July 22, 2020

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2020-47)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Notice 2020-47 Public Comment Invited on Recommendations for 2020-2021 Priority Guidance Plan

Dear Ladies and Gentlemen:

On behalf of the members of the New Markets Tax Credit ("NMTC") Working Group, we submit the following comments, considerations and recommendations regarding existing NMTC rules and regulations, which we believe will increase the effectiveness and efficiency of the NMTC program. For your convenience, we have also included an executive summary and further explanation of the items included in the executive summary, which should be read in conjunction with this letter.

The members of the NMTC Working Group are participants in the NMTC industry who work together to help resolve technical NMTC program issues and provide recommendations to make the NMTC program even more efficient in delivering benefits to qualified businesses located in low-income communities around the country. Our group includes over 60 organizations that are allocatees, nonprofit and for-profit community development entities ("CDEs"), consultants, investors, accountants and lawyers.

For your convenience, the recommendations have been summarized in the attached Executive Summary and are listed in what we believe to be in the order of highest priority. However, we believe that each recommendation should be considered to generate and sustain the greatest possible community impact. Additionally, we have included previously submitted comments and recommendations for issues occurring in the NMTC program related to the COVID-19 pandemic. Our comments reflect the work of more than 60 member organizations participating on numerous conference calls and countless drafting sessions over several years. We trust you will find our comments useful and instructive. All of the NMTC Working Group's previous comments regarding these issues, as well as many others, can be found on our website (www.nmtcworkinggroup.com) in the Comment Letters section.

We appreciate the opportunity to comment on ways to further enhance the good being done by the NMTC program, and we also appreciate the level of commitment, dedication and outreach that has been shown and continues to be shown by the CDFI Fund, the Internal Revenue Service ("IRS") and the Department of Treasury's Office of Tax Policy in implementing and managing the NMTC program. The CDFI Fund, IRS and Treasury have proven to be capable managers of the NMTC program. This is evidenced by the tremendous success the NMTC program has enjoyed since its inception in 2000 by targeting billions of dollars of investments in low-income communities across the country. We applaud the various offices within Treasury that have worked with all those involved in these transactions to ensure that those dollars get into highly distressed communities as efficiently as possible.

Since the program's inception, the knowledge, understanding and experience among participants in the NMTC program has been continuously rising, as has the demand and competition for the NMTC among participants in the NMTC program, including investors, lenders, CDEs and qualified businesses. The interaction of these and other factors has led to ever-greater efficiencies and effectiveness of the NMTC program in delivering much-needed subsidy to qualified businesses.[1] These factors have also helped direct a greater portion of the NMTC program to the nation's most distressed low-income communities and to qualified businesses, generating even greater community impacts.

We commend the IRS for requesting items to be included on its annual Priority Guidance Plan. We believe that one of the most effective ways to further improve the efficiency of the NMTC program requires a statutory change – that is to make the credit permanent. Congress has exhibited a trend of granting short-term extensions, which creates uncertainty in the industry. In 2019, Congress passed the Fiscal Year 2020 appropriations bill, H.R. 1865, which included a one-year, $5.0 billion extension through 2020; however, uncertainty remains surrounding the NMTC program regarding its long-term future. Uncertainty in any aspect, especially as it relates to the future of authorization for the NMTC program, limits the number of investors and potential CDEs willing to participate, and also limits the level of long-term investment that existing investors and CDEs are willing to make. Willingness by investors to participate in the NMTC program would also be greatly enhanced if a permanent extension of the NMTC included provisions that eliminates the basis reduction and that would allow the NMTC to offset the alternative minimum tax (AMT).[2] Both provisions would put the NMTC program on par with Low-Income Housing Tax Credits, Historic Tax Credits and certain Renewable Energy Tax Credits, and would increase the demand by investors for the NMTC. An increase in demand by investors would lead to an even greater amount of subsidy reaching qualified businesses. Additionally, if the NMTC program were made permanent, CDEs and other NMTC program participants would dedicate more resources to the NMTC program and generate even greater efficiencies. Since the economic downturn, the financing of qualified

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[1] See "Reports Indicate that NMTC Program Improves with Age," Novogradac Journal of Tax Credits, July 2011, Volume II, Issue VII.
[2] For further discussion of AMT implications, see §2.16 of Novogradac & Company New Markets Tax Credit Handbook, 2011.

businesses has become increasingly complicated, requiring industry participants to become progressively more creative in transaction structuring while simultaneously ensuring that as much subsidy from the NMTCs as possible reaches qualified active low-income community businesses ("QALICBs").

We believe that the following comments, considerations and recommendations concerning existing NMTC rules and regulations, if pursued and adopted, will increase the effectiveness and efficiency of the NMTC program. That said, we believe one regulatory change rises above all others in its potential to positively impact the NMTC program – the manner in which tax credit recapture is determined. By imposing the risk of full recapture, plus interest and penalties, for the full term of the investment for all potential causes of recapture, the NMTC program has created a level of compliance analysis and transaction structuring unrivaled by other tax credit programs. A reduction in tax-credit-recapture risk during the term of the investment would lower overall transaction costs and help facilitate the financing of specific types of businesses that tax credit investors are currently reluctant to make.

The following comments, considerations, and recommendations specifically relate to regulatory changes. Because many of the proposed revisions to the regulations clarify policies that many industry participants have thought were already implicit in the regulations, we believe it would be helpful if the proposed changes, at the option of the taxpayer, could be relied on for periods prior to their effective date. Otherwise, CDEs will receive no additional comfort that transactions structured before the effective date will be allowed to rely on any of the clarifications and guidance provided in the proposed regulations.

We appreciate the opportunity to submit our suggestions for issues that should be included on the 2020-2021 Priority Guidance Plan. We believe that further guidance on these issues is essential to sustain and increase the impact of the NMTC program on low-income communities. With further guidance, we believe that the NMTC can be an even more effective tool in restoring economic growth throughout the country. We commend the Department of Treasury and IRS for their continuing efforts to improve and clarify tax guidance for the NMTC program in order to ensure its continuing success. Thank you in advance for your time and consideration.

Please do not hesitate to contact us if you have any questions regarding our comments or if we can be of further assistance. We would be happy to discuss our comments in further detail.

Yours very truly,
Novogradac and Company LLP

by

Brad Elphick

Recommendations for 2020-2021 Priority Guidance Plan
Executive Summary

This executive summary should be read in conjunction with our letter dated June 22, 2020 to the Internal Revenue Service regarding recommendations for the 2020-2021 Priority Guidance Plan. We believe these comments, considerations and recommendations concerning existing NMTC rules and regulations, if pursued and adopted by Treasury, will increase the effectiveness and efficiency of the NMTC program. The comments are organized by priority in which we believe they should be addressed.

