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Comments Invited on Long-Awaited Non-Metro QEI Rule

By Alex Ruiz, Novogradac & Company LLP

On May 22, the Community Development Financial Institutions (CDFI) Fund invited comments regarding how, for purposes of the New Markets Tax Credit (NMTC) Program, it should ensure that non-metropolitan counties receive a proportional allocation of qualified equity investments (QEIs).

“The New Markets Tax Credit Program has proven to be a flexible tool for redevelopment of low-income communities, supporting business loans and investments, real estate development, and job creation in distressed communities throughout the country. We are asking the public to comment on the provision in the statute so that we can best address the issue of investment in non-metropolitan counties under the program,” said CDFI Fund Director Kimberly A. Reed.

Background

Under Internal Revenue Code (IRC) Section 45D, taxpayers that make QEIs in qualified community development entities (CDEs) may claim a tax credit equal to 5 percent of the QEI the first three years and 6 percent for the next four years, for a total of 39 percent. The CDE must use substantially all of the cash from a QEI to make qualified low-income community investments (QLICs).

The term low-income community, as defined under IRC Section 45D(e)(1), means any population census tract in which: the poverty rate is at least 20 percent; or, in the case of a tract not located within a metropolitan area, the median family income for such tract does not exceed 80 percent of statewide median family income; or, in the case of a tract located within a metropolitan area, the median family income for such tract does not exceed 80 percent of the greater of statewide median family income or the metropolitan area median family income.

In addition, pursuant to the American Jobs Cre-

ation Act of 2004, certain other census tracts and targeted populations may be treated as low-income communities. Section 102(b)(6) of the Tax Relief and Health Care Act of 2006 amended IRC Section 45D(i)(6) to provide that the Treasury Secretary shall prescribe regulations to ensure that non-metropolitan counties receive a proportional allocation of QEIs.

Non-Metro QEIs

The CDFI Fund is seeking comments from the public regarding how it should ensure that non-metropolitan counties receive a proportional allocation of QEIs. Commentators are encouraged to consider, at a minimum, the following issues: alternatives for ensuring that non-metropolitan areas receive a proportional allocation of QEIs, an appropriate definition for the term “proportional,” the review process, and how the CDFI can ensure compliance.

Allocations of QEIs

IRC Section 45D(i)(6) requires that non-metropolitan areas receive a proportional allocation of QEIs. However, the CDFI Fund does not allocate QEIs to geographic areas, per se. Rather, as the CDFI Fund explains in the May 22 notice, it allocates NMTCs to CDEs, the vast majority of which have service areas encompassing statewide, multi-state or national markets, and which include both metropolitan and non-metropolitan counties. Further, the CDFI Fund points out that the location of an allocatee CDE’s headquarters is neither indicative of the geographic locations of its investors (the sources of its QEIs), nor of where it intends to make its QLICs. An allocatee headquartered in a non-metropolitan area may make QLICs in metropolitan areas, just as an allocatee headquartered in a metropolitan area may make QLICs in non-metropolitan areas. Similarly, an allocatee’s investors may be located in metropolitan or non-metropolitan counties. Consequently, commentators are asked to con-

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sider the following possible alternatives for ensuring that non-metropolitan areas receive a proportional allocation of QEIs:

- a. Location of investors - Should the CDFI Fund endeavor to ensure that a desired proportion of investors (those persons or entities making QEIs in CDEs) reside or be headquartered in non-metropolitan counties?
- b. Location of allocatees - Should the CDFI Fund endeavor to ensure that either:
 - i. A desired proportion of NMTC allocatees (as a percentage of the total number of allocatees) in any given NMTC allocation round is headquartered in non-metropolitan counties; or
 - ii. a desired proportion of NMTC allocation authority (as a percentage of the total dollar amount of allocation authority) in any given NMTC allocation round is provided to CDEs headquartered in non-metropolitan counties?
- c. Principal service area of allocatees - Should the CDFI Fund endeavor to ensure that either:
 - i. A desired proportion of NMTC allocatees (as a percentage of the total number of allocatees) in any given NMTC allocation round is "principally serving" (i.e., making QLICs in) non-metropolitan counties; or
 - ii. a desired proportion of NMTC allocation authority (as a percentage of the total dollar amount of allocation authority) in any given NMTC allocation round is provided to CDEs principally serving non-metropolitan counties? If so, what is the appropriate meaning of "principally serving" (e.g., 85 percent of total QLICs made by the CDE, 50 percent of total QLICs made by the CDE, or another calculation)?
- d. Location of QLICs - Should the CDFI Fund endeavor to ensure that a desired proportion of QLICs is provided in non-metropolitan counties, without consideration of where the CDE is headquartered or which counties (metropolitan vs. non-metropolitan) that it is principally serving?

Proportionality

The notice also asks commentators to consider, in accordance with one or more of the alternatives presented under the first issue above, the most appropriate definition of the term "proportional."

Specifically, with respect to alternatives (a) and (d) under the first issue, should the CDFI Fund define the term proportional to mean: the proportion of the U.S. population that resides in non-metropolitan areas (approximately 17.4 percent); the proportion of low-income communities that are located in non-metropolitan areas (approximately 25 percent); or another calculation?

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And with respect to alternatives (b) and (c) under the notice's first issue, the CDFI Fund asks if the proportion should be based upon: the total applicant pool for a given NMTC allocation round (for example, if 25 percent of the applicant pool consists of CDEs that predominantly serve non-metropolitan areas, the CDFI Fund would ensure that 25 percent of the allocatees predominantly serve rural areas); or that portion of the applicant pool that, after the first phase of application review and scoring, met or exceeded the minimum scoring threshold to be eligible for NMTC allocations?

Finally, with respect to alternatives (c) and (d) under the first issue raised in the notice, commentators are asked to consider whether the percentage of QLICIs made in low-income communities should be based upon the total number of QLICIs made by a CDE, or the total dollar amount of those QLICIs?

Review Process

The CDFI Fund also asks commentators to consider what changes should be made to the allocation application review and decision-making process to ensure that there is a proportional allocation of QEIs in non-metropolitan areas.

For example, in prior allocation rounds, the CDFI Fund has provided as many as five priority points to applicants that demonstrated a track record of having successfully provided capital or technical assistance to disadvantaged businesses or communities, pursuant to IRC Section 45D(f)(2). In this case, the notices suggests the CDFI Fund could adopt priority points based on a CDE's track record of serving non-metropolitan areas, a forward-looking commitment to serving non-metropolitan areas, or both a track record and forward-looking commitments.

Alternatively, the notice asks commentators to consider the re-ranking of applicants. In this scenario, the CDFI Fund would consider advancing lower scoring applicants that predominantly serve non-metropolitan areas over higher scoring applicants so that the desired proportionality is achieved.

Compliance

The CDFI Fund states in the notice that it must have a mechanism to ensure that allocatees comply with any non-metropolitan area proportionality requirement. As such, commentators are asked to consider whether the CDFI Fund should require that applicants specify in their applications the percentage of their QEI proceeds that they will use to make investments in non-metropolitan areas and then be held to those percentages as a condition of their allocation agreements.

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Submitting Comments

The complete text of the May 22 *Federal Register* notice may be found online at www.newmarketscredits.com. Comments should be sent by mail to: NMTC Program Manager, CDFI Fund, U.S. Department of the Treasury, 601 13th Street, NW., Suite 200 South, Washington, DC 20005; by e-mail to cdfihelp@cdfi.treas.gov; or by facsimile at (202) 622-7754. Comments will be accepted until July 6, 2007. ❖

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