

Transcript of Dec. 12, 2008, IRS Hearing on Proposed Regulations(REG-149404-07) Modifying New Markets Tax Credit

PANELISTS:

Julie Hanlon-Bolton, attorney (passthroughs & special industries), Internal Revenue Service;
Paul Handleman, branch chief (passthroughs & special industries), IRS;
Danielle Grimm, special counsel to the associate chief counsel (passthroughs & special industries), IRS;

WITNESSES:

Michael Novogradac, Novogradac & Co.;
Alison Feighan, New Markets Tax Credit Coalition;
Radhika Reddy, Ariel Ventures, LLC

MS. GRIMM: Well, good morning. We're going to get started with the hearing.

This is the public hearing on the proposed regulations which amend the New Markets tax credit regulations. On August 11th, 2008, the service published proposed regulations in the *Federal Register* and at the same time announced that a public hearing would be held today, December 12th, 2008.

Two people have requested the opportunity to speak this morning. Each person will have 10 minutes to speak. There is a lighted indicator on the top of podium. When three minutes are left, the light will turn from green to yellow, which indicates that you have three minutes left to speak. When the light turns red, your time is over.

I'd like to introduce our panel. My name is Danielle Grimm, I'm a special counsel to the associate chief counsel, passthroughs & special industries; and to my left is Paul Handleman, branch chief of Branch 5 of passthroughs & special industries; and to his left is Julie Hanlon-Bolton. She's an attorney in Branch 5 of passthroughs & special industries. Jean Ross, attorney adviser, Office of Tax Policy, is also a member of our team, but because of competing commitments, she was unable to join us today.

Our first speaker is Michael Novogradac, representing Novogradac & Company.

Michael, you can approach.

MR. NOVOGRADAC: Great. Thank you.

I'm Michael Novogradac here representing Novogradac & Company. We're a national accounting firm that does a lot of work in the New Markets tax credit area. I'm also here representing the comments of the New Markets Tax Credit Working Group. I know many of you are familiar with the New Markets Tax Credit Working Group. It's a group of CDEs that are working in the New Markets tax credit area--CDEs being community development entities.

And these--in addition to CDEs being represented within the New Markets Tax Credit Working Group, we have a large number of industry participants, including other accounting firms, other law firms, lenders and such.

And we first of all, commend the IRS and Treasury on a good set of amendments to the regulations. Unfortunately, we're not going to spend our time talking about all the good things we like. We're going to end up commenting on additional things that we would like to see in the regulations.

Our comment letter—many of you have also seen it—represents comments that are supportive of over 24 companies and over 30 people and their signatories' on the letter. And our comments themselves, we actually have 23 sections and more than that in terms of comments. So obviously, I won't be going through all of our comments today.

One of the questions that always comes up is: which sort of comments are most important? And we spent a lot of time aggregating our comments among a number of participants--even those beyond those that signed onto the actual final letter. And I can assure you that every comment in here is very important to more than one group out there. So I think they're all sort of very important.

One area where I wanted to spend a little bit of time is the whole area of redemption. And a lot of our comments apply to the redemption area. And the first area there has to do with the timing of distributions. And there in our comments we suggested that, if you make a distribution in a subsequent year, you should be able to elect to treat everything you made in the prior year.

And the idea being that, within the regulations, there's this general concept of operating income. And operating income--and right now, the distributions need to be made within the year in which you generate operating income. It's hard from an accounting perspective to know in a particular calendar year what your operating income is because you never know what could happen on December 31st. So companies would like to be able to wait until the end of a given year and determine their operating income and then deem any distribution to be made with respect to that operating income as having been made in the prior year.

There are other examples in the code where these deemed concepts exist and we think the concept of a deemed distribution the prior year would be a useful addition to the regulations.

We also think the regulations did a good job of allowing distributions to come out of current operating income in the prior year, but we think it ought to do more than that and that you ought to be able to make distributions out of cumulative operating income. Similar to the way the rules for C corporations, within New Markets you can make distributions that are cumulative. We'd like to see it made out of cumulative or operating income safe harbor as well.

