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November 6, 2008

CCA:PA:LPD:PR (REG-149404-07)
ROOM 5203
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Dear Sir or Madam:

I am responding on behalf of Reznick Group to the request for comments on proposed amendments to 26 CFR Part I to provide and clarify rules relating to the new markets tax credit ("NMTC") under section 45D of the Code. We support the proposed amendments to Regulation 1.45D-1 and believe the modifications clarify the existing regulations, reduce recapture uncertainty, and will attract increased investment in low-income communities.

Reznick Group is a national, public accounting firm which provides consulting, audit and tax services to hundreds of clients involved in community development. We have been advising clients since the inception of the NMTC program and are considered a leader in the industry. Our clients include community development financial institutions, community development entities ("CDE"), investors, sponsors and qualified active low-income community businesses ("QALICB").

The change to the redemption safe harbor to provide that pro rata cash distributions by a CDE to its partners will not be treated as a redemption if the distribution does not exceed the sum of the CDE's operating income for the taxable year and the CDE's undistributed operating income for the prior taxable year will aid both CDE's and their investors. Currently, many CDE's are making conservative estimates of operating income to ensure that distributions to their partners are within the safe harbor. Consequently, cash from operating income in one year is accumulated and may not be distributed in a subsequent year because the distribution would be outside the safe harbor. This change also permits the CDE to make return on investments to its partners more timely. With this change the CDE will be able to make an accurate determination of its operating income for the current year and make a distribution in the subsequent year.

We would like to suggest that rather than restricting the safe harbor to the sum of the current year and prior year undistributed operating income, that the safe harbor be broadened to bring within it cash distributions that do not exceed the current year operating income and all prior years undistributed operating income. This would provide additional flexibility to CDE's as some CDE's are creating loan loss reserves out of operating income due to the higher risk associated with many QALICB loans. After several years of positive loan performance history, the CDE may determine that the reserves can be

reduced and would like to distribute the cash to its partners but is reluctant to do so because it is outside the safe harbor.

Broadening the safe harbor to bring within it cash distributions that do not exceed the current year operating income and all prior years undistributed operating income would also alleviate issues that might arise involving short year returns. For example, CDE's tend not to close their books for the year until an audit is completed by their public accountant. If the CDE is a calendar year taxpayer, the audit may not be complete for 90 to 120 days after year end. If there were two short year returns caused, perhaps, by a section 708(b)(1)(B) termination, that between the two returns covered the same twelve months covered by the audit, a distribution in the current year might exceed the current taxable year's operating income and the prior taxable year's undistributed operating income because the prior taxable year was not for a full twelve months.

Regarding the determination of operating income, we support the addition of tax-exempt income under section 103 and any other depreciation and amortization deductions under the Code to the list of Code sections that determine the amount of operating income. We would suggest that this computation be clarified further to require operating income to be reduced by deductions disallowed under section 265 to generate tax-exempt income under section 103. We also support the clarification that CDE's may rely on section 1.704-1(b)(1)(vii) to determine its allocable share of deductions listed as adjustments to arrive at operating income

We concur with the proposed regulation's treatment of a termination of a partnership CDE under section 708(b)(1)(B) and the application of the reasonable expectation test to CDEs that make investments or loans through other CDEs.

The notice requested comments on how to define, under section 1.45D-1(d)(2)(i), the dollar amounts received by a CDE "in payment of, or for, capital, equity, or principal" for the purpose of determining whether or not the dollars received must be reinvested in other QALICBs within 12 months. The character of payments received related to a loan should be governed by the terms of the loan agreement. Most loan agreements require payments to be applied to interest first and many QALICB loans prohibit prepayment of principal. CDEs making shorter term loans are following the loan documents to determine when payments received are returns of principal and are reinvesting those proceeds timely to maintain compliance with the substantially all test.

With respect to an equity investment in a QALICB, if the QALICB is a C corporation we suggest that the determination of whether the distribution is a return on capital be determined under the redemption rules of 1.45D-1(e)(3)(i) and if under those rules it is determined that the distribution is a dividend under section 301(c)(1) then the proceeds should not be taken into account for purposes of the substantially all test. If the QALICB is a partnership, we suggest that a distribution to the CDE be considered a return on investment and not taken into account for purposes of the substantially all test if the distribution does not exceed the CDEs allocable share of the QALICBs operating income as defined in section 1.45D-1(e)(3)(iii).



We appreciate the opportunity to provide comments on the proposed regulations. We think the clarifications and modifications to the existing regulation alleviate some uncertainty and will give greater comfort to CDEs and their investors and ultimately, benefit the QALICBs by attracting additional investment and providing additional flexibility to QALICBs.

Sincerely,

A handwritten signature in blue ink, appearing to read "David G. Norton".

David G. Norton

Principal