

Private Letter Ruling Sheds Light on Targeted Populations Gross Income Requirement

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Section 221 of the American Jobs Creation Act of 2004 (P.L. 108-357) amended Section 45D(e)(2) of the Internal Revenue Code of 1986 to allow businesses to qualify for new markets tax credit (NMTC) financing by serving low-income persons as a “targeted population” instead of being required to locate in a low-income area. Since then, questions have arisen about how the low-income persons are required to “pay for” the services they receive. Private letter ruling 200910024 (PLR), released March 6, 2009, analyzes certain types of income that a qualified active low-income community business (QALICB) may consider to be derived from sales, rentals, services or other transactions with individuals who are low-income persons for purposes of satisfying the gross income test for an entity serving targeted populations under Section 45D(e)(2) of the Internal Revenue Code and Section 3.03(2)(a)(i) of Notice 2006-60 (2006-29 I.R.B. 82). Although not precedential, the PLR may be a useful tool for evaluating whether a potential transaction would qualify under the targeted populations requirements.

The facts in the PLR involve a not-for-profit health-care clinic that provides health-care services to patients whose income is primarily less than 200 percent of the federal poverty guidelines. Many of the patients are working poor with no health insurance. The clinic staff verifies a patient’s income (adjusted for family size) and documents the income in the clinic’s practice management system.

The clinic collects fees for services from patients; those who lack health insurance are permitted to pay on a discounted fee schedule. The clinic also receives income through both private and public insurance programs, and federal and state grants, as well as foundation and private grants. For example, the clinic receives an annual health center program grant from the Bureau of Primary Health

Care (BPHC) at the Health Resources and Services Administration (HRSA) of the U.S. Department of Health and Human Services. The grant supports the clinic’s provision of health services to persons living in medically underserved areas. The grant is administered under 42 U.S.C. Section 254b. Grant recipients such as the clinic are required to report the sources of its income into a Uniform Data System (UDS). The data in a UDS report from a health center are audited by HRSA. The clinic also uses that data to inform its financial statements, which are audited annually by an independent auditing firm.

Based upon its need to expand its health-care services, the clinic intends to build a new clinic building on a site that is not in a low-income community. The clinic believes, however, that due to its low-income patient population, it will satisfy the requirements to be a QALICB for low-income targeted populations.

Section 3.03(2)(a)(i) of Notice 2006-60 allows a business to qualify as a QALICB for low-income targeted populations if at least 50 percent of the entity’s total gross income for any taxable year is derived from sales, rentals, services or other transactions with individuals who are low-income persons. The clinic requested a ruling that the term “derived from” include not only gross income derived from payments made directly by patients, but also third-party payments (such as from an insurance company) and contributions to the clinic on behalf of patients in the form of federal and state grants and in-kind contributions, such as utility costs, building rent, labor costs, drug costs and medical supplies.

Based upon the above facts and law, the IRS concluded that the term “derived from” includes gross income derived from payments made directly by low-

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income persons to the clinic, as well as federal, state or local grants, charitable donations or in-kind contributions, as well as collected fees, insurance re-imburements and other sources as gross income derived from sales, rentals, services or other transactions with patients as long as these payments and contributions are provided on behalf of patients on an individual basis or as a class of individuals. The IRS also specifically concluded that the portion of the BHPC grant that is used to cover the costs of health-care services to clinic's patients should be considered gross income derived from services provided to patients.

Businesses such as health-care clinics that rely on third-party payments on behalf of the low-income persons they serve should find added comfort in analyzing whether at least 50 percent of their income is derived from low-income persons as based upon the rulings in the PLR. Proposed regulations on how targeted populations may be treated as eligible low-income communities were published on September 24, 2008 (Fed. Reg. Vol. 73, No. 186, p. 54990) but made no mention of how the "derived from" language was to be interpreted. Whether final regu-

lations will include such guidance is uncertain, but the PLR does signal the IRS's current views on this issue.

Though the PLR provides some clarity with respect to the meaning of "derived from," ambiguities remain in determining whether a business will qualify as a targeted populations QALICB under the gross income requirement.

First, the PLR explicitly states that the IRS gives no opinion on whether the patients in question were indeed low-income persons for purposes of Section 3.03 of Notice 2006-60. At this time, there is no other guidance on this issue. The preamble to the September 24, 2008 proposed regulations mentions three methods — the measure used by the U.S. Census Bureau, the measure under 24 CFR Part 5 that is used by the U.S. Department of Housing and Urban Development (HUD), and the measure of income on the IRS Form 1040. It suggests that the IRS is leaning toward the Census Bureau measure but requests further comments on the most appropriate measure. At least one industry group has provided comments to the IRS that qualified businesses should be allowed to

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use any of the above measures. However, if only one measure is selected, the group preferred that the IRS adopt the HUD standard since it is consistent with low-income determinations used in the Section 8 rental voucher program and the low-income housing tax credit program.

Second, the PLR is silent on whether the clinic could have relied upon the state or federal assistance programs' income determinations as a way of substantiating a patient's income. The preamble to the proposed regulations rejects the idea that a person who qualifies under the income guidelines of other federal programs targeted specifically to low-income individuals and families may use such qualification as a proxy for meeting the targeted populations requirements. Nonetheless, it seems reasonable that if one can establish that a governmental program establishes the same (or lower) income limitations as the new markets tax credit requirements, a business should be able to rely on such data to substantiate a person's income as meeting the targeted populations limitations.

Finally, a number of questions remain regarding whether it is possible to satisfy the so-called "reasonable expectations test" of Treasury Regulations Section 1.45D-1(d)(6). For example, if a QALICB can demonstrate that it currently generates at least 50 percent of its income from serving low-income persons, what kind of data should a community development entity (CDE) review to establish whether it is reasonable to expect that the QALICB will continue serving low-income persons? Should the CDE consider one or more years of prior data to confirm that there has been a history of serving low-income persons? Should the QALICB project a significant cushion (such as meeting the test at 60 percent instead of 50 percent)?

Also, can the CDE be comfortable that the population served by the business will continue to be

predominantly low-income? For example, in the facts of the PLR, the potential clinic site was located across the street from a qualifying low-income census tract and the clinic believed that its patients would be drawn from the surrounding community. Similarly, assume a QALICB decides to verify income based on a person's qualification under a federal program (e.g. if the patient qualifies for another program intended to serve low-income persons and the QALICB has established that such program's guidelines are sufficiently analogous to the NMTC requirements as discussed above). Is it reasonable for the QALICB to expect that the government program will maintain its income limitations for the new markets tax credit seven-year compliance period so the QALICB could reasonably continue to rely on that methodology for evaluating low-income status?

While the PLR does not provide guidance on all of the areas of ambiguity under the current targeted populations rules, it nevertheless remains an important document for a business navigating the oftentimes difficult task of determining whether it satisfies the requirements for businesses serving targeted populations low-income communities. ❖

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