1. **Loan Modifications** – Treas. Reg. §1.1001-3 should be modified to temporarily suspend the application of this regulation to modifications of qualified low-income community investment ("QLICI") loans during the calendar years 2020 and 2021 in response to the COVID-19 pandemic.

2. **Redemption Safe Harbor for Partnership CDEs:**
   - *Timing of distributions* – Treasury Regulation §1.45D-1(e)(3) should be modified to allow CDEs, solely for purposes of determining if a recapture event has occurred, to treat distributions made by the due date (including extensions) of a CDE's federal income tax return as having been made in the prior taxable year;
   - *Distributions made for prior year(s)* – Treasury Regulation §1.45D-1(e)(3) should be modified to allow CDEs taxed as partnerships the ability to make distributions for prior years' accumulated profits, similar to current regulations allowing corporations to make distributions out of accumulated earnings and profits from all prior taxable years;
   - *Catch-up period* – CDEs should be allowed to apply these rules retroactively to allow them to "catch-up" their distributions;
   - *Definition of operating income - capital gains* – Treasury Regulation §1.45D-1(e)(3)(iii)(A) should be modified to include capital gains in the calculation of operating income;
   - *Special exceptions* – Treasury Regulation §1.45D-1(e)(3) should be modified to define "operating income" to include QLICI loan interest payments without regard to whether the income should be accrued for federal income tax purposes up to the amount of the loan loss reserve held by the CDE. It should also be modified to add back the tax deductions incurred by the qualified active low-income community business or the CDE that do not reduce the CDE's operating cash flow.
   - *Allocation among multiple QEIs* – Guidance is needed under Treasury Regulation §1.45D-1(e)(2)(ii) to clarify the definition of "proceeds of the investment". Guidance is also needed under Treasury Regulation §1.45D-1(e)(2)(iii) to clarify how distributions from the CDE which constitute a return of capital will be attributed

among those QEIs. CDEs should be permitted to elect to use any reasonable method to treat proceeds from a repaid QLICI as applicable to the QEIs made into that CDE. Further, the Regulations should state that the use of a FIFO method, a LIFO method or a pro-rata allocation method should be allowed if consistently applied; and

- *C Corporation filing consolidated return* – A C Corporation CDE distributes all of its earnings and profits to its parent and makes a payment to its parent for its allocable share of income taxes. This payment should not be considered a distribution in excess of earnings and profits.

3. **Application of the Rehabilitation Tax Credit Safe Harbor, Rev. Proc. 2014-12, to Transactions which Involve the New Markets Tax Credit** – Clarification should be provided on the application of Sections 4.01 and 4.05(3) from Revenue Procedure 2014-12 to transactions combining HTCs and NMTCs. Without further guidance, these two provisions will continue to have a chilling effect on combining the two tax credits.

4. **Definition of Control** – Treasury Regulation §1.45D-1(d)(6)(ii)(B) should modify the definition of "control" for purposes of the "reasonable expectation" safe harbor by removing the reference to a value-based test and clarifying voting and management rights that should be considered for control.

5. **Partnership Allocations (IRC section 704(b))** – Internal Revenue Code §45D and §704(b) provide no specific reference on how the NMTC should be allocated among partners in a partnership. Guidance on this issue would be very helpful, particularly to CDEs seeking to make venture capital investments.

6. **De Minimis Rule** - Treasury Regulation §1.45D-1(d)(5)(iii)(B) should be modified to state the following: "Certain other trades or businesses. The term 'qualified business' does not include any trade or business, (i) from which more than 10 percent of its total gross receipts are derived from, the operations of any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or (ii) consisting of any store the principal business of which is the sale of alcoholic beverages for consumption off premises. In determining whether this 10 percent test is satisfied, only gross receipts from the taxpayer's trade or business activity that includes operations of any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, are taken into account."

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7. **Reasonable Expectations** – CDEs should be able to use the reasonable expectations safe harbor in Treas. Reg. 1.45D-1(d)(6)(i) in the event an entity ceases to constitute a QALICB due to the COVID-19 pandemic.

Recommendations for 2020-2021 Priority Guidance Plan

Regulatory Changes

1. 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 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.

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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.

2. Redemption Safe Harbor for Partnership CDEs

In a letter dated April 24, 2006, we submitted comments and suggested language for the Treasury Regulation on redemption (Treasury Regulation § 1.45D-1(e)(3)) regarding the timing of distributions and distributions made for prior years' accumulated profits. The NMTC Working Group requests that the suggested language offered in our previous letter be further considered. We still believe that our suggested changes will lessen the unnecessary administrative burden for CDEs as well as the undue risk of recapture faced by investors in CDEs. By lessening the administrative burden to CDEs, more of the NMTC subsidy can be made available to qualified businesses. Similarly, by lessening the undue risk of recapture to investors, more equity capital can be raised and invested in qualified businesses. We commend the Department of Treasury for its efforts in proposing changes to the regulations. However, we still request that our recommendations be considered as an alternative to the proposed changes in the regulations. For your convenience, we are resubmitting our comments below from our previous letter with certain changes made to incorporate the proposed changes in the Regulations.

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Final Regulation Section 1.45D-1(e)(3)(iii) provides a safe-harbor for CDEs that are considered a partnership for Federal tax purposes. The Regulation specifically states:

> ". . . a pro rata cash distribution by the CDE to its partners based on each partner's capital interest in the CDE during the taxable year will not be treated as a redemption for purposes of paragraph (e)(2)(iii) of this section if the distribution does not exceed the CDE's operating income for the taxable year."

a. Timing of distributions

The Final Regulation then defines Operating Income.[3] However, the Final Regulation implies that the distribution must be made in the same taxable year to which the Operating Income is attributed. By requiring the distribution to be made in the same year, CDEs are required to estimate Operating Income before the end of the taxable year rather than rely on its books and records which are typically closed and adjusted after year end. Even with the changes in the proposed regulations that allow distribution of the current taxable year's Operating Income and the prior taxable year's undistributed Operating Income this remains an issue for the CDE.

