

[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-101826-11]

RIN 1545-BK04

New Markets Tax Credit Non-Real Estate Investments

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations modifying the new markets tax credit program to facilitate and encourage investments in non-real estate businesses in low-income communities. The regulations will affect taxpayers claiming the new markets tax credit and businesses in low-income communities relying on the program. This document also provides a notice of a public hearing on these proposed regulations. The Treasury Department and the IRS have published separately in this issue of the Federal Register an advance notice of proposed rulemaking REG-114206-11 requesting comments on additional modifications to the new markets tax credit program to facilitate and encourage investments in non-real estate businesses in low-income communities.

DATES: Written or electronic comments must be received by September 8, 2011.

Outlines of topics to be discussed at the public hearing scheduled for Thursday September 29, 2011, must be received by September 8, 2011.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-101826-11), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-101826-11), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC, or sent electronically, via the Federal eRulemaking Portal at <http://www.regulations.gov> (IRS REG-101826-11). The public hearing will be held in the Auditorium of the Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Julie Hanlon-Bolton, (202) 622-3040; concerning submission of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Richard Hurst, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document amends 26 CFR part 1 to provide additional rules relating to the new markets tax credit under section 45D of the Internal Revenue Code (Code). Section 45D was added to the Code by section 121 of the Community Renewal Tax Relief Act of 2000 (Public Law 106-554, 114 Stat. 2763 (2000)) and amended by section 221 of the American Jobs Creation Act of 2004 (Public Law 108-357, 118 Stat. 1418 (2004)), section 101 of the Gulf Opportunity Zone Act of 2005 (Public Law 109-135, 119 Stat. 25 (2005)), Division A, section 102 of the Tax Relief and Health Care Act of 2006 (Public Law 109-432, 120 Stat. 2922 (2006)), section 302, Division C of the Tax

Extenders and Alternative Minimum Tax Relief Act of 2008 (Public Law 110-343, 122 Stat. 3765 (2008)), section 1403(a)(1) of the American Recovery and Reinvestment Tax Act of 2009 (Public Law 111-5, 123 Stat. 115 (2009)), and section 733 of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Public Law 111-312, 124 Stat. 3296 (2010)).

Groups and organizations representing investors, qualified community development entities, businesses, and other entities involved with the new markets tax credit program have submitted comments requesting additional guidance to encourage more investment in non-real estate businesses. The commentators suggested that revising the new markets tax credit program to encourage investment in non-real estate businesses will bring increased amounts of capital to underserved businesses in low-income communities. The Treasury Department and IRS believe that revisions of the reinvestment rules of the new markets tax credit program would have a positive impact on the ability of the program to benefit non-real estate businesses in low-income communities.

General Overview

Section 45D(a)(1) allows a new markets tax credit on certain credit allowance dates described in section 45D(a)(3) with respect to a qualified equity investment in a qualified community development entity (CDE) described in section 45D(c).

Under section 45D(b)(1), an equity investment in a CDE is a qualified equity investment if, among other requirements: (A) the investment is acquired by the taxpayer at its original issue (directly or through an underwriter) solely in exchange for cash; (B)

substantially all of the cash is used by the CDE to make qualified low-income community investments; and (C) the investment is designated for purposes of section 45D by the CDE.

Under section 45D(b)(2), the maximum amount of equity investments issued by a CDE that may be designated by the CDE as qualified equity investments shall not exceed the portion of the new markets tax credit limitation set forth in section 45D(f)(1) that is allocated to the CDE by the Secretary under section 45D(f)(2).

Section 45D(c)(1) provides that an entity is a CDE if, among other requirements, the entity is certified by the Secretary as a CDE.

Section 45D(d)(1) defines qualified low-income community investment to mean: (A) any capital or equity investment in, or loan to, any qualified active low-income community business (as defined in section 45D(d)(2)); (B) the purchase from another CDE of any loan made by the entity that is a qualified low-income community investment; (C) financial counseling and other services specified in regulations prescribed by the Secretary to businesses located in, and residents of, low-income communities; and (D) any equity investment in, or loan to, any CDE.

Under section 45D(d)(2)(A), a qualified active low-income community business is any corporation (including a nonprofit corporation) or partnership if for such year, among other requirements, (i) at least 50 percent of the total gross income of the entity is derived from the active conduct of a qualified business within any low-income community, (ii) a substantial portion of the use of the tangible property of the entity (whether owned or leased) is within any low-income community, and (iii) a substantial

portion of the services performed for the entity by its employees are performed in any low-income community.

