April 22, 2020

via electronic mail

Hon. David J. Kautter
Assistant Secretary for Tax Policy
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Hon. Charles P. Rettig
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Request to Provide Guidance and Postpone Certain Deadlines for the New Markets Tax Credit Program due to the COVID-19 Pandemic

Dear Assistant Secretary Kautter and Commissioner Rettig:

On behalf of the members of the New Markets Tax Credit Working Group (NMTC Working Group), we are writing to request guidance and relief from certain provisions impacting qualified businesses in low-income communities, community development entities (CDEs) and investors that participate in the NMTC program. We hope the following comments and recommendations are helpful to the IRS in delivering timely guidance regarding a COVID-19 response.

The members of the NMTC Working Group are participants in the NMTC industry who work together to help resolve technical issues and provide recommendations to make the incentive even more efficient in delivering benefits to qualified businesses located in low-income communities around the country. Our group includes more than 60 organizations that are allocatees, nonprofit and for-profit CDEs, consultants, investors, accountants and lawyers. The recommendations included for your consideration below are based upon comments received from these members.

The Secretary of the Treasury or his delegate (Secretary) has broad authority under IRC § 7508A to postpone certain deadlines for taxpayers affected by a federally declared disaster. We believe the issues listed below are within the scope of the agencies' regulatory authority, as illustrated by the Secretary in Revenue Procedure 2018-58, and other guidance. We believe this authority has been triggered by the President's declaration of a national emergency on March 13, 2020, which includes his instruction to the Secretary to provide relief from tax deadlines under § 7508A.

In addition to our request for extending up to one year certain deadlines under § 7508A, we also recommend that the Department of the Treasury (Treasury) and the Internal Revenue Service (IRS) make certain modifications and clarifications to other regulatory and subregulatory guidance as more fully discussed below. The guidance we request below related to redemptions under the NMTC regulations has also been included in prior submissions to the IRS Priority Guidance Plan for many years. The most recently submitted letter to the IRS is attached as an exhibit. We request that you refer to this letter for a more in-depth discussion of the regulatory issues we believe would benefit from modifications.

Regulatory Guidance

Loan Modifications

We request the rules under Treas. Reg. §1.1001-3 be modified to temporarily suspend the application of Treas. Reg. §1.1001-3 to modifications of qualified low-income community investment (QLICI) loans during the calendar years 2020 and 2021 for reasons explained further below.

We also request the IRS publish a notice that confirms that a significant modification to a QLICI loan that is made to alleviate a qualified active low-income community business' (QALICB's) economic distress, which results in the deemed exchange of the original QLICI loan for a new debt instrument under Treas. Reg. §1.1001-3, does not constitute "amounts received" in repayment of that QLICI loan for purposes of Treas. Reg. §1.45D-1(d)(2) and thus does not trigger or result in a reinvestment. We believe a key distinction between a significant modification under Treas. Reg. §1.1001-3 and an amount received under Treas. Reg. §1.45D-1(d)(2) is that Treas. Reg. §1.45D-1(d)(2) is intended to refer to actual cash or property repayments of QLICI loans, while Treas. Reg. §1.1001-3 is intended to address deemed tax consequences when material terms of a loan are modified.

If the requested guidance above is provided, CDEs would be able to quickly react to severe changes in the economic conditions of its borrowers as a result of the COVID-19 pandemic by providing economically accommodating modifications to loan terms. Without this guidance, CDEs will be forced to address two issues caused by the debt modification rules:

(i) determining whether a realization event has occurred that requires the recognition of gain or loss by CDEs (lenders) and QALICBs (borrowers) due to a deemed exchange of the QLICI loans, and

(ii) determining whether a deemed exchange constitutes a reissuance of a QLICI loan that would require the CDE to retest the qualifications of the borrower's business or reset the reasonable expectations safe harbor.