For example, the books and records of a calendar year CDE may not be closed and adjusted until January 15. Additionally, the tax returns will not be completed in most cases until sometime in March. As a result, the only way a CDE can distribute its Operating Income before the end of the taxable year is if the CDE estimates its Operating Income for the given year. If the CDE miscalculates its estimate of

[3] For purposes of calculating operating income, Reg. 1.45D-1(e)(3)(iii) defines operating income as:

(A) The CDE's taxable income as determined under section 703, except that—
   (1) The items described in section 703(a)(1) shall be aggregated with the non-separately stated tax items of the partnership; and
   (2) Any gain resulting from the sale of a capital asset under section 1221(a) or section 1231 property shall not be included in taxable income;
(B) Tax-exempt income under section 103;
(C) Deductions under section 165, but only to the extent the losses were realized from qualified low-income community investments under paragraph (d)(1) of this section;
(D) Deductions under sections 167 and 168, including the additional first-year depreciation under section 168(k), and any other depreciation and amortization deductions under the IRC;
(E) Start-up expenditures amortized under section 195; and
(F) Organizational expenses amortized under section 709.

Operating Income and distributes cash in excess of Operating Income, then investors in the CDE could potentially suffer recapture.

In order for the CDE to accurately determine Operating Income as defined in the Regulation, the CDE must wait until after year-end to calculate Operating Income. There are several examples throughout the Internal Revenue Code ("IRC") that allow an entity to treat a distribution as having been made in a given taxable year if it makes the distribution within a certain amount of time after the end of a given taxable year. For example, IRC Section 855 allows a regulated investment company to treat a distribution as having been made in a given taxable year if it declares the dividend prior to the due date for the filing of the tax return, including any extensions, and distributes the dividend within 12 months after the taxable year.[4] IRC Section 857(b)(9) allows a real estate investment trust to treat a distribution as having been made on December 31 of a given taxable year if the distribution is made by January 31 of the following taxable year.[5]

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[4] IRC Section 855(a) provides the following rule for distributions after close of taxable year:

(a) General rule.

For purposes of this chapter, if a regulated investment company—

(1) declares a dividend prior to the time prescribed by law for the filing of its return for a taxable year (including the period of any extension of time granted for filing such return), and
(2) distributes the amount of such dividend to shareholders in the 12-month period following the close of such taxable year and not later than the date of the first regular dividend payment made after such declaration,

the amount so declared and distributed shall, to the extent the company elects in such return in accordance with regulations prescribed by the Secretary, be considered as having been paid during such taxable year, except as provided in subsections (b) , (c) and (d) .

[5] IRC Section 857(b)(9) allows dividends to be paid in the following year but deemed paid in the year they were declared:

(9) Time certain dividends taken into account.

For purposes of this title, any dividend declared by a real estate investment trust in October, November, or December of any calendar year and payable to shareholders of record on a specified date in such a month shall be deemed—

(A) to have been received by each shareholder on December 31 of such calendar year, and
(B) to have been paid by such trust on December 31 of such calendar year (or, if earlier, as provided in section 858).

The preceding sentence shall apply only if such dividend is actually paid by the company during January of the following calendar year.

Furthermore, 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).

We recommend that the Regulation be clarified to allow CDEs, solely for purposes of determining if a recapture event has occurred, to treat distributions made by the due date (including extensions) of a CDE's federal income tax return to be treated as made in the prior taxable year. We have provided sample language for your consideration to incorporate this recommendation in Final Regulation Section 1.45D-1(e)(3)(iii) included below and in Exhibit A:

> (iv) Solely for purposes of calculating a redemption under paragraph (e)(3) of this section, cash distributions made by the due date (including extensions) of a CDE's federal income tax return shall, at the election of the CDE, be treated as made in the prior taxable year.

b. Distributions made for prior year(s)

In a given taxable year, a CDE may not want to or may not be able to distribute all of its Operating Income to its investors. The Regulation currently does not allow the CDE that is taxed as a partnership for federal tax purposes to carry this undistributed Operating Income forward to future years. The Proposed Regulation allows a CDE to distribute undistributed operating income from the prior taxable year only. If, however, the CDE is taxed as a corporation, it is permitted to make distributions out of accumulated earnings and profits. It seems inequitable that corporations may make distributions out of accumulated earnings and profits from all prior taxable years but entities taxed as partnerships are only permitted to make distributions out of current year Operating Income and undistributed Operating Income from the prior taxable year.

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There are numerous examples of the inequities of this rule. For example, a CDE makes a three year loan that requires a balloon payment at the end of year 3 for the amount of principal and accrued interest. The CDE has accrued the interest income over the three years but has not received any current cash payments of interest. At the end of year 3, the CDE receives cash for the repayment of the loan it made and corresponding accrued interest. However, because the taxable year in which the loan was repaid will only reflect the interest income for that year in its Operating Income calculation as the Regulation is currently interpreted, about two-thirds of the cash will be trapped at the CDE, unable to be distributed. 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.

Another example relates to a CDE that decides to hold its interest income received in the earlier years of its NMTC investment period in a reserve account, to hedge against future potential loan losses or unanticipated operating expenses. As the CDE's operations stabilize, the CDE may be in a position to release some of these prior earnings and provide a return to its investors. However, under the current and proposed regulations, the CDE would be unable to pay distributions to its partners for its undistributed Operating Income, except for amounts related to the current and immediate prior year.

Additionally, 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 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.

In an effort to create symmetry between the rules for corporations and partnerships as it relates to the Regulation, we ask that a CDE be allowed to make distributions from 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.[6] We ask that entities taxed as partnerships be allowed to make distributions from Operating Income in the same manner. By creating 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 and in Exhibit A:

> (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 or profits interest in the CDE during the taxable year will not be treated as a 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

[6] 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.

> 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. For purposes of this paragraph (e)(3)(iii), with respect to any taxable year, operating income is the sum of:

If the proposed regulations are not changed to incorporate our previous comments regarding the inclusion of all prior taxable years' undistributed Operating Income and the timing of when distributions can be made, we recommend that the regulations clarify the calculation of how distributions are applied to undistributed Operating Income. It is currently unclear as to which year's Operating Income would be deemed to be distributed first. For example, a CDE has $100 of Operating Income for the current taxable year and $100 of undistributed Operating Income for the prior taxable year for a total of $200 that could be distributed based upon the safe harbor provision in the proposed regulations. If the CDE has $120 of cash that it intends to distribute pro rata to its partners, would the $120 distribution be applied first to the prior year's undistributed Operating Income of $100 with the remaining $20 applied to the current year's Operating Income, thereby leaving $80 of undistributed current taxable year Operating Income (which would be available for distribution in the following taxable year)? Or, would the $120 distribution first be applied to the entire current taxable year's Operating Income and next only $20 attributable to the undistributed Operating Income from the prior taxable year (thus leaving $80 of prior year Operating Income not available for distribution and no amount of current year Operating Income available for distribution in the following taxable year)? We believe that the CDE should be allowed to use the former approach using a first-in first-out (FIFO) methodology. Otherwise, $80 of undistributed Operating Income will be unavailable to the CDE for distribution during the next taxable year.