Under section 45D(d)(3), with certain exceptions, a qualified business is any trade or business. The rental to others of real property is a qualified business only if, among other requirements, the real property is located in a low-income community.

Explanation of Provisions

The new markets tax credit under section 45D has been a successful tool for encouraging private sector investments in low-income communities. According to the Treasury Department's Community Development Financial Institutions Fund, through 2009, the new markets tax credit has helped to spur \$16 billion of investments in approximately 3,000 businesses and real estate projects located in low-income communities throughout the country, including investments in manufacturing businesses, alternative energy companies, charter schools, health care facilities, and job training centers. Although new markets tax credit investments may be made in non-real estate businesses, the investments made to date have been predominantly in real estate projects. Through 2009, only 35 percent of new market tax credit dollars invested in qualified active low-income community businesses were invested in non-real estate businesses, and much of this investment supported real estate related projects (for example, purchasing or renovations of owner-occupied facilities).

Currently, the new markets tax credit program generally requires that a CDE that receives returns on investments (including principal repayments from amortizing loans) re-invest those proceeds into other qualified low-income community investments during

the seven-year credit period. This reinvestment requirement makes it difficult for CDEs to provide working capital and equipment loans to non-real estate businesses because these loans are ordinarily amortizing loans with a term of five years or less. Therefore, the proposed regulations would allow a CDE that makes a qualified low-income community investment involving a non-real estate business to invest certain returns of capital from those investments in unrelated certified community development financial institutions that are CDEs under section 45D(c)(2)(B) (certified CDFIs) at various points during the seven-year credit period. CDFIs are financial institutions that provide credit and financial services to underserved markets and populations. The CDE's reinvestment of returned capital in certified CDFIs would be considered to meet the reinvestment requirements of the new markets tax credit program. The proposed regulations would allow an increasing aggregate amount to be invested in certified CDFIs and treated as continuously invested in a qualified low-income community investment in the latter years of the seven-year credit period.

The proposed regulations define a non-real estate qualified active low-income community business as any business whose predominant business activity (measured by more than 50 percent of the business' gross income) does not include the development (including construction of new facilities and rehabilitation/enhancement of existing facilities), management, or leasing of real estate. The purpose of the investment or loan must not be connected to the development (including construction of new facilities and rehabilitation/enhancement of existing facilities), management, or leasing of real estate.

Proposed Effective Date

The rules contained in these regulations are proposed to apply to taxable years ending on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

Request for Comments

The IRS and the Treasury Department invite taxpayers to submit comments on issues relating to how a CDE can make a qualified low-income community investment into a non-real estate qualified active low-income community business. In particular, the IRS and the Treasury Department encourage taxpayers to submit comments on the following issues:

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 non-amortizing loan, the loan period, and the loan repayment schedule?

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?

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?

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?

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)?

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?

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. Comments are

requested on all aspects of the proposed regulations. In addition, the IRS and the Treasury Department specifically request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for September 29, 2011, beginning at 10 a.m. in the Auditorium of the Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. In addition, all visitors must present photo identification to enter the building. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit electronic or written comments by September 8, 2011, and an outline of the topics to be discussed and the time to be devoted to each topic by September 8, 2011. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Julie Hanlon Bolton with the Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and the Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.45D-1 is amended by:

1. Amending paragraph (a) as follows:

a. Adding entries for paragraphs (c)(8), (d)(9), (d)(9)(i), (d)(9)(ii), (d)(9)(ii)(A), (d)(9)(ii)(B), (d)(9)(ii)(C) and (h)(3).

b. Revising the entry for paragraph (d)(1)(i).

2. Revising paragraphs (c)(1)(iii), (c)(3)(ii), and (d)(1)(i).

3. Adding new paragraphs (c)(8), (d)(9), and (h)(3).

The additions and revisions read as follows:

§1.45D-1 New Markets tax credit.

* * * * *

(c) * * *

(8) Non-real estate qualified equity investment.

(d) * * *

(1) * * *

(i) Investment in a qualified active low-income community business or a non-real estate qualified active low-income community business.

* * * * *

(9) Non-real estate qualified active low-income community business.

(i) Definition.

(ii) Payments of, or for, capital, equity or principal with respect to a non-real estate qualified active low-income community business.

(A) In general.

(B) Seventh year of the credit period.

(C) Amounts received from a certified Community Development Financial Institution.

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(h) * * *

(3) Investments in non-real estate businesses.