And I would point out that this notion of being able to elect to treat the distribution as having been made in the prior year applies even if you have the cumulative operating income concept. And that's because, if an entity has operating income one year and a loss the next year, they would like to not taint the loss--they would like to be able to distribute out operating income from the previous year.

I'd also point out that, if we don't go down this cumulative operating income route--which would be our first sort of desire--then we do need to have guidance on how you determine, when you make a distribution, which year's income it comes out of.

I also think that, if we don't go down this cumulative operating income concept, there needs to be some transition rule for all those entities that, for many years, have been limiting their distributions in a given year because they were concerned about the definition of operating income and have some sort of catch up where they could catch up from the prior years. But those two comments aren't really necessary if you go down the cumulative operating income concept.

And then my sort of third major comment in the concept of operating income and redemption for community development entities has to do with capital gains. We think that capital gains should be included as an addition to operating income. So if a CDE generates capital gains, those capital gains should be able to be distributed to their investors.

From the reinvestment rules perspective, you only have to reinvest up to the original cost. So if you don't have to reinvest the money, you should be able to distribute the money. There ought to be a sort of parity between: do have I have to reinvest it? If not, I should be able to distribute it. I shouldn't be forced to keep it in the CDE.

And we recognize that these comments are dealing with the safe harbor and it's just a safe harbor. But everyone is operating as if it was the rule because the safe harbor you know you're safe. The moment you step outside the safe harbor, no one can tell you that you're safe. So we appreciate that it is just a

safe harbor, but just know that it does operate as the rule.

Switching over from redemptions to the other major area--in addition to dealing with operating income passthrough entities, you have C corporations. And there is a concern among a number of C corporations that are CDEs that, when it comes time to pay their federal taxes, that if they give their money to their parent and then the parent uses that money to pay the federal taxes, that that could be viewed as a redemption. And that's because the E& P--earnings and profits--that's how you determine if you have redemption for a C corp. That is reduced by federal taxes.

So theoretically, you'd say in an ideal world the subsidiary entity would go out and separately write a check for their federal--their share of federal taxes, in which case you wouldn't have this issue. But as a practical matter, within large corporate organizations, it's not that easy to have one subsidiary write a check. So having a rule that allows federal taxes that are paid on behalf of a C corp. to be deemed to be allowable would be a good addition.

And I would also point out that I have in our comments--we actually have sample language on all of our various comments here.

Kind of moving onto another sort of general matter is the effective date. I think it's important that the effective date be perspective. However, existing entities should be able to elect to apply the regulations in the past. And I say that because, to the extent that the regulations allow something going forward, there's always a concern that, if you can't elect to apply those in the past, might someone come in and say: well, the fact that the IRS had to say you can now do it must have meant you couldn't have done it before. And we're sensitive to entities that may have thought they were sort of operating within the proper interpretation and that that argument could be made at some future date.

We also wanted to comment on the reinvestment rules in terms of how you determine if an entity--if a distribution from a qualified business is a return of capital versus return on capital. I do think the parity with how you determine if you have a redemption works so you could use the operating income definition and the E& P definition.

And I'll actually close with sort of two other comments that sort of get a lot of attention. One is a lot of CDEs want to invest in other CDEs. And if those CDEs go off and make the qualified investments--I think there are a lot of reasons why that's good for the program--however, there's a concern if you invest in another CDE: what if that CDE doesn't continue to be a CDE? And there's this whole concept of reasonable expectations. And entities would like to be able to rely on reasonable expectations that a CDE will continue to be a CDE and basically use the reasonable expectation test on the reliance of the other entity being a CDE.

And then the other area I'd comment on is the related-party rule. That's been an issue that's been out there for quite a long time and it kind of keeps coming back. And that has to do with whether or not, if a CDE invests in another entity, whether or not they're going to violate the related-party rule. And it's been interpreted as after the CDE makes the investment, they can't be related parties.