c. Catch-up period

We recommend that CDEs be allowed to apply these rules retroactively to allow them to "catch-up" their distributions. Without guidance on this issue, many CDEs chose not to make distributions due to the severe risk of recapture. If this guidance had

existed, they would have made distributions in prior taxable years. If our recommendation to allow CDEs to distribute the cumulative amount of all prior taxable years' undistributed Operating Income is not incorporated into the final changes, we recommend that guidance be provided to allow CDEs with undistributed Operating Income from any prior taxable year to distribute their undistributed Operating Income. For all taxable years following the year in which the guidance is finalized, the CDE would only be able to distribute the sum of the current taxable year Operating Income and the undistributed Operating Income from the prior taxable year as provided in the Proposed Regulation. For example, a CDE began generating $100 of Operating Income beginning taxable year 2006 and $100 every year thereafter through 2009 for a total of $400 of Operating Income. However, to date, the CDE hadn't distributed its Operating Income each year due to the lack of guidance in the regulations. If the proposed regulations are finalized March 15, 2009, the CDE would then be able to "catch-up" its distributions by distributing the entire $400 during 2009. In 2010 and each year thereafter, under the safe harbor provision, the CDE would be able to distribute the sum of its current taxable year's Operating Income and prior taxable year undistributed Operating Income.

d. Definition of Operating Income – capital gains

We commend Treasury for adopting our comments related to the inclusion of tax-exempt income and the CDE's allocable share of depreciation and amortization in the calculation of Operating Income. However, the inclusion of capital gains was not addressed in the proposed regulations. Some CDEs are making venture capital investments in qualified businesses. A goal of the NMTC program is for CDEs to provide equity capital (the most patient form of capital) to businesses located in distressed communities. If these investments are redeemed or otherwise sold, the CDE must reinvest the lesser of the proceeds received or the original cost basis. Amounts received in excess of the original cost basis do not need to be reinvested. However, the definition of Operating Income excludes capital gains. As such, while profits do not need to be reinvested by the CDE they cannot be distributed to investors without risking a recapture event. We recommend that capital gains be included in Operating Income and have provided sample language below and in Exhibit A:

(A) The CDE's taxable income as determined under section 703, except that—

(1) The items described in section 703(a)(1) shall be aggregated with the non-separately stated tax items of the partnership; ~~and~~

> ~~(2) Any gain resulting from the sale of a capital asset under section 1221(a) or section 1231 property shall not be included in taxable income;~~

e. Special exceptions

The amendment to the Regulations to allow distributions in a succeeding year of undistributed operating income from a prior year is useful given the difficulty of determining the actual operating income before year-end. The amendment does not address, however, the situations in which a CDE receives QLICI loan interest payments or equity distributions sufficient to make projected distributions which exceed the operating income safe harbor due to unanticipated losses incurred by the CDE or the QALICB.

> Example #1: CDE makes loans to a QALICB. The QALICB defaults on its interest payments due to the CDE, and, as a result of this default, the CDE may incur additional expenses (or may be uncertain as to its ability to accrue the interest income). The CDE has a loan loss reserve set aside equal to 5% of the QEI, and uses the funds in the loan loss reserve to make distributions pro rata in accordance with the financial projections at closing. The distributions are in the amounts required for the Investment Fund (a) to pay interest due with respect to a Leverage Loan (or the economic return on an equity investment) made to the Investment Fund to fund a portion of the QEI and (b) to pay the Investment Fund's projected operating expenses.
>
> Example #2: CDE makes a loan and an equity investment in a QALICB. The equity investment generates unanticipated losses which are not funded by the CDE. The unanticipated losses may be funded by project reserves, QALICB affiliate contributions or loans, or third party financing. The CDE receives the projected cash flow from the QLICI loan (or equity investment) and makes distributions pro rata to its members in accordance with the financial projections provided at closing. The distributions are in the amounts required for the Investment Fund (a) to pay interest due with respect to a Leverage Loan (or the economic return on an equity investment) made to the Investment Fund to fund a portion of the QEI and (b) to pay the Investment Fund's projected operating expenses.

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The legislative history and the Final Treasury Regulations state that there is a recapture event if the investment is redeemed or "otherwise cashed out." The distributions described above in Examples #1 and #2 do not constitute a "cashing out" of the QEI since they are funded by loan loss reserve funds set aside for use in the event of defaults on QLICI loan payments or QLICI loan interest payments (or a return on an equity investment). The distributions are in amounts required to pay Leverage Loan debt service (or the economic return on an equity investment) and operating expenses of the Investment Fund.

The request is to modify the safe harbor to define "operating income" to include QLICI loan interest payments without regard to whether the income should be accrued for federal income tax purposes up to the amount of the loan loss reserve held by the CDE We have provided sample language below and in Exhibit A:

> (A) The CDE's taxable income as determined under section 703, except that—
>
> > (1) The items described in section 703(a)(1) shall be aggregated with the non-separately stated tax items of the partnership; and
> >
> > ~~(2) Any gain resulting from the sale of a capital asset under section 1221(a) or section 1231 property shall not be included in taxable income;~~
> >
> > (2) Interest income with respect to a loan that is a qualified low-income community investment that is not accrued for federal income tax purposes in connection with a payment default shall be included in the CDE's taxable income up to an amount equal to the CDE's loan loss reserve maintained in compliance with paragraph (d)(3) of this section.

We also recommend to add back the tax deductions incurred by the qualified active low-income community business or the CDE that exceed the CDE's cumulative taxable income realized from such equity investment. We have provided sample language below and in Exhibit A:

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(G) Deductions under Section 162, with respect to expenses incurred by the CDE or the qualified active low-income community business in excess of operating revenues, and

(1) If incurred by the CDE, such expenses are funded by (a) the CDE's loan loss reserve maintained in compliance with paragraph (d)(3) of this section or (b) reserves or financing not funded by qualified equity investments provided to the CDE; or

(2) If incurred by the qualified active low-income community business, such expenses are funded by (a) reserves held by the qualified active low-income community business, or (b) financing provided to the qualified active low-income community business (other than qualified low-income community investments made by the CDE).

