

Objective:

Determination that the real estate business (“Borrower/Investee”) is a QALICB in accordance with Internal Revenue Code Section 45(d)(2).

Background:

In accordance with Section 45(d)(2)(A)(i)-(v), an entity can be termed as a QALICB with respect to a taxable year if for such year it derives at least 50% of its total gross income from the active conduct of a qualified business in any low-income community, a substantial portion of its tangible property is within any low-income community, a substantial portion of its employee services are performed in any low-income community, less than 5 percent of its average aggregate unadjusted cost basis of its assets are attributable to collectibles other than collectibles held primarily for sale to customers in the ordinary course of business, and less than 5 percent of its average aggregate unadjusted cost basis of its assets are attributable to nonqualified financial property.

Recommended Practices:

- Information to be obtained from the management of the proposed QALICB:
 - Name of the business
 - Nature of the business
 - Street address of principal location
 - Street address, census tract numbers, county names of locations where employee services are performed and/or where tangible property is used.
- List of documents that should be obtained from management of proposed QALICB:
 - Trial balance as of beginning of current tax year or end of prior year (if available)
 - Year-to-date (working) trial balance (i.e. for current year)
 - Unaudited financials for the current period (if available)
 - Prior year audited financials (if available)
 - Prior year tax return (if available)
 - Form SS-4 (if newly formed)
 - Partnership/Operating Agreement

- Other documents that should be obtained from management of proposed QALICB, if applicable:
 - Classification of gross income by the location from which it is derived (for multi-site locations)
 - Classification of payments to employees by the location from which it is derived (for multi-site locations)
 - Leased property listing (optional)
 - Commercial rental property lease agreement (optional)

Note: These procedures should be performed using the year-to-date trial balance. Audited financials and prior period tax returns should only be used to corroborate the information provided on the year-to-date trial balance and unaudited financial statements.

Low-Income Census Tract Test

- Verify business is located in a low-income census tract.

Excluded Business Test

- Inquire of management regarding the nature and type of business.
- Review prior year tax return (if available) to obtain SIC Code and business activity
 - Partnership/ LLC – Page 1 of Form 1065
 - S Corp – Page 1 of Form 1120S
 - C Corp – Page 3 of Form 1120
 - Individual – Schedule C of Form 1040
- Review lines 14 and 15 of Form SS-4, if it is a newly formed entity
- Based on above, proposed QALICB does not operate the excluded businesses listed below:
 - Massage parlor
 - Hot tub facility
 - Suntan facility
 - Country Club

- Racetrack or other facility used for gambling
- Sale of alcoholic beverages for consumption off premises.
- Development or holding of intangibles for sale.
- Private or Commercial Golf Course
- Farming
- Residential Rental Property under Section 168(e)(2)(A) (80% of gross income from rental of dwelling units)

Note 1: If any of these boxes is checked, the business may not qualify as a QALICB as it conducts an excluded business.

Note 2: If the business includes residential rental, see residential rental test below.

❖ Potential Additional Procedures

- Review notes to audited financials (if available) to determine the nature and type of business and verify that the proposed QALICB is not conducting an excluded business.

Residential Rental Test

If the business is mixed-use:

- Review year-to-date trial balance to determine the total income from all rental activities and amount of income from residential rental activities.
- The test is met if the percentage of income from residential rental activities is less than 80% of the total rental activities.

❖ Potential Additional Procedures

- Compare year-to-date trial balance to prior year tax return (if available) or prior year audited financials (if available) to ensure that current year data appears reasonable.

Note: Test is applied on a building by building basis.

Gross Income Test

- Review year-to-date trial balance to determine gross income.
- Obtain listing from management detailing location(s) where income is generated.
- Verify location(s) where income is generated is/are located in any low-income community.
- Test is met if the percentage of gross income derived from active conduct of business in any low-income community is 50%.

Note: Gross-Income test may be satisfied if the services test or tangible property test is met at 50%.

❖ Potential Additional Procedures

- Compare year-to-date trial balance to prior year tax return (if available) or prior year audited financials (if available) to ensure that current year data appears reasonable.

Services Test

- Obtain a listing from management of all employees, location where employees perform their services, and salary and wages paid.
- Verify location(s) where employees perform their service(s) is/are located in any low-income community.
- Review year-to-date trial balance and tie the total wages and salaries as reported on the trial balance to schedule obtained from management.
- Service test is met if 40% of the wages and salaries paid are for services rendered in any low-income community.

Note: Only for businesses not meeting the Gross Income Test

- If the Services Test is met at a 50% level, the proposed QALICB is deemed to have met the Gross Income Test.
- If the proposed QALICB does not have any employees, the proposed QALICB will be deemed to have met the services test if it meets the property test at an 85% level or higher.

❖ Potential Additional Procedures

- Compare year-to-date trial balance to prior year tax return (if available) or prior year audited financials (if available) to ensure that current year data appears reasonable.

Tangible Property Test

- Verify that tangible property is used in a low-income census tract through inquiry of management (and documented in management’s representation letter)
- Review year-to-date trial balance and trial balance as of beginning of current tax year (or trial balance as of end of prior year) to calculate total average unadjusted cost basis of tangible property.
- Obtain listing from management of all tangible property and leased property. For leased property, management should also provide estimated fair market value and basis of determination of fair market value.
- Review year-to-date trial balance and tie cost basis as reported on the trial balance to the depreciation schedule(s) obtained from management.
- For leased property, review documentation relating to valuation of leased property and determine if the valuation established by the entity is reasonable.
- Tangible Property test is met if 40% of the use of tangible property (owned or leased) is in any low-income community.

Note: Only for businesses not meeting the Gross Income Test

- If the Tangible Property Test is met at a 50% level, the proposed QALICB is deemed to have met the Gross Income Test.

❖ Potential Additional Procedures

- Compare year-to-date trial balance to prior year tax return (if available) or prior year audited financials (if available) to ensure that current year data appears reasonable.

Collectibles Test

- Inquire of management if there are collectibles not held for sale in the ordinary course of business.
 - Review year-to-date trial balance to verify management’s assertion.
 - Review year-to-date trial balance and trial balance as of beginning of current tax year (or trial balance as of end of prior year) to calculate average unadjusted cost basis of the business’s assets.
 - The Collectibles Test is met if less than 5% of the average aggregate unadjusted cost basis of the business’s assets are attributable to collectibles not held for sale in the ordinary course of business.
- ❖ **Potential Additional Procedures**
- Compare year-to-date trial balance to prior year tax return (if available) or prior year audited financials (if available) to ensure that current year data appears reasonable.

Nonqualified Financial Property Test

- Inquire of management if there is nonqualified financial property.
 - Review year-to-date trial balance to verify management’s assertion.
 - Review year-to-date trial balance and trial balance as of beginning of current tax year (or trial balance as of end of prior year) to calculate average unadjusted cost basis of the business’s assets.
 - The Nonqualified Financial Property test is met if less than 5% of the average aggregate unadjusted cost basis of the business’s assets are attributable to nonqualified financial property.
- ❖ **Potential Additional Procedures**
- Compare year-to-date trial balance to prior year tax return (if available) or prior year audited financials (if available) to ensure that current year data appears reasonable.