

August 20, 2010

Mr. Michael Mundaca
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Re: Definition of Control – Treasury Regulation §1.45D-1(d)(6)(ii)(B)

Dear Mr. Mundaca:

As participants in the New Markets Tax Credit (“NMTC”) Working Group, we, the undersigned, have joined together to provide input on an issue of importance to the NMTC industry. Since the inception of the program, the number of qualified low-income community investments (“QLICIs”) made as equity investments has been limited due to several factors including the interpretation of the related party test by the Community Development Financial Institutions (“CDFI”) Fund. The CDFI Fund recently changed its interpretation of the related party test, and this change paves the road for community development entities (“CDEs”) to make majority interest equity investments. However, one concern that investors in CDEs have relates to their preference to minimize tax credit recapture risk through reliance on the reasonable expectations test. Unfortunately, Treasury’s current regulatory definition of control frustrates their ability to do so if the CDE makes a majority interest equity investment. This letter reflects our views and suggested approach for addressing this situation. In short, as more fully explained below, the definition of control as defined in Treasury Regulation §1.45D-1(d)(6)(ii)(B), should be revised to remove any measurement based upon the value of direct or indirect ownership and solely rely on control based upon voting or management rights.

In several comment letters submitted over the years, the NMTC Working Group has recommended changes be made to the CDFI Fund’s related party test definition and measurement in order to encourage CDEs to make majority equity investments in qualified active low-income community businesses (“QALICBs”). This year, the CDFI Fund made changes consistent with the NMTC Working Group’s recommendations that would allow a CDE to make majority equity interest investments without violating its allocation agreement so long as it had committed to investing substantially all of its proceeds in entities that were considered unrelated before it invested. This change was a significant step and one that the industry applauds the CDFI Fund for making.

However, it is unlikely that many CDEs will make majority interest equity investments because of an issue related to the reasonable expectations test defined in Treasury Regulation §1.45D-1(d)(6). The Regulations provide that if a CDE:

“...reasonably expects, at the time the CDE makes the capital or equity investment in, or loan to, the entity, that the entity will satisfy the requirements to

be a qualified active low-income community business [for the term of the investment...]"

then the QALICB will continue to be deemed a QALICB even if it falls out of compliance at a later time. This provision permits a CDE to avoid suffering a recapture event if the QALICB ceases to qualify as a QALICB during the recapture period for reasons that are outside the control of the CDE.

However, the Regulations further require that if the CDE has or obtains control of the QALICB, it generally must ensure that the entity remains a QALICB for the entire 7-year compliance period and cannot rely on its reasonable expectation at the time the investment is made to avoid a recapture event.

Investors do not want to be subject to strict liability for recapture merely because they acquire a majority equity interest in the QALICB if they do not also have management or voting rights that would allow them to control QALICB status. As a result of the broad definition of "control" under the reasonable expectation test, investors in the current market are unlikely to allow the CDE to acquire a majority equity interest in a QALICB.

If a CDE cannot rely on the reasonable expectation test, investors perceive the compliance risk as too great and most are unwilling to enter into such a transaction. This outcome is unfortunate since equity investments are generally the most patient form of capital and would also reduce the burden of ensuring that the subsidy can remain at the QALICB.

The current definition of control in Treasury Regulation §1.45D-1(d)(6)(ii)(B) states (emphasis added):

“Control means, with respect to an entity, **direct or indirect ownership (based on value)** or control (based on voting or management rights) of more than 50 percent of the entity. For purposes of the preceding sentence, the term management rights means the power to influence the management policies or investment decisions of the entity.”

The problem for equity investors is the imputation of control based on “direct or indirect ownership (based on value)”. Currently there is no clear guidance on how to calculate direct or indirect ownership “based on value”. It is unclear to us how value is determined and how it is relevant to whether or not the CDE is controlling the QALICB. We believe that the concept of control should be based solely on the CDE’s ability to control the QALICB’s status as a QALICB through voting or management rights.

It would also be helpful to clarify the meaning of “control” given the variety of possible equity structures and documentation used in New Markets transactions. The potential for confusion is compounded by the fact that the CDFI Fund has adopted its own definitions regarding “control” in the NMTC arena -- definitions that do not necessarily work well for this purpose.

We believe that the only type of control based on voting or management rights that should be of concern in the context of the reasonable expectation test is control based on rights that enable the CDE to either (i) cause the QALICB to take actions that result in the QALICB

failing to remain a QALICB, or (ii) allow the CDE to override or block actions by the QALICB when the authority to take such actions is necessary to enable the entity to remain a QALICB. The ability to exercise management or voting control on other issues would not seem to bear on whether the CDE should be allowed to rely on its own reasonable expectation of compliance as a safe harbor.