(3) Examples. – The application of paragraph (e)(3)(iii)(F) is illustrated by the following examples:

Example 1. (i) X is a partnership and a CDE that has received a new markets tax credit allocation from the Secretary. Y acquires a qualified equity investment in X. X uses the proceeds of Y's qualified equity investment to make qualified low-income community investments that consist of a loan and an equity investment in B. B is a qualified active low-income community business. X makes the equity investment in B through A which is a wholly-owned subsidiary of X and a disregarded entity for federal income tax purposes. X is a calendar year taxpayer.

(ii) B rents a building to A. A's required annual lease payments of $400,000 are sufficient to cover the annual debt service payments of $350,000 due by B with respect to the loan QLICI and to pay B's operating expenses of $50,000.

(iii) For the year ended December 31, 2008, A has tax losses from operations of $150,000 and is only able to make lease payments of $250,000 to B. B makes the debt service payment of $350,000 to X and pays its operating expenses utilizing $150,000 of reserves held by B. For the year ended December 31, 2008, X's interest income is $350,000 and tax losses from its investment in A are $150,000. Under paragraph (e)(3)(iii)(F)(ii) of this section, $150,000 would be added to X's *operating income* for the year ended December 31, 2008.

Example 2. The facts are the same as in *Example 1* except that A borrows $150,000 from a lender and uses the loan proceeds to make the $400,000 lease payment to B. B makes the debt service payment of $350,000 to X. Under paragraph (e)(3)(iii)(F)(ii) of this section, $150,000 would be added to X's *operating income* for the taxable year ended December 31, 2008.

f. Allocation among multiple QEIs

In the event that multiple QLICIs are made into the same qualified active low-income community business ("QALICB") (e.g. installments of historic tax credit equity or advances of a construction loan), there is uncertainty as to how payments of or for capital, equity or principal received by the CDE should be attributed to those QLICIs. Under Treasury Regulation Section 1.45D-1(e)(2)(ii) there is a recapture event with respect to a QEI if "the proceeds of the investment cease to be used in a manner that satisfies the substantially all requirement." It is not clear under this Regulation how the "proceeds of the investment" are defined. This is particularly relevant where (i) multiple QLICIs are made to a single borrower over a period of time, and (ii) these

QLICIs are funded from multiple QEIs. In this situation, it is not clear whether the borrower would be deemed to have repaid the QLICI made with the first QEI, the last QEI or repaid QLICIs made proportionally from each QEI.

Similar uncertainty exists under Section 1.45D-1(e)(2)(iii) where multiple QEIs are made into one CDE over a period of time. In this case, there is uncertainty as to how distributions from the CDE which constitute a return of capital will be attributed among those QEIs for purposes of the redemption test for QEIs. For example, consider the case where multiple QEIs have funded a single QLICI. Cash is paid to the CDE by the borrower and that cash is distributed to the investor as a return of capital. Which QEI has been redeemed? This is particularly relevant where the first of a series of QEIs has reached its seventh anniversary but later QEIs have not.

We believe in both cases CDEs should be permitted to elect to use any reasonable method to treat proceeds from a repaid QLICI as applicable to the QEIs made into that CDE. Further, the Regulation should state that the use of a FIFO method, a LIFO method or a pro-rata allocation method should be allowed if consistently applied.

g. C Corporation filing consolidated return

If a CDE is taxed as a C corporation and is included in a consolidated return, then it will likely make cash payments to its parent, the qualified equity investment ("QEI") holder, to fund the CDE's portion of the consolidated group of corporations' income tax liability. Under Regulation 1.45D-1(e)(3)(i), a C corporation's distributions to its parent are limited to earnings and profits. Earnings and profits are reduced by federal income taxes. If a C corporation CDE distributed all its earnings and profits to its parent, and made a payment to its parent for its allocable share of income taxes, there is concern that the payment to the parent would be treated as a distribution in excess of earnings and profits. We have provided sample language below and in Exhibit A:

(3) Redemption.

(i) Equity investment in a C corporation. For purposes of paragraph (e)(2)(iii) of this section, an equity investment in a CDE that is treated as a C corporation for Federal tax purposes is redeemed when section 302(a) applies to amounts received by the equity holder. An equity investment is treated as cashed out when section 301(c)(2) or section 301(c)(3) applies to

amounts received by the equity holder. An equity investment is not treated as cashed out when only section 301(c)(1) applies to amounts received by the equity holder. Solely for purposes of subsection (e) of this section, a CDE that is included in a consolidated return shall treat cash payments made to its parent corporation or any members of the consolidated group as a payment of income taxes by the CDE to the extent of the CDE's allocable share of income taxes.

3. Application of the Rehabilitation Tax Credit Safe Harbor, Rev. Proc. 2014-12, to Transactions which Involve the New Markets Tax Credit

In December 2013, the Service published Revenue Procedure 2014-12, providing a "safe harbor" for transactions involving the rehabilitation tax credit in Section 47 of the Code. Two provisions in that revenue procedure have implications for projects that involve the new markets tax credit.

First, Section 4.01 provides that an HTC investor holding an interest in the Master Tenant Partnership may not also invest in the Developer Partnership (other than through an indirect interest in the Developer Partnership held through the Master Tenant Partnership) unless such investment is a separately negotiated, distinct economic arrangement (e.g., a separate arm's length investment into the Developer Partnership to share in allocations of federal new markets tax credits or low income housing tax credits). Second, Section 4.05(3) generally prohibits the Developer Partnership, Master Tenant Partnership or a Principal of either from lending the investor funds used to acquire an interest in the Partnership.

As discussed below, these provisions are discouraging investors from combining HTCs and NMTCs in the same transaction. Based on conversations with IRS and Treasury representatives involved in drafting the revenue procedure, we understand that Section 4.01 and Section 4.05(3) were not intended to have a chilling effect on combining the HTC with the NMTC. Accordingly, we recommend that IRS priority guidance clarify the application of these provisions so as to facilitate their combined use.

Section 4.01

When a single investor invests in a project that generates both NMTCs and HTCs, the investor often contributes NMTC equity and HTC equity to a single investment fund, which combines that equity with the proceeds of a leverage loan ("Leverage Loan") to

the investment fund ("Fund") and contributes the combined proceeds to a certified community development entity ("CDE") that is generally, but not always, unrelated to the Fund or the investor. The CDE, in turn, uses the combined proceeds to make a qualified low-income community investment (either a loan to, or an equity investment in), the Developer Partnership and an equity investment in the Master Tenant Partnership. The HTC and NMTC portions of the transaction are closed simultaneously and the investment attributable to the NMTC and the HTCs flow through the same structure, making it difficult to split the NMTC and HTC pieces into two pieces for purposes of determining that there is separately negotiated, distinct economic arrangement. Moreover, it is unclear what would make an investment in the Developer Partnership "separate and arm's length" where the parties to the HTC and NMTC pieces of the transaction are all the same. The result of this lack of clarity regarding the intent of Section 4.01 has had a chilling effect on investment in combined NMTC/HTC transactions.