We think there ought to be some version of a rule that says you look at the test before the CDE invests in the qualified business, because we think--particularly in this environment--the ability of CDEs to make equity investments in businesses is--there's a lot of demand for that. And this related-party rule, in essence, prevents the ability of CDEs to make any substantial amount of equity investment into CDEs--or in qualified businesses.

So those are the points of our letter I wanted to highlight. As I mentioned, there are a lot of comments in there. They're all very important. We spent a lot of time, had a lot of phone calls; had a lot of meetings to generate those comments. I hope that you give consideration to all of them--even the ones I don't mention here today.

And with that, I'm an accountant, so I like to be under budget so I've got 56 seconds left. (Laughter.)

MS. GRIMM: Well, thank you.

Does anyone have any questions?

MR. HANDLEMAN: It's maybe a question or more of a comment on the related-party rule.

MR. NOVOGRADAC: Yes.

MR. HANDLEMAN: We've had conversations, as you know. Through delegations the secretary of treasury delegated the authority for making allocations to the CDFI funds. And that related-party rule is really in the priority points for the CDFI fund.

And so are you suggesting that we, the IRS, have authority through our regulatory means of addressing this issue?

MR. NOVOGRADAC: I'm suggesting that the rule change. And if the way for it to change is for the IRS to address it and say that they--addressing it by saying the rule applies beforehand, that would be great.

Conversely, if a CDFI fund were to kind of revisit the rule and conclude that it's before, that would be great. And if both of you think that it takes a statutory change--which we don't think it does, but if you did--then I'd say tell us, so we can pursue a statutory change.

MR. HANDLEMAN: OK. Another question I had is in terms of the redemption for a CDE that's a corporation. So basically, is the suggestion or the proposal that, even though the corpus CDE is making distribution that would exceed E& P, nonetheless, because it's being used only for paying--I guess the taxes attributable to that corporate CDEs income--that we should deem that as not in the redemption?

MR. NOVOGRADAC: Yes. That is correct. That's the recommendation.

MS. GRIMM: OK, well thank you.

MR. NOVOGRADAC: OK, great. Thank you.

MS. GRIMM: OK. Our next speaker is Alison Feighan, representing the New Markets Tax Credit Coalition.

And I hope I pronounced your name correctly.

MS. FEIGHAN: You did.

Well, thank you very much for this opportunity to testify. I'm speaking on behalf of the New Markets Tax Credit Coalition, which is a coalition of more than 140 members. We represent both community development entities, as well as investors and other tax and community development experts.

The comments that we submitted were on behalf of the organizations within the coalition. As Mike noted, we also went beyond commenting on the specific amendments that were in the proposed rule to comment and sort of reiterate other issues that the coalition's commented on in the past.

I will say that representing the industry that has become more seasoned, as the credit has been out there operating in the market, we are increasingly seeing areas where they are seeking IRS clarification. And whether it is through a specific ruling or when you issue a proposed rule providing some kind of examples that can give investors, in particular, guidance as to what is or is not allowed, that would give us great comfort.

And I think it's particularly important, because as you know, the recapture provisions on New Markets are

so severe that it does lead investors to be very cautious to ensure that when they are entering into a New Markets transaction, they're entering in within the parameters of current regs. And I think that is what drives us to seek clarification on issues that some might think fit within the current reg.

Regarding the specific comments that were included in the amendments, the coalition does support the amendment that applies the reasonable expectation test to CDEs making investments in other CDEs. And we have recommended that that be expanded to ensure that the reasonable expectation protection does apply to those passthrough CDEs, that investors can be assured that if they are investing in a CDE that is passing through that investment to another CDE, that there is a reasonable expectation there that the second-tier CDE, so to speak, will maintain its CDE status throughout the life of the investment.

This is particularly important as we see more and more CDEs investing in other CDEs that may be working and doing very good work in low-income communities, as intended by the New Markets credit, but don't have the capacity themselves to apply directly for the credit. And so we're seeing a lot of that activity, and I think if that clarification were made, it would give investors much more comfort in investing in CDEs that are doing that very important work.