If a realization event was deemed to have occurred, or if a deemed reissuance of a QLICI loan requires retesting of a QALICB, then a CDE will encounter considerably more difficultly in providing relief to a QALICB, and will likely incur significant additional time and expense determining the amount and extent of any relief that can be provided.

Under Treas. Reg. § 1.1001-1(a), a realization event occurs when property is exchanged for other property that differs materially in kind or extent. Under Treas. Reg. § 1.1001-3(e)(3), a change in the timing of payments is a significant modification if it results in the material deferral of scheduled payments. If it's deemed that a realization event has occurred for any reason, exchange gain or loss must be recognized, if any. Any exchange loss recognized by a CDE will reduce earnings and profits accumulated if the CDE is taxed as a corporation and taxable income if it's taxed as a partnership.

In the NMTC regulations regarding recapture under Treas. Reg. § 1.45D-1(e), redemption is defined as it relates to equity investments in a C corporation, an S corporation or equity investments that are a capital interest in a partnership. Any exchange loss calculated as described above would impact the determination of whether a redemption has occurred as a result of distributions made. For CDEs taxed as corporations, recognizing an exchange loss would result in a reduction of the CDE's accumulated earnings and profits for a taxable year. More specifically, a reduction in accumulated earnings and profits generally reduces the amount of cash a CDE is allowed to distribute to its shareholders and any excess distributions would require the CDE to determine if a redemption of qualified equity investments (QEIs), which is a recapture event, has occurred. For CDEs taxed as partnerships, any exchange loss that reduces the CDE's taxable income would be added back in accordance with the safe harbor under Treas. Reg. § 1.45D-1(e)(3)(iii)(B) and not have an impact on the CDE's ability to make distributions. We note that a deemed realization event could also result in corresponding exchange gain being recognized by the QALICB, adding additional financial stress to the business.

Regarding qualification of a loan as a QLICI, if an exchange is deemed to occur, CDEs may be treated as having issued new QLICI loans, which could make debt modification transactions even more costly than they would otherwise be. Both Section 45D and the related regulations define a QLICI to include "any capital or equity investment in, or loan to, any qualified active low-income community business." Once a QLICI loan is made, the NMTC regulations do not address what happens if there is a deemed exchange of debt instruments under Treas. Reg. §1.1001-3.

In addressing the substantially-all requirement, NMTC regulations focus almost exclusively on the amount of cash that the CDE initially invests in QLICIs to QALICBs and the requirements relating to the return of cash, if any, that CDEs receive from QALICBs. If CDEs are deemed to have issued new QLICIs, then investors and CDEs would be compelled to re-verify QALICB status, which would necessitate much of the same due diligence and analysis as was done at the outset of the transaction, including updates to projections, updates to tax opinions, and often new agreed-upon procedures reports from accountants. Such costs would impose a significant additional economic burden on the parties, particularly QALICBs, at a time when they are already beset by financial hardship.

If QALICBs failed to qualify on retesting as a result of the COVID-19 pandemic, CDEs would generally have no choice but to call the loan, further exacerbating the damage to the QALICB and the CDE. In addition, if a modification results in a deemed exchange that results in a CDE treated as having issued new QLICI loans, this would require CDEs to re-establish their expectations regarding future QALICB compliance in order to benefit from the reasonable expectations safe harbor under Treas. Reg. § 1.45D-1(d)(6)(i), including any changes the QALICB has experienced since the original QLICI was issued. Both outcomes may drastically worsen the difficult financial conditions already faced by the business.

Redemption Safe Harbor for Partnerships – Timing of Cash Receipts and Distributions

In any given taxable year, a CDE that is taxed as a partnership for federal tax purposes is able to apply a safe harbor that permits the CDE to distribute to its investor(s) an amount up to its "operating income" for only such taxable year under Treas. Reg. 1.45D-1(e)(3)(iii)[1]. As a result of the COVID-19 pandemic, many CDEs are attempting to make modifications to QLICIs they have made, in order to provide relief to borrowers that have been affected. Many of these modifications will include deferral of debt service payments (generally interest payments).