Section 4.05(3)

The Leverage Loan, a unique feature of NMTC transactions, is often provided by the Developer Partnership, the Master Partnership, a Principal of either, or a person related to one or more of them. If a Principal of the Developer Partnership makes a Leverage Loan to the Fund (which may be 100% owned by the investor), the proceeds of that Leverage Loan (together with the Fund equity) flow through the CDE into the Developer Partnership, either as a loan or an equity investment. Therefore, through the Leverage Loan, the Principal of the Developer Partnership may be considered to have indirectly loaned to the investor funds that, after being funneled through the CDE, permit the investor to indirectly benefit from the CDE's interest in the Developer Partnership. This possibility has had a chilling effect on the interest of investors in combining HTCs and NMTCs in the same transaction. We believe that the prohibition in Section 4.05(3) was not intended to apply to prohibit such a loan to the investor, or the Fund, even if used in connection with the investor's or the Fund's acquisition of an interest in the Developer Partnership or the Master Tenant Partnership

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Consistent with the foregoing, we request that guidance be issued as follows:

Section 4.01

We request that guidance provide that a qualified low-income community investment made by a CDE in a Developer Partnership shall be considered a separately negotiated, distinct economic arrangement for purposes of Section 4.01 of Revenue Procedure 2014-12 notwithstanding the fact that the HTC investor has an indirect interest in the CDE through the Fund, provided that the CDE's Manager or the Manager's Controlling Entity has management control and/or investment control of the CDE within the meaning of the CDFI Fund's "Certification, Compliance Monitoring and Evaluation Frequently Asked Questions" document dated March 2019, regardless of whether the investor or the CDE also has an investment in the Master Tenant. Alternatively, we request that guidance provide that a qualified low-income community investment made as a loan to the Developer Partnership does not constitute a prohibited "investment" in the Developer Partnership for purposes of Section 4.01 of Revenue Procedure 2014-12.

Section 4.05(3)

We request that guidance provide that a Developer Partnership, a Master Tenant Partnership, a Principal of either, or a related person to any of them may lend funds to an investor or to a Fund to which the investor has contributed equity, provided that the proceeds are invested in a CDE and do not exceed the amount used by the CDE to make a qualified low income community investment in the Development Partnership.

4. Definition of Control

In several comment letters submitted over the years, the NMTC Working Group has recommended changes be made to the CDFI Fund's related party test definition and measurement in order to encourage CDEs to make majority equity investments in qualified active low-income community businesses ("QALICBs"). The CDFI Fund made changes consistent with the NMTC Working Group's recommendations that would allow a CDE to make majority equity interest investments without violating its allocation agreement so long as it had committed to investing substantially all of its proceeds in entities that were considered unrelated before it invested. This change was a significant step and one that the industry applauds the CDFI Fund for making.

However, it is unlikely that many CDEs will make majority interest equity investments because of an issue related to the reasonable expectations test defined in Treasury Regulation §1.45D-1(d)(6). The Regulations provide that if a CDE:

> "…reasonably expects, at the time the CDE makes the capital or equity investment in, or loan to, the entity, that the entity will satisfy the requirements to be a qualified active low-income community business [for the term of the investment…]"

then the QALICB will continue to be deemed a QALICB even if it falls out of compliance at a later time. This provision permits a CDE to avoid suffering a recapture event if the QALICB ceases to qualify as a QALICB during the recapture period for reasons that are outside the control of the CDE.

However, the Regulations further require that if the CDE has or obtains control of the QALICB, it generally must ensure that the entity remains a QALICB for the entire 7-year compliance period and cannot rely on its reasonable expectation at the time the investment is made to avoid a recapture event.

Investors do not want to be subject to strict liability for recapture merely because they acquire a majority equity interest in the QALICB if they do not also have management or voting rights that would allow them to control QALICB status. As a result of the broad definition of "control" under the reasonable expectation test, investors in the current market are unlikely to allow the CDE to acquire a majority equity interest in a QALICB.

If a CDE cannot rely on the reasonable expectation test, investors perceive the compliance risk as too great and most are unwilling to enter into such a transaction. This outcome is unfortunate since equity investments are generally the most patient form of capital and would also reduce the burden of ensuring that the subsidy can remain at the QALICB.

The current definition of control in Treasury Regulation §1.45D-1(d)(6)(ii)(B) states (emphasis added):

> "Control means, with respect to an entity, direct or indirect ownership (based on value) or control (based on voting or management rights) of more than 50 percent of the entity. For purposes of the preceding sentence, the term management rights means the power to influence the management policies or investment decisions of the entity."

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The problem for equity investors is the imputation of control based on “direct or indirect ownership (based on value)”. Currently there is no clear guidance on how to calculate direct or indirect ownership “based on value”. It is unclear to us how value is determined and how it is relevant to whether or not the CDE is controlling the QALICB. We believe that the concept of control should be based solely on the CDE’s ability to control the QALICB’s status as a QALICB through voting or management rights.

It would also be helpful to clarify the meaning of “control” given the variety of possible equity structures and documentation used in New Markets transactions. The potential for confusion is compounded by the fact that the CDFI Fund has adopted its own definitions regarding “control” in the NMTC arena -- definitions that do not necessarily work well for this purpose.

We believe that the only type of control based on voting or management rights that should be of concern in the context of the reasonable expectation test is control based on rights that enable the CDE to either (i) cause the QALICB to take actions that result in the QALICB failing to remain a QALICB, or (ii) allow the CDE to override or block actions by the QALICB when the authority to take such actions is necessary to enable the entity to remain a QALICB. The ability to exercise management or voting control on other issues would not seem to bear on whether the CDE should be allowed to rely on its own reasonable expectation of compliance as a safe harbor.