The other comments that I'd like to make are off of the amendments that you all proposed. The coalition has, for a long time, put forward recommendations designed to encourage more lending and investing in non-real estate QALICBs. We were pleased that in this last round of allocations there were actually more CDEs that said they would commit their New Markets investments to investing in non-real estate QALICBs. But there's still some limitations, particularly on the lending side, that have inhibited CDs from doing more lending into community development QALICBs. Particularly there is--because of the recapture provisions, most of the loans going out to QALICBs have been formed as seven-year, non-amortizing loans, which limits the ability of CDEs to finance working capital, and other activities that are very important to businesses operating in low-income communities.

The coalition has recommended that the CDE allow the establishment of a sinking fund that would permit the CDE to direct principal repayments into a designated account. Without accumulating those funds, they wouldn't be counted against the substantially all test and they wouldn't run up against the nonqualified financial properties test, but they would allow that safety for a CDE to make those amortizing loans while, at the same time, providing some safety net that those loans wouldn't be counting against the CDEs' substantially all test. We went on in our comments to suggest that that account could even be set up at a third-party certified CDFI bank, if that would give the IRS more comfort as to there being this third party holding that account.

The other issue/comment that we had related to encouraging more investing, particularly in non-real estate QALICBs relates to an interest in CDEs making venture capital investments. Now, this is really we're requesting a clarification that, for venture capital, which is a high-touch industry where fund managers are often asked to sit on the board of the business, take part in management decisions, and commonly the investors pay a 2.5 to 3 percent management fee to the fund managers. If that could be counted as financial services, financial counseling, under which is currently a qualified QALICB activity, that would allow venture capital funds to more easily account for those services.

It would be up to the investor to decide whether they were comfortable putting their money there, but with the IRS saying that it would qualify under the current QALICB test. And I think that's the kind of thing that if you could even put an example in the final rule, identifying that as a qualified activity, that would give investors a great deal of comfort.

The coalition has two recommendations that are really aimed at trying to reduce the cost of New Markets tax credit transactions, which is an ongoing concern of the industry. Obviously, if we can reduce the cost of CDE transactions we can ensure that more of the benefits of the credit goes down to the low-income communities where it's intended to be.

The first has to do with exempting New Markets transactions from the true debt analysis. I think we're hearing more frequently from CDEs that, with the declining real estate values, where appraised values of

a property are frequently below the true development costs, the cost of getting certification from a CDE that their investments into a business are true debt is adding costs to the transaction.

One way to solve this would be to get back to the related-party test. If IRS could intervene--the coalition takes issue right now with the way the CDFI Fund has defined "related party." If that were changed to be a test where a QALICB--a CDE, before making the investment, was determined not to be related to the QALICB, it would allow the CDE to make significant equity investments into a business, which I think, again, was one of the goals of the program, and get around this true debt analysis, where in this market we're seeing a much more of a demand for equity investments as the debt piece of the equation is pulled back.

And we know this doesn't, at the moment, fall into the IRS's role—that this has been something that you've handed over to the CDFI Fund, but it's been an issue. We've talked to the CDFI Fund about it, and we actually would urge, in this economy, that it be something that can get ruled on in some fashion before the '09 allocations come forward. Again, it would reduce the cost of the transaction and allow funds to get more immediately added into projects in the form of equity.

I see my yellow light is on. I have a lot more to say.

Those were some of the very critical issues. The other issue related to cost is ensuring that New Markets Tax Credit transactions are exempt from Section 183, as well—which the low-income housing tax credit investments are currently exempt from that rule. And as we see possible codification of economic substance on the horizon, we need to make sure that New Markets transactions also are exempt from economic substance.

