds that provide equity and loans to small and medium businesses to create jobs, funds that provide equity or loans to minority and women-owned businesses, and others with similar missions and purposes.

6. Should a qualified equity investment made before the effective date of the final regulations be eligible for designation as a non-real estate qualified equity investment?

No. Providing retroactive provisions confuses taxpayers and leads to risks and unintended consequences. Our recommendation would be to make this provision effective prospectively.

Cohen-Ariel Recommendations:

We respectfully submit the following recommendations regarding this provision:

Reducing investor risk:

One of the issues with using NMTC to invest in operating businesses is the risk of recapture due to amortizing loans. Investor risk increases the fees involved in providing investors with protection against recapture.

To provide the investor with more certainty, we recommend that a safe harbor provision be added to the proposed regulation. The safe harbor provision would provide that the substantially-all test would be met if:

1. The CDE satisfies the substantially-all requirements under Treas. Reg. §1.45D-1(c)(5) upon the initial qualified equity investment into a non-real estate business, and
2. Amounts received by the CDE as a return of capital, equity, or principal must be reinvested or held by the CDE during the remaining seven-year credit period.

Applying the safe harbor provision up front and throughout the entire seven-year credit period would provide the investor with greater protection and confidence that risk of recapture would not occur. It also would provide the CDE with the flexibility of using other investment vehicles to allow the leveraged model to be used for transactions with non-real estate businesses.

Increasing Investor Pool:

In order for CDEs to encourage investment in non-real estate NMTC transactions, there will be a need to expand the current investor pool. This will allow investors with appetites for smaller tax credit transaction deals as well as venture capital funds to participate in the NMTC program. The main restriction that has prevented these types of investors in participating in the NMTC program is the AMT.

In order to expand the investor pool, modifications will need to be made to allow NMTC to be offset against AMT. We recommend that modification is made to §38(c)(4)(B) to include NMTC. Below is the specific text to modify.

x. the credit determined under section 45D

Additionally, for venture capital funds where the owner/members/partners are comprised of both taxpaying investors and tax-exempt investors, providing an exception that allows the fund to specially allocate the NMTC to taxable “partners”—without violating the substantially-all test, as long as reductions in basis are reflected in the partners capital—would encourage mixed investor funds to participate in NMTC deals.

Sinking Fund:

If the regulations could provide that the QALICB itself could establish a sinking fund at the CDFI, which would be used at the end of the credit period to retire the loans from the CDE, and allow a third-party leverage lender to maintain a security interest in this sinking fund, that situation could expand the lending efforts by CDEs to non-real estate QALICBs. This would require regulations to exclude such sinking fund from the non-financial assets calculation.

We appreciate the opportunity to submit these comments. We commend the IRS and the Department of Treasury’s efforts in providing this proposed regulation with the hopes of increasing the NMTC program to non-real estate businesses. We look forward to working with

IRS on future discussions regarding this specific provision and other items related to the NMTC program.

Very truly yours,

COHEN & COMPANY, LTD.
Certified Public Accountants

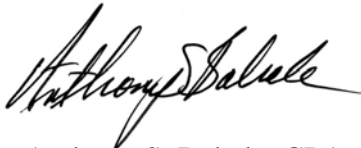
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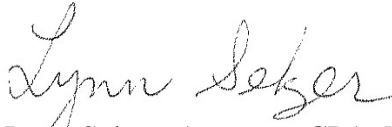
David Sobochan, CPA
Principal
Cohen & Company, Ltd.



Radhika Reddy, MBA, MA-Tax
Partner
Ariel Ventures, LLC



Anthony S. Bakale, CPA
Partner
Cohen & Company, Ltd.



Lynn Selzer, Attorney, CPA, MBA
Partner
Ariel Ventures, LLC



Chris Madison, CPA, MT
Partner
Cohen & Company, Ltd.

Outline of Hearing Topics

We would appreciate the opportunity to speak at the upcoming hearing on the proposed regulation. Below is a brief outline of what we planned to discuss at the hearing:

1.) Answers to questions listed in the NPR:

- Issues related to the leveraged loan structure that impact the proposed regulation including interest payment imbalance and investor risk.
- Issues related to venture capital investments in NMTC including AMT limitations, tax-exempt entities, and special partnership allocations.
- Satisfying the substantially-all test through the use of a certified CDFI or other alternative investments.

2.) Answers to questions listed in the ANPR:

- Impact of simplifying the substantiation requirements on CDEs investment in non-real estate QALICB/second CDEs including investor risk considerations and additional fees involved in the transaction.
- Transaction caps and their impact on investments in non-real estate QALICBs.
- Attempts to use minimum requirements for second CDEs and the unintended consequences of doing so.
- Non-statutory revisions that would lead to more investments in non-real estate QALICBs including revisions to allocation agreements and greater weight provided to CDEs that provide loans/investments to non-real estate QALICBs.
- Changes to the reasonable expectations test including removing indirect ownership from the definition of control under §1.45D-1(d)(6)(ii)(B) and increasing the percentage of ownership test to 80%.

Recommendations from Cohen-Ariel:

- Reduction of investor risk through the use of a safe harbor provision designed to prevent recapture of the NMTC.
- Increasing the investor pool by amendments to the code and providing special allocations for tax-exempt partners.
- Incorporating a sinking fund to allow a leveraged loan structure for non-real estate QALICBs.