We note that there are some areas where a CDE’s actions could indirectly affect compliance decisions by the QALICB, and one important example would be the right to remove a general partner of a partnership, the managing member of an LLC, or a majority of the directors of a corporation. Removal rights are commonly required by investors in scenarios in which a CDE is making equity investments in a QALICB. We believe that the existence of such rights in the CDE to remove **for cause** a managing member, general partner, or other party or parties with management control should not, by itself, be deemed to confer voting or management control on the CDE. Where removal is limited to “for cause” events (i.e., failure of the general partner, managing member, or majority of directors to comply with their obligations under the organizational documents), the threat of removal would not represent a mechanism for influencing management decisions that is tantamount to direct management control. Moreover, removal provisions typically contemplate the appointment of a substitute managing member, general partner, or directors, rather than entitling the CDE to manage the QALICB itself. In such a case, so long as the CDE does not actually “control” the substitute management, then the CDE could still satisfy the control test as we have recommended it be changed herein.

Accordingly, we recommend that the definition of "Control" contained in Treasury regulations be updated to remove the reference to a value based test and clarify voting and management rights that should be considered. Specifically, we recommend the following change to Treasury Regulation §1.45D-1(d)(6)(ii)(B):

> "Control means, with respect to an entity, ~~direct or indirect ownership (based on value) or~~ control ~~(based on voting or management rights) of more than 50 percent of the entity based on~~ of voting or management rights that enable the CDE to either (i) cause the QALICB to take actions that result in the QALICB failing to remain a QALICB, or (ii) to override or block actions by the QALICB that are necessary to enable the entity to remain a QALICB.
>
> (a) The existence of rights in the CDE to remove for cause a managing member of a limited liability company, a general partner of a limited partnership, or majority of directors of a corporation by substituting a new managing member, general partner, or majority of directors with control would not, by itself, be deemed to give the CDE 'control' for purposes of this provision."

If these changes are adopted, it is likely that equity transactions could be structured in a manner that would attract investors by successfully addressing the issue of control and providing CDE's with the ability to rely on the reasonable expectations test. Without such a change, it is likely that investors will continue to sit on the sidelines when it comes to investing in CDEs that intend to make equity investments and will continue to effectively prevent the most patient form of capital, equity investments, from being made to QALICBs.

5. Partnership Allocations (IRC section 704(b))

It is currently unclear as to how a partnership allocates NMTCs among its partners. Internal Revenue Code ("IRC") §45D and §704(b) provide no specific reference on how the NMTC should be allocated among partners in a partnership. The NMTC is a unique credit that doesn't generate a readily identifiable expense similar to other credits like the low-income housing tax credit, which subsidizes construction costs that generate depreciation expense. In the absence of current specific guidelines, we believe that NMTCs should be allocated among the partners in a partnership in a manner that is most

consistent with the existing §704(b) partnership allocation regulations. Therefore, the NMTC should be allocated in the same manner as the NMTC basis reduction which in turn should be allocated in the manner agreed to by the partners of the partnership and that is consistent with the partnership allocation safe harbor rules under existing Treasury Regulations. Guidance on this issue would be very helpful, particularly to CDEs seeking to make venture capital investments.

6. De Minimis Rule

Under Treasury Regulation §1.45D-1(d)(5)(iii)(B), a qualified business for a CDE excludes several types of business. The regulation specifically provides:

> (B) Certain other trades or businesses. The term qualified business does not include any trade or business consisting of the operations of any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises.

In IRC Section 1400N, certain tax benefits, including an expansion of available new markets tax credits, were made available to investments made to Gulf Opportunity Zone (GO Zone) properties. In Section 1400N(p)(3)(A)(i), "qualified Gulf Opportunity Zone Property" specifically excluded "any property used in connection with any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises" and such property was not eligible for GO Zone tax benefits. Although applicable only for purposes of Section 1400N(p)(3)(A)(i), in Internal Revenue Bulletin 2006-33, Notice 2006-77, the IRS provided the following guidance: "a taxpayer's trade or business that has less than 10% of its total gross receipts derived from massages, tanning services, or a hot tub facility is not treated as, respectively, a massage parlor, suntan facility, or a hot tub facility." For purposes of this guidance, "only gross receipts from the taxpayer's trade or business activity that includes the massages, tanning services, or hot tub facility are taken into account."

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We recommend that Treasury Regulation §1.45D-1(d)(5)(iii)(B) be revised to incorporate the following language:

> (B) Certain other trades or businesses. The term qualified business does not include any trade or business, (i) from which more than 10 percent of its total gross receipts are derived from, the operations of any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or (ii) consisting of any store the principal business of which is the sale of alcoholic beverages for consumption off premises. In determining whether this 10 percent test is satisfied, only gross receipts from the taxpayer's trade or business activity that includes operations of any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, are taken into account.

We note that this is consistent with the Internal Revenue Bulletin 2006-33, Notice 2006-77, in which the IRS provided similar guidance for properties considered in the GO Zone. We recommend that the additional language mentioned above be added to the Treasury Regulation §1.45D-1(d)(5)(iii)(B) and be applicable to all new markets tax credit properties.

7. 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.

NMTC WORKING GROUP™
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Recommendations for 2020-2021 Priority Guidance Plan
Exhibit A

Proposed Amendments to New Markets Tax Credit Regulations
Treasury Regulation Section 1.45D-1
Pursuant to I.R.C. § 45D(g)(3)(C)
Revisions in Red, Underlined Typeface

(e) Recapture.

(1) In general. If, at any time during the 7-year period beginning on the date of the original issue of a qualified equity investment in a CDE, there is a recapture event under paragraph (e)(2) of this section with respect to such investment, then the tax imposed by Chapter 1 of the Internal Revenue Code for the taxable year in which the recapture event occurs is increased by the credit recapture amount under section 45D(g)(2). A recapture event under paragraph (e)(2) of this section requires recapture of credits allowed to the taxpayer who purchased the equity investment from the CDE at its original issue and to all subsequent holders of that investment.

(2) Recapture event. There is a recapture event with respect to an equity investment in a CDE if—

(i) The entity ceases to be a CDE;

(ii) The proceeds of the investment cease to be used in a manner that satisfies the substantially-all requirement of paragraph (c)(1)(ii) of this section; or

(iii) The investment is redeemed or otherwise cashed out by the CDE.

(3) Redemption.

(i) Equity investment in a C corporation. For purposes of paragraph (e)(2)(iii) of this section, an equity investment in a CDE that is treated as a C corporation for Federal tax purposes is redeemed when section 302(a) applies to amounts received by the equity holder. An equity investment is treated as cashed out when section 301(c)(2) or section 301(c)(3) applies to amounts received by the equity holder. An equity investment is not treated as cashed out when only section 301(c)(1) applies to amounts received by the equity holder. Solely for purposes of subsection (e) of this section, a CDE that is included in a consolidated return shall treat cash payments made to its parent corporation

or any members of the consolidated group as a payment of income taxes by the CDE to the extent of the CDE's allocable share of income taxes.