Both of those tests obviously are looking at what the benefits outside of a tax credit are to a transaction, and the New Markets Tax Credit was authorized specifically to use a tax credit to get capital into communities that it otherwise wouldn't be going because of the perceived financial risk of those communities. So we think that there's a clear case to be made that New Markets transactions shouldn't be applied--the 183 test shouldn't be applied to New Markets, nor if the economic substance test is, in fact, codified, we need to be exempt from that as well.

We have comments on clarifying what constitute a tenant-excluded business. We've seen a few examples of investments in projects where the business wants to lease to--it could be a state agency in the state in some other part of their activity, operates a lottery system or has state liquor stores, and for that reason you can't house the state's job training center within a new-market tax credit facility. So we'd like to see that clarified in the next round of regulations.

We'd also ask you just to consider--in our written comments, we've suggested ways that the current rule can be clarified to encourage, where appropriate, CDEs to invest in housing, particularly as the housing crisis has deepened in low-income communities. We've seen CDEs look at creative ways where they can purchase, aggregate, finance businesses--nonprofit businesses to a large extent--that are purchasing foreclosed homes, rehabbing them, and selling them to maintain their affordability and selling them to residents of the low-income community.

This is not something that a lot of CDEs are doing, but to be able to allow those that are doing it to not run up against the nonqualified financial property test, that the purchasing of those homes be considered business inventory. And there are also some cases where there may need to be some relief from the ability to lease those homes, or lease-to-own or rent those homes to tenants in a low-income community. So we've got recommendations in our written comments on that as well.

We've got a long list of comments on targeted population. We look forward to being back in a few months to talk to you about that particular issue, and we appreciate you having a separate hearing on that. I think my time is up.

MS. GRIMM: Well, thank you for your comments.

MS. FEIGHAN: Thanks.

MS. GRIMM: Does the panel have any questions?

MR. HANDLEMAN: Yes, I have some questions on the housing. In the common literature, excuse me, it seems to fall into two groups between those that basically have--existing homeowners and those who basically seem to be acquiring homes for basically resale. For the ones with the existing homeowners is the concern that we, the IRS, would not view that basically the CDE has purchased the homes and made a new loan, whether it be the first or second, to the existing homeowner --

MS. FEIGHAN: Right.

MR. HANDLEMAN: I mean, the issue seems to me that we would say that it's simply a mere passage of title, but benefits and burdens of ownership have to remain with the homeowner, and therefore it wouldn't meet one of the exceptions to being nonqualified financial properties?

MS. FEIGHAN: Exactly. Right.

MR. HANDLEMAN: And then the other one--so you basically want us to say, under those facts, that it would still not be--that the financing be provided by the CDE to the homeowner, essentially. The mortgagor wouldn't qualify, or be excluded from the definition of nonqualified financial property.

MS. FEIGHAN: Right.

MR. HANDLEMAN: And then for the second part where basically the CDE is simply acquiring houses for resale, what is the concern there, that we would also say that that financing is nonqualified financial property, because that may be --

MS. FEIGHAN: I think there it's really--there are those who think that that is currently allowed under the regulations, that that would be considered--that the act of that QALICB business is acquiring those homes as inventory and looking to resell them. But I think investors have been seeking some additional clarification that, in fact, that wouldn't be considered--

MR. HANDLEMAN: So you're simply looking for a clarification that under those cases—

MS. FEIGHAN: Under 1397.

MR. HANDLEMAN: --that would be meet the exception--

MS. FEIGHAN: Right.

MR. HANDLEMAN: --for accounts receivable under the provision.

MS. FEIGHAN: Exactly. Exactly.

MR. HANDLEMAN: But the other thing I'd ask, and you mentioned this also, leasing--lease-to-own--

MS. FEIGHAN: That recently came up. I think that the groups who are looking at doing this--and, again, this is sort of a changing market as CDEs, who many of them operate a range of programs in low-income communities, are looking for ways to deal with the deepening housing crisis. So the idea would be to keep these homes that have been previously owned in the affordable housing stock and retain ownership for low-income people in the community. I think they were looking at options that if not to turn over the house for immediate ownership to a low-income resident, that there be an opportunity to possibly rent that home with the--or lease that home with the idea that it would be owned by the individual at some point in time. So the lease—we wanted to make sure that those various options are available to the aggregator--

MR. HANDLEMAN: So on the lease-to-own that you're describing now, you're asking us basically to say that it doesn't run afoul of the rule that the rental real property--

MS. FEIGHAN: Exactly.