* * * * *

(c) * * *

(1) * * *

(iii) The investment is designated for purposes of section 45D and this section as a qualified equity investment or a non-real estate qualified equity investment (as defined in paragraph (c)(8) of this section) by the CDE on its books and records using any reasonable method.

* * * * *

(3) * * *

(ii) * * * Notwithstanding paragraph (c)(3)(i) of this section, an equity investment in an entity is eligible to be designated as a qualified equity investment or a non-real estate qualified equity investment under paragraph (c)(1)(iii) of this section if--

* * * * *

(8) Non-real estate qualified equity investment. If a qualified equity investment is designated as a non-real estate qualified equity investment under paragraph (c)(1)(iii) of this section, then the qualified equity investment may only satisfy the substantially-all

requirement under paragraph (c)(5) of this section if the CDE only makes qualified low-income community investments that are directly traceable to non-real estate qualified active low-income community businesses (as defined in paragraph (d)(9) of this section). The proceeds of a non-real estate qualified equity investment cannot be used for transactions involving a qualified active low-income community business that is not a non-real estate qualified active low-income community business.

(d) * * *

(1) * * *

(i) Investment in a qualified active low-income community business or a non-real estate qualified active low-income community business. Any capital or equity investment in, or loan to, any qualified active low-income community business (as defined in paragraph (d)(4) of this section) or any non-real estate qualified active low-income community business (as defined in paragraph (d)(9) of this section).

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(9) Non-real estate qualified active low-income community business--(i)

Definition. The term non-real estate qualified active low-income community business means any qualified active low-income community business (as defined in paragraph (d)(4) of this section) whose predominant business activity does not include the development (including construction of new facilities and rehabilitation/enhancement of existing facilities), management, or leasing of real estate. For purposes of the preceding sentence, predominant business activity means a business activity that generates more than 50 percent of the business' gross income. The purpose of the

capital or equity investment in, or loan to, the non-real estate qualified active low-income community business must not be connected to the development (including construction of new facilities and rehabilitation/enhancement of existing facilities), management, or leasing of real estate.

(ii) Payments of, or for, capital, equity or principal with respect to a non-real estate qualified active low-income community business--(A) In general. For purposes of paragraph (d)(2)(i) of this section, a portion of the amounts received by a CDE in payment of, or for, capital, equity, or principal with respect to a non-real estate qualified active low-income community business after year one of the 7-year credit period (as defined by paragraph (c)(5)(i) of this section) may be reinvested by the CDE in a certified community development financial institution that is a CDE under section 45D(c)(2)(B) (certified CDFI) (as defined by 12 CFR Part 1805.201) and that is unrelated to the CDE (in accordance with section 267(b) or section 707(b)(1)). Any portion that the CDE chooses to reinvest in a certified CDFI must be reinvested by the CDE no later than 30 days from the date of receipt to be treated as continuously invested in a qualified low-income community investment for purposes of paragraph (d)(2)(i) of this section. If the amount reinvested in a certified CDFI exceeds the maximum aggregate portion of the non-real estate qualified equity investment, then the excess will not be treated as invested in a qualified low-income community investment. The maximum aggregate portion of the non-real estate qualified equity investment that may be reinvested into a certified CDFI, which will be treated as continuously invested in a qualified low-income community investment, may not exceed the following

percentages of the non-real estate qualified equity investment in the following years:

- (1) 15 percent in Year 2 of the 7-year credit period;
- (2) 30 percent in Year 3 of the 7-year credit period;
- (3) 50 percent in Year 4 of the 7-year credit period; and
- (4) 85 percent in Year 5 and Year 6 of the 7-year credit period.

(B) Seventh year of the credit period. Amounts received by a CDE in payment of, or for, capital, equity, or principal with respect to a non-real estate qualified active low-income community business (as defined in paragraph (d)(9)(i) of this section) during the seventh year of the 7-year credit period do not have to be reinvested by the CDE in a qualified low-income community investment in order to be treated as continuously invested in a qualified low-income community investment.

(C) Amounts received from a certified Community Development Financial Institution. Except for the seventh year of the credit period under paragraph (d)(9)(ii)(B) of this section, amounts received from a certified CDFI must be reinvested by the CDE no later than 30 days from the date of receipt to be treated as continuously invested in a qualified low-income community investment.

* * * * *

(h) * * *

(3) Investments in non-real estate businesses. The rules in paragraphs (c)(8) and (d)(9) of this section apply to taxable years ending on or after the date of publication of the Treasury decision adopting these rules as final regulation in the **Federal Register**.

Steven T. Miller,
Deputy Commissioner for Services and Enforcement.