(ii) Equity investment in an S corporation. For purposes of paragraph (e)(2)(iii) of this section, an equity investment in a CDE that is an S corporation is redeemed when section 302(a) applies to amounts received by the equity holder. An equity investment in an S corporation is treated as cashed out when a distribution to a shareholder described in section 1368(a) exceeds the accumulated adjustments account determined under §1.1368-2 and any accumulated earnings and profits of the S corporation.

(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 or profits interest in the CDE during the taxable year will not be treated as a 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 do- 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. For purposes of this paragraph (e)(3)(iii), with respect to any taxable year, operating income is the sum of:

(A) The CDE's taxable income as determined under section 703, except that—

(1) The items described in section 703(a)(1) shall be aggregated with the non-separately stated tax items of the partnership; and

~~(2) Any gain resulting from the sale of a capital asset under section 1221(a) or section 1231 property shall not be included in taxable income;~~

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(2) Interest income with respect to a loan that is a qualified low-income community investment that is not accrued for federal income tax purposes in connection with a payment default shall be included in the CDE's taxable income up to an amount equal to the CDE's loan loss reserve maintained in compliance with paragraph (d)(3) of this section.

(B) Tax-exempt income under section 103;

(C) Deductions under section 165, but only to the extent the losses were realized from qualified low-income community investments under paragraph (d)(1) of this section;

(D) Deductions under sections 167 and 168, including the additional first-year depreciation under section 168(k) and any other depreciation and amortization deductions under the Code

(E) Start-up expenditures amortized under section 195; and

(F) Organizational expenses amortized under section 709; and

(G) Deductions under Section 162, with respect to expenses incurred by the CDE or the qualified active low-income community business in excess of operating revenues, and

(1) If incurred by the CDE, such expenses are funded by (a) the CDE's loan loss reserve maintained in compliance with paragraph (d)(3) of this section or (b) reserves or financing not funded by qualified equity investments provided to the CDE; or

(2) If incurred by the qualified active low-income community business, such expenses are funded by (a) reserves held by the qualified active low-income community business, or (b) financing provided to the qualified active low-income community business (other than qualified low-income community investments made by the CDE).

Recommendations for 2020-2021 Priority Guidance Plan
Exhibit A

(3) Examples. – The application of paragraph (e)(3)(iii)(F) is illustrated by the following examples:

Example 1. (i) X is a partnership and a CDE that has received a new markets tax credit allocation from the Secretary. Y acquires a qualified equity investment in X. X uses the proceeds of Y's qualified equity investment to make qualified low-income community investments that consist of a loan and an equity investment in B. B is a qualified active low-income community business. X makes the equity investment in B through A which is a wholly-owned subsidiary of X and a disregarded entity for federal income tax purposes. X is a calendar year taxpayer.

(ii) B rents a building to A. A's required annual lease payments of $400,000 are sufficient to cover the annual debt service payments of $350,000 due by B with respect to the loan QLICI and to pay B's operating expenses of $50,000.

(iii) For the year ended December 31, 2008, A has tax losses from operations of $150,000 and is only able to make lease payments of $250,000 to B. B makes the debt service payment of $350,000 to X and pays its operating expenses utilizing $150,000 of reserves held by B. For the year ended December 31, 2008, X's interest income is $350,000 and tax losses from its investment in A are $150,000. Under paragraph (e)(3)(iii)(F)(ii) of this section, $150,000 would be added to X's operating income for the year ended December 31, 2008.

Example 2. The facts are the same as in Example 1 except that A borrows $150,000 from a lender and uses the loan proceeds to make the $400,000 lease payment to B. B makes the debt service payment of $350,000 to X. Under paragraph (e)(3)(iii)(F)(ii) of this section,

$150,000 would be added to X's operating income for the taxable year ended December 31, 2008.

(iv) Solely for purposes of calculating a redemption under paragraph (e)(3) of this section, cash distributions made by the due date (including extensions) of a CDE's federal income tax return shall, at the election of the CDE, be treated as made in the prior taxable year.

Recommendations for 2020-2021 Priority Guidance Plan

Proposed Amendments to New Markets Tax Credit Regulations
Treasury Regulation Section 1.45D-1
Pursuant to I.R.C. § 45D(b)(1)(B)
Revisions in Red, Underlined Typeface

(2) Payments of, or for, capital, equity or principal.

(i) In general. Except as otherwise provided in this paragraph (d)(2), amounts received by a CDE in payment of, or for, capital, equity or principal with respect to a qualified low-income community investment must be reinvested by the CDE in a qualified low-income community investment no later than 12 months from the date of receipt to be treated as continuously invested in a qualified low-income community investment. For purposes of determining if a distribution from an equity investment is a payment of, or for, capital or equity, rules similar to the rules for determining whether a redemption occurred in accordance with paragraph (e)(3) shall apply as appropriate given the type of entity making the distribution to the CDE. If the amounts received by the CDE are equal to or greater than the cost basis of the original qualified low-income community investment (or applicable portion thereof), and the CDE reinvests, in accordance with this paragraph (d)(2)(i), an amount at least equal to such original cost basis, then an amount equal to such original cost basis will be treated as continuously invested in a qualified low-income community investment. In addition, if the amounts received by the CDE are equal to or greater than the cost basis of the original qualified low-income community investment (or applicable portion thereof), and the CDE reinvests, in accordance with this paragraph (d)(2)(i), an amount less than such original cost basis, then only the amount so reinvested will be treated as continuously invested in a qualified low- income community investment. If the amounts received by the CDE are less than the cost basis of the original qualified low-income community investment (or applicable portion thereof), and the CDE reinvests an amount in accordance with this paragraph (d)(2)(i), then the amount treated as continuously invested in a qualified low-income community investment will equal the excess (if any) of such original cost basis over the amounts received by the CDE that are not so reinvested. Amounts received by a CDE in payment of, or for, capital, equity or principal with respect to a qualified low-income community investment during the seventh year of the 7-year credit period (as defined in paragraph (c)(5)(i) of this section) 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.

Example: CDE A makes an equity investment in a partnership. The investment is a qualified low-income community investment in a qualified active low-income community business. The qualified business makes a distribution to CDE A. The

distribution will not be considered a return of capital for reinvestment consideration if either the distribution does not exceed the partnership's operating income (as defined in the regulations pursuant to Reg. 1.45D-1(e)(3)) for the taxable year) or the distribution and all prior distributions do not exceed the partnership's cumulative operating income for all years.