MR. HANDLEMAN: --others can't be residential enterprises.

MS. FEIGHAN: Exactly. Exactly.

MR. HANDLEMAN: And one other clarification from one of your other points about the sinking fund. I assume this is also basically another issue with nonqualified financial property. Because, once again, I assume the sinking is an asset of the business.

MS. FEIGHAN: Right.

MR. HANDLEMAN: And so basically you're asking us to create another exception for nonqualified financial property because the loan agreement requires--call it the borrower--to put money in the sinking fund.

MS. FEIGHAN: Right.

MR. HANDLEMAN: Nonetheless we would say that it's excluded.

MS. FEIGHAN: And we were looking at various ways to get around that. One would be this idea of setting up--either making all certified CDFI banks an opportunity to put those funds at a third-party bank that would be controlled by that third-party bank. Would that then exempt the CDE from running afoul of an unqualified financial property?

MR. HANDLEMAN: Well, the question I have is, then whose asset is that? Is it the asset of the business, the qualified low-income community business, or is that the CDE's asset? I assume it's not the CDFI bank's asset.

MS. FEIGHAN: It's not the CDFI bank's asset. I think we would--if it were considered to be an asset of the CDE, we would need to be exempt from the nonqualified financial property test, or if it were allowed --

MR. HANDLEMAN: I think it would be the opposite.

MS. FEIGHAN: No, I'm sorry. If it was considered to be an asset of the QALICB we would need to get clarification that it wasn't running afoul of that. I mean, I think we'd have to establish that the fund was set up with the sole purpose of being able to repay the debt to the CDE. I mean, here two groups are--the CDEs are looking at creative ways to address sort of those range of financing needs that businesses have, and investors--again, because of the recapture rules--are concerned about investing.

Even if you've got a CDE with a really active pipeline of deals, investors are concerned about investing in any kind of amortized debt where there may be that principle coming back into the CDE that they can't get out effectively within that seven-year window or three-year window or, you know --

MR. HANDLEMAN: But isn't the concern that if you basically have a seven-year loan with a balloon at the end, that the borrower may not be able to pay it back.

MS. FEIGHAN: Exactly.

MR. HANDLEMAN: So that's why --

MS. FEIGHAN: --or refinance it quickly. So the idea was set up this sinking fund so you're basically

allowing that flexibility or that protection to the borrower, or that you don't put them in a position at the end of seven years where they've got this large balloon payment.

MS. HANLON-BOLTON: What if they can't pay it, I mean, the first seven years because it's a new business and--I mean, is the CDE--is it going to be in the agreement?

MR. HANDLEMAN: The loan agreement.

MS. HANLON-BOLTON: The loan--yes, the loan agreement?

MS. FEIGHAN: Well, the --

MS. GRIMM: The sinking fund.

MS. HANLON-BOLTON: Yes.

MR. HANDLEMAN: Yes.

MS. FEIGHAN: Yes, I think it would have to be--it would clearly be part of the loan agreement that the loan was structured over seven years with the expectation that X amount of the principal repayments would go into this fund for purposes of --

MR. HANDLEMAN: It sounds like basically it's an amortizing loan except for money isn't going directly back to the CDE so that the CDE --

MS. FEIGHAN: Right.

MR. HANDLEMAN: --is not subject to the reinvestment rules.

MS. FEIGHAN: We're looking at ways to facilitate the ability for CDEs to make amortizing loans without running afoul of current regs.

MR. HANDLEMAN: OK, I have one last question related to the true debt. I mean, it's not clear what exactly you're asking us to promulgate. Once again, you know, in relation to QALICBs it has to be an equity investment, an interim loan to the business.

