

Objective:

Documenting the substantially-all test in accordance with Section 45D of the Internal Revenue Code and the Temporary Regulations issued by the Department of the Treasury.

Background:

In accordance with Internal Revenue Code Section 45D(b)(1)(B), substantially-all of the cash received from qualified equity investments must be used by the qualified community development entity to make qualified low-income community investments.

The substantially-all requirement is treated as satisfied for an annual period if either the direct tracing calculation or the safe harbor calculation is performed every six months and the average of the calculations for the annual period is at least 85 percent.

Recommended Practices:

- Create separate accounts in the general ledger for:
 - Qualified equity investment
 - Loan loss reserve
 - Return of Investment/Principal account
 - Return on Investment/Interest income

- Prepare the following schedule:
 - Qualified Equity Investment Due Date Schedule providing details of the equity investments to be received showing the date, amount of equity investments, QLICI due dates, and substantially all due dates.

Direct Tracing Test/Safe Harbor Calculation

The direct tracing calculation/Safe Harbor Calculation should be calculated six months after the receipt of a qualified equity investment and every six months thereafter. To satisfy the Substantially All Test the average for an annual period should be least 85 percent.

*Note: For the **Direct Tracing Test** the following procedures should be performed separately for each qualified equity investment. For example, if the CDE received a QEI on 1/1/03 and other QEI on 3/1/03 under the direct tracing method the CDE must perform the substantially all calculation on 7/1/03 for the first QEI and 9/1/03 for the second QEI. CDEs may elect to aggregate multiple qualified equity investments received*

*in the same day. For the **Safe Harbor Calculation** the following procedures should be performed at the CDE level.*

Six Months:

- For the six month period for which the calculation will be performed, obtain the following
 - Report of QEIs issued during the last six months from the CDFI Fund website *My CDFI*.
 - Detailed general ledger from the accounting department
 - Bank statements
 - Investment agreements
 - Partnership/operating agreements (if applicable)
 - Loan agreements (if applicable)
 - Qualified Equity Investment Due Date Schedule
 - Schedule of all returns of principal and returns of investment (if applicable)

Additional Documents, if available

- Loan Amortization tables
 - Most recent tax return from the proposed QALICB (if available)
- Review *My CDFI* website, bank statements and investment/loan agreements to verify the
 - amount and date of receipt of the QEI
 - amount and date of receipt of return ON investments
 - amount and date of receipt of interest income from the proposed QALICB (if the QLICIs are loans)
 - Estimated interest income can be calculated from loan agreements or amortization tables.

- Tie back to tax returns/ audited financial statements (if any) received from the proposed QALICB)
 - Review banks statements
 - Tie back to investment agreements, financial projections for any scheduled preferred returns, fees, cash flow distributions
 - Tie back to tax returns/ audited financial statements (if any) received from the proposed QALICB
 - Verify amount distributed does not exceed the taxable income as this could be a return OF investment
- amount and date of receipt of return OF investments
 - amount and date of return of principal (if any)
 - Tie back to the loan agreements and amortization tables
 - Tie back to tax returns/audited financial statements (if any) received from the proposed QALICB)
 - Tie back to investment agreements, financial projections for any scheduled return of investments
 - Also, verify distribution to partners/members by tying back to investment agreements and financial projections
 - Tie back to tax returns/ audited financial statements (if any) received from the proposed QALICB)
- amount and date any qualified low-income community investments were made that are directly traceable to the qualified equity investment for which the calculation is being performed (Direct Tracing)
- amount of reserves maintained on the qualified active low-income community investments made
 - Up to 5% of QEI maybe held for reserves

- amount and date of operating expenses incurred on making the qualified active low-income community investments
 - Tie back to the general ledger to ensure that expenses are properly classified
- Amount, date, and classification of cash deposits and withdrawals
- Verify from the Qualified Equity Investment Due Date Schedule whether any reinvestments of principal have to be made within the following six months.
 - If the return of principal is in respect of a loan, the reinvestment timeframe available is until the end of the following calendar year
 - If the return of principal is in respect of an equity investment, the reinvestment timeframe available is within 12 months of the receipt of the principal
- Complete Exhibit I : Direct Tracing Calculation/Exhibit II : Safe Harbor Calculation.
- *Twelve Months:*
 - Perform Procedures under *Six Months*.
 - Verify that the average of either the Exhibit I : Direct Tracing Calculation or Exhibit II: Safe Harbor Calculation is at least 85%.