These deferrals, if they are not repaid fully before year end, will generally cause a CDE to accrue and recognize interest income in a year that is before the year the interest income is scheduled to be paid. If the deferred interest income is collected in later years, the CDE will generally have cash receipts that exceed the operating income in those later years. This would result in substantial amounts of cash being "trapped" at the CDE level (as further described below).

The above Regulation currently does not generally allow a CDE that is taxed as a partnership for federal tax purposes to carry any undistributed operating income forward to be distributed in future years. If, however, the CDE is taxed as a corporation, it is permitted to make distributions out of accumulated earnings and profits, which is determined cumulatively over the current and all prior taxable years.

It seems inequitable that CDEs that are taxed as corporations may make distributions out of accumulated earnings and profits from all prior taxable years, but CDEs taxed as partnerships are only permitted to make distributions out of current year operating income and undistributed operating income from the prior taxable year. The inequities of this rule are illustrated by the following example.

A CDE might make a seven year interest only loan that requires a balloon payment at the end of year 7 for the amount of principal and any accrued interest. Due to the ongoing impacts of the COVID-19 pandemic to the borrower, assume that the CDE agrees in year 3 of the seven year

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[1] We note that Prop. Treas. Reg. § 1.45D-1(e)(3)(iii) allows a distribution of undistributed "operating income" for the prior taxable year, but that provision only applies to taxable years ending on or after the rule is finalized.

term to defer payments of interest for the remainder of the year. The CDE will have accrued the interest income during the deferral period but may not have received any current cash payments of interest. Assume further that at the end of year 4, the CDE receives cash for the repayment of the accrued interest from year 3 in addition to the interest incurred in year 4. However, as the Regulation is currently interpreted, because the taxable income for taxable year 4 will only include the interest income for year 4 in its Operating Income calculation, the CDE will be unable to make a distribution in year 4 of the cash it received in year 4 for the interest income earned in year 3. The same will be true in years 5, 6, and 7, as the CDE will continue to be unable to distribute interest income earned in year 3 but not received until year 4.

As a result, this cash will be trapped at the CDE, unable to be distributed, until the end of the CDE's compliance period. Indeed, given the extent to which CDEs may need to defer interest payments and the large proportion of CDEs that are partnerships, the amounts trapped at CDEs could aggregate tens or even hundreds of millions of dollars, which will add to the adverse impact of the current crisis on leverage lenders and other debt capital sources in these transactions. With a carry-forward of undistributed operating income from prior years, the CDE would be able to distribute cash received when accrued interest is paid, which is consistent with the general intent of the operating income safe harbor to enable CDEs to distribute the interest income they receive.

To increase symmetry between the rules for corporations and partnerships as it relates to the safe harbor for distributions to CDE partners, we ask that a CDE be allowed to make distributions from cumulative operating income in the same manner that a C corporation can make a distribution from earnings and profits. IRC Section 316 defines a dividend as being a distribution out of accumulated earnings and profits or from current earnings and profits without regard to the accumulated earnings and profits at the time the distribution was made.[2]

By increasing this symmetry between corporations and partnerships, the burden on partnership CDEs to avoid redemption when distributing operating income without jeopardizing the NMTCs will be alleviated. We have provided sample language for your consideration below:

> (iii) Capital interest in a partnership. In the case of an equity investment that is a capital interest in a CDE that is a partnership for Federal tax purposes, a pro rata cash distribution by the CDE to its partners based on each partner's capital <u>or profits</u> interest in the CDE during the taxable year_will not be treated as a

[2] IRC Section 316(a) defines a dividend for purpose of distributions by a C corporation as follows:

(a) General rule.