MS. FEIGHAN: Right.

MR. HANDLEMAN: We understand that there's tension because of the related-persons rule that they want--that the taxpayers have agreed, basically, through the allocation agreement, to make loans or to avoid making loans from a related person--or I should say equity investments from a related person.

MS. FEIGHAN: Equity investments.

MR. HANDLEMAN: So is it simply that you're asking us to say that the CDE doesn't have to determine, for tax purposes, whether the money provided to the business is a loan or equity to that entity?

MS. FEIGHAN: CDEs are looking at ways that they can put more equity--which for many of these businesses is the most difficult piece of the financing divide— to put more equity into their businesses. And I think that's become particularly important as the loan-to-value ratios in the market have changed, and it's been harder and harder for businesses to secure the debt. So the demand on being able to fill that gap with equity financing has become greater.

MR. HANDLEMAN: So it's the point that--are you saying that it would be money that would be equity in the business, but for the priority points and the allocation agreement with the CDFI fund, it would be considered a loan still? So what --

MS. FEIGHAN: Well, right now, with the way that the priority points are given, applicants find themselves in that position of saying, we're going to have to choose between responding to the equity needs of the businesses, that we would like to, you know, keep this patient capital in the businesses you want to finance, or being able to have highly competitive applications going into the CDFI fund. And from the beginning we have said that we think the relationship--that the way that the related-party test is set up discourages equity investing in these businesses, which we would argue was one of the primary intents of the New Markets Tax Credit Program.

MR. HANDLEMAN: I understand, but once again, I think our view, as I mentioned with Mike Novogradac, is the related--the priority points is really an issue for the CDFI fund --

MS. FEIGHAN: Right.

MR. HANDLEMAN: --and if they want our assistance on it, they--they can't always ask, but we view it as their issue. But it seems that what you're proposing to deal with the issue is basically telling one arm of Treasury that it's still a loan for the priority points, for the allocation agreement, but then it really would be equity for the investment.

MS. FEIGHAN: Well, if the related-party test were changed and the related-party test were judged that the CDE was in a controlling equity position with the business before it made the QALICB, it would be considered a related-entity and couldn't get the additional points. But if the test was made after the investment, CDEs could take a greater equity position in a business--a greater ownership position in the business, make an equity investment, and not be penalized.

So our ultimate goal is to allow the CDEs to make a greater equity investment in businesses, which right now the related-arty test prevents them from doing if they way to be in a competitive position in applying for funds.

The other option we put out which was presented to us by some of the community development organizations--I probably will not be able to speak to it as eloquently as they--is to exempt them from the true-debt analysis, which right now they are forced to prove that for the seven-year--that they are not violating --

MR. HANDLEMAN: They're making a loan for federal tax purposes.

MS. FEIGHAN: They're making a loan.

And so my understanding is they're having to get a lot of rulings made and documentation that, in fact, while they're trying to keep this patient capital in a business, it is true debt.

So I think we have sort of these competing tensions of CDEs who are trying to provide the most patient capital they can in these businesses, while showing that it's debt, and I think that increasingly they're finding that the real need is on the equity financing.

MR. HANDLEMAN: Thank you.

MS. FEIGHAN: And we would be happy to try to follow up with additional comments, if there's an opportunity to do so, on this particular issue.

MR. HANDLEMAN: Well, we will be working through the comments. There are lots of comments --

MS. FEIGHAN: Right.

MR. HANDLEMAN: --as we finalize the regulation.

MS. HANLON-BOLTON: I just have one question. You talked about the venture capital issue and you said it would be great if IRS gave an example. Can you give an example right now for us?

MS. FEIGHAN: Sure, and we'd be happy to write one up as well. But it would basically be a CDE receives a QEI for a million dollars, and they would like to use--you know, exceeding the 15 percent of that, for technical assistance and administrative costs involved in supporting that business investment. Right now they are limited in their ability to use their QEI because they can--without running afoul of the substantially all test. So they just want clarification. And, I mean, as we read it I think it does fit under financial counseling and other services, but just to clarify that that kind of intensive, hands-on, you know, board involvement working with the business would be considered financial counseling.