We note that there are some areas where a CDE's actions could indirectly affect compliance decisions by the QALICB, and one important example would be the right to remove a general partner of a partnership, the managing member of an LLC, or a majority of the directors of a corporation. Removal rights are commonly required by investors in scenarios in which a CDE is making equity investments in a QALICB. We believe that the existence of such rights in the CDE to remove **for cause** a managing member, general partner, or other party or parties with management control should not, by itself, be deemed to confer voting or management control on the CDE. Where removal is limited to "for cause" events (i.e., failure of the general partner, managing member, or majority of directors to comply with their obligations under the organizational documents), the threat of removal would not represent a mechanism for influencing management decisions that is tantamount to direct management control. Moreover, removal provisions typically contemplate the appointment of a substitute managing member, general partner, or directors, rather than entitling the CDE to manage the QALICB itself. In such a case, so long as the CDE does not actually "control" the substitute management, then the CDE could still satisfy the control test as we have recommended it be changed herein.

Accordingly, we recommend that the definition of "Control" contained in Treasury regulations be updated to remove the reference to a value based test and clarify voting and management rights that should be considered. Specifically, we recommend the following change to Treasury Regulation §1.45D-1(d)(6)(ii)(B):

"Control means, with respect to an entity, ~~direct or indirect ownership (based on value) or control (based on voting or management rights) of more than 50 percent of the entity based on~~ of voting or management rights that enable the CDE to either (i) cause the QALICB to take actions that result in the QALICB failing to remain a QALICB, or (ii) to override or block actions by the QALICB that are necessary to enable the entity to remain a QALICB.

- (a) The existence of rights in the CDE to remove for cause a managing member of a limited liability company, a general partner of a limited partnership, or majority of directors of a corporation by substituting a new managing member, general partner, or majority of directors with control would not, by itself, be deemed to give the CDE 'control' for purposes of this provision."**


If these changes are adopted, it is likely that equity transactions could be structured in a manner that would attract investors by successfully addressing the issue of control and providing CDE's with the ability to rely on the reasonable expectations test. Without such a change, it is likely that investors will continue to sit on the sidelines when it comes to investing in CDEs that

intend to make equity investments and will continue to effectively prevent the most patient form of capital, equity investments, from being made to QALICBs.


We are excited about the positive impact that the NMTC Program is having on the nation's low-income communities and low-income persons and the potential for future success. However, we feel that the program can become even more efficient and deliver more subsidy to the end users within low-income communities if this change is made. We appreciate the opportunity to submit our suggestions on the NMTC Regulation definition of control. Thank you in advance for your time and consideration.

Please do not hesitate to contact us if you have any questions regarding our comments or if we can be of further assistance.

Yours very truly,
Novogradac & Company LLP


by
Michael J. Novogradac,
along with the undersigned

Novogradac & Company LLP


by
Brad Elphick,

Michael Johnson
Advantage Capital Partners

Jerry Breed
Donna Rodney
Bryan Cave LLP

Charles J. Spies, III
CEI Capital Management LLC

Doug Bystry
Melissa A. DeMotte
Clearinghouse CDFI

Steve Luca
Cleveland Development Advisors

Julie A. Treppa
Coblentz, Patch, Duffy & Bass LLP

Joseph Wesolowski
Enterprise Community Investment, Inc.

Steven F. Ginsberg
Darryl P. Jacobs
Ginsberg Jacobs LLC

Robert K. Jenkins, Jr.
Stephanie Best
Hampton Roads Ventures, LLC

Kristin A. DeKuiiper
Holland & Knight LLP

Mr. Michael Mundaca

August 20, 2010

Page 5 of 5

Edward J. Lieberman
Husch Blackwell Sanders LLP

Frank A. Hoffman
Matthew E. Conrad
Kreig DeVault LLP

Paul M. O'Hanlon
Daniel J. Skomal
Leverage Law Group, LLC

Linda E. Heiney
MBS Urban Initiatives CDE, LLC

John Leith-Tetrault
National Trust Community Investment
Corp.

Herbert F. Stevens
Nixon Peabody LLP

Bruce A. Bonjour
Robert D. Stephan
Perkins Coie LLP

Scott A. Lindquist
Jonathan M. Kaden
Sonnenschein Nath & Rosenthal LLP

Steven F. Mount
Erik J. Rickard
Squire Sanders & Dempsey L.L.P.

Jose Villalobos
TELACU

Bill Whitman
Telesis Corporation

J.P. Latenser
Travois

Cam Turner
United Fund Advisors

Marc Hirshman
US Bancorp Community
Development Corp.

Lee Winslet
Wells Fargo Community Development
Enterprises, Inc.

cc: Brandon Carlton
Paul Handleman
Rosa Martinez