For purposes of this subtitle, the term "dividend" means any distribution of property made by a corporation to its shareholders—

(1) out of its earnings and profits accumulated after February 28, 1913, or
(2) out of its earnings and profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

redemption for purposes of paragraph (e)(2)(iii) of this section if either the distribution does not exceed the CDE's operating income for the taxable year or the distribution and all prior distributions does not exceed the CDE's cumulative operating income for all years. In addition, a non-pro rata de minimis cash distribution by a CDE to a partner or partners during the taxable year will not be treated as a redemption. A non-pro rata de minimis cash distribution may not exceed the lesser of (A) 5 percent of the greater of (1) the CDE's operating income for that taxable year or (2) the CDE's cumulative operating income for all years less all prior distributions or (B) 10 percent of the partner's capital interest in the CDE.

It is unclear whether the changes reflected above can be accomplished without a formal change in the safe harbor regulation, and whether there is any process other than a regulations project that could address this issue. This process may be too long to be helpful to CDEs who will be facing this issue this year.

We suggest that this might be approached as a technical correction to the regulations, addressing the inconsistency noted above between CDEs that are partnerships and those that are corporations – one for which there seems to be no logical basis. Thus, perhaps the IRS could issue a policy notice that they intend to undertake the correction of this inconsistency in the regulations, so as to allow partnership CDEs to include deferred interest from prior years in operating income for later years, and until the actual correction is adopted, taxpayers would be permitted to rely on such notice. We also ask that you consider providing the guidance we have requested for both debt modifications and NMTC redemption to provide the most relief to CDEs that want to make modifications to existing QLICI loans.

Section 7508A Deadline Extension Requests

The NMTC Working Group requests the following IRS Section 7508A relief:

Reasonable Working Capital Safe Harbor

A 12-month extension to the Reasonable Working Capital Safe Harbor in Reg. 1.45D-1(d)(4)(i)(E)(2) for construction of real property. It currently allows proceeds that are expended within 12 months after the date the investment or loan is made to be treated as a reasonable amount of working capital. Because of delays due to ongoing and future business impacts of the COVID-19 pandemic, we request that the notice temporarily extend the safe harbor to 24 months.

QEI Deployment

A 12-month extension to the existing 12-month period allowed to make investments under Reg. 1.45D-1(c)(5)(iv) such that CDEs that had raised qualified equity investments (QEIs) and are experiencing difficulty in deploying those proceeds as a result of the COVID-19 pandemic, will temporarily have additional time to make investments.

QLICI Reinvestments

A 12-month extension to the existing 12-month period allowed to make reinvestments under Reg. 1.45D-1(d)(2)(i) such that CDEs that have received amounts that are payment of, or for, capital, equity or principal with respect to a QLICI and are experiencing difficulty in reinvesting those proceeds as a result of the COVID-19 pandemic, will temporarily have additional time to make reinvestments.

Subregulatory Guidance

Reasonable Expectations

We request the IRS publish a notice that provides guidance that, if an entity ceases to constitute a QALICB for purposes of Treas. Reg. 1.45D-1(d)(4) or Treas. Reg. 1.45D-1(d)(5) in any year due to ongoing and future business impacts of the COVID-19 pandemic, such failure will be deemed not reasonably foreseeable and the CDE will be protected by the reasonable expectations safe harbor in Treas. Reg. 1.45D-1(d)(6)(i), to the extent otherwise applicable. We believe a notice confirming that CDEs can specifically rely on their original expectations will provide comfort as QALICBs endure the economic hardships and various stay-at-home orders as a result of the COVID-19 pandemic.

We appreciate the time and effort Treasury and the IRS spend on providing guidance and relief for the NMTC program. We hope that you find these comments and recommendations helpful for dealing with the COVID 19 pandemic.

Yours very truly,
Novogradac & Company LLP

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cc: Hon. Michael J. Desmond, Chief Counsel, Internal Revenue Service
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Michael Novey, Office of Tax Policy, Treasury
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EXHIBIT A

NMTC Working Group Letter to the IRS on
Recommendations for the 2019-2020 Priority Guidance Plan
December 12, 2019