MS. GRIMM: And then I also have a question on the tenant-excluded business. You had given the example of the lottery and the state government, which I actually hadn't thought about, but is that something--I'd heard this example before where you have a hotel and there's a spa in the hotel. Is it that kind of issue?

MS. FEIGHAN: Right.

MR. HANDLEMAN: Well, I think one case is simply that the ineligible business activities in the same building, what I thought were the state lotteries, there actually is multiple buildings, only one of which is being used for the QALICB, and then one of those lessees is the state government and they have a lottery function someplace else.

MS. FEIGHAN: Someplace else that is in no way--

MR. HANDLEMAN: And then we would say that, you know, since they have a "tainted" business activity, even if it's in another location, you're asking us basically to exclude that.

MS. FEIGHAN: And that other business activity isn't--right, isn't being related.

MR. HANDLEMAN: Thank you.

MS. GRIMM: Thank you.

Well, that concludes the two speakers that we had scheduled to speak today. Is there anyone else who would like to speak or add comments?

Yes?

RADHIKA REDDY: I just want to say --

MR. HANDLEMAN: You have to come to the microphone, please.

MS. GRIMM: And if you could just state your name and who you represent.

MS. REDDY: Thank you. I'm Radhika Reddy from Ariel Ventures. We have New Markets-complaint software and we have about 28, 30 CDEs that we work with on compliance issues. So to echo a lot of what is happening, what Mike said and Alison, we face a lot of those issues with our clients. And definitely on this nonqualified financial property issue, is there something you can think about saying that a QALICB should be--you should ensure that they don't have nonqualified financial property at the beginning? But if a business is successful and it generates a lot of cash, it gets disqualified.

So we are forcing businesses to distribute out money that could be held because of that. So it's very impractical. A start-up business, nothing; it's phenomenally successful, it gets disqualified. The whole intention is to build businesses that are successful, so it doesn't make logical business sense. So if you can do something to say it's nonqualified financial property at the date of investment but not going

forward. I don't know, I mean if that's a possibility.

MR. HANDLEMAN: To clarify, do you mean--are you talking about the case where the CDE controls the business? Is it reasonable expectations? Or is it a reasonable expectation that the business is going to be so successful that they're going to have basically a lot of cash and --

MS. REDDY: Yes, these are the seven-year projections we do for the QALICB, so when you do--and the business is able to generate a lot of cash in seven years, it gets disqualified. So the projections have to show distributions after owners or something take money out of the business, which is very impractical.

And another thing is--like these reserves. That's definitely another issue. You know, it's considered nonqualified financial property. So this is causing a lot of pain and expense and defeats the purpose.

And another practical issue, definitely the safe harbor, what Alison said, if that could, you know, it will be handled. And if there is de minimus rule for redemption, like some state--imposed state tax for the CDE, in a change after they did their QEI, so they suddenly had a loss, some \$2,000, \$3,000 and now that's in a redemption situation. So is there some de minimus or, you know, bank fees, simple things like that that nobody thought about? These transactions are so tight. Every dollar is distributed out. I mean, it's causing a major problem for several CDEs.

So just these things have come up. I thought I would bring it to your attention to help clarify.

MR. HANDLEMAN: We always encourage people to write in with comments at any time, even though the official comment period has ended, so if you want to submit anything in writing, we would be happy to look at it because it helps us with working on our final--

MS. REDDY: Can we still do it?

MR. HANDLEMAN: Yes, please.

MS. REDDY: OK, yes, because, you know--OK. I mean, I'll do that.

MS. GRIMM: OK, thank you.

MS. REDDY: Thank you.

MS. GRIMM: Is there anyone else who would like to speak?

OK, well, then this officially concludes our hearing today. Thank you for attending.