

Part I

Section 45D.--New Markets Tax Credit

26 CFR 1.45D-1T: New markets tax credit.

Rev. Rul. 2003-20

ISSUE

For purposes of determining the new markets tax credit allowable under § 45D of the Internal Revenue Code, does the amount of the qualified equity investment made by a limited liability company (LLC) classified as a partnership include cash from a nonrecourse loan to the LLC that the LLC invests as equity in a qualified community development entity?

FACTS

In Year 1, CDE, a qualified community development entity under § 45D(c), receives a new markets tax credit allocation of \$2,000_x from the Secretary of the Treasury. In Year 2, X, a widely-held C corporation, contributes \$792_x for a 99-percent member interest in LLC, a limited liability company that is classified as a partnership for federal tax purposes. Y, a widely-held C corporation, contributes \$8_x for a 1-percent managing member interest in LLC. LLC borrows \$1,200_x from Bank, an unrelated third party. LLC contributes \$2,000_x for an equity interest in CDE, which is a limited liability company classified as a partnership for federal tax purposes. CDE designates LLC's equity investment in CDE as a qualified equity investment under § 45D(b)(1)(C).

The \$1,200_x loan from Bank is a nonrecourse liability that is characterized as indebtedness of LLC for federal tax purposes. The loan is secured only by LLC's interest in CDE. The loan is not secured by any assets of CDE. The full amount of the loan is repayable at the end of Year 9. The loan is not convertible into an equity interest in LLC.

On April 1 of Year 2, CDE lends the \$2,000_x to a qualified active low-income community business, as defined in § 45D(d)(2)(A). This \$2,000_x loan is repayable in full at the end of Year 9. Interest payments received by CDE from the qualified active low-income community business are distributed to LLC. X and Y retain their membership interests in LLC, and LLC retains its \$2,000_x equity investment in CDE, until the end of Year 9. The entire \$2,000_x loan by CDE remains outstanding, and the borrower continues to qualify as a qualified active low-income community business, until the end of Year 9.

LLC claims its qualified equity investment in CDE is \$2,000 \times on each credit allowance date and allocates the new markets tax credit with respect to this amount to X and Y in accordance with § 704(b).

LAW

Section 45D(a)(1) provides that for purposes of § 38, in the case of a taxpayer who holds a qualified equity investment on a credit allowance date (as defined in § 45D(a)(3)) of the investment which occurs during the taxable year, the new markets tax credit determined under § 45D for the taxable year is an amount equal to the applicable percentage (as defined in § 45D(a)(2)) of the amount paid to the qualified community development entity for the investment at its original issue. Section 7701(a)(14) defines the term “taxpayer” to mean any person subject to any internal revenue tax. Section 7701(a)(1) provides that the term “person” shall be construed to mean and include an individual, a trust, estate, partnership, association, company or corporation.

Section 45D(b)(1) defines the term “qualified equity investment” as any equity investment in a qualified community development entity if (A) the investment is acquired by the taxpayer at its original issue (directly or through an underwriter) solely in exchange for cash, (B) substantially all of the cash is used by the qualified community development entity to make qualified low-income community investments, and (C) the investment is designated for purposes of § 45D by the qualified community development entity.

Section 45D(b)(2) provides that the maximum amount of equity investments issued by a qualified community development entity which may be designated under § 45D(b)(1)(C) by the entity shall not exceed the portion of the limitation amount allocated under § 45D(f) to the entity.

Section 45D(b)(6) defines the term “equity investment” as (A) any stock (other than nonqualified preferred stock as defined in § 351(g)(2)) in an entity that is a corporation, and (B) any capital interest in an entity that is a partnership.

Section 45D(c)(1) defines the term “qualified community development entity” as any domestic corporation or partnership if (A) the primary mission of the entity is serving, or providing investment capital for, low-income communities or low-income persons, (B) the entity maintains accountability to residents of low-income communities through their representation on any governing board of the entity or on any advisory board to the entity, and (C) the entity is certified by the Secretary for purposes of § 45D as being a qualified community development entity.

Section 45D(d)(1) defines the term “qualified low-income community investment” as (A) any capital or equity investment in, or loan to, any qualified active low-income community business, (B) the purchase from another qualified community development entity of any loan made by the entity which is a qualified low-income community investment, (C) financial counseling and other services specified in regulations

prescribed by the Secretary to businesses located in, and residents of, low-income communities, and (D) any equity investment in, or loan to, any qualified community development entity. Section 45D(d)(2)(A) defines the term “qualified active low-income community business” as any corporation or partnership that satisfies the requirements of § 45D(d)(2)(A)(i) through (v).

ANALYSIS

Section 45D(b)(1)(A) requires that a qualified equity investment be acquired by the taxpayer solely in exchange for cash. Section 45D does not prohibit a taxpayer (including any taxpayer who is a person as defined under § 7701(a)(1)) from using cash derived from a borrowing, including nonrecourse borrowing, to make a qualified equity investment in a qualified community development entity. The facts of this revenue ruling state that the loan from Bank is characterized as indebtedness of LLC for federal tax purposes. The loan proceeds and the contributions by X and Y to LLC are used by LLC to make an equity investment of \$2,000x in CDE. The requirements of § 45D(b)(1)(A) are satisfied because LLC acquires its investment in CDE at its original issue solely in exchange for cash. The requirements of § 45D(b)(1)(B) are satisfied because CDE uses the entire equity investment of \$2,000x to make a qualified low-income community investment. The requirements of § 45D(b)(1)(C) are satisfied because CDE designates the equity investment of \$2,000x for purposes of § 45D. Accordingly, LLC is treated as having made a qualified equity investment of \$2,000x in CDE when LLC acquires its equity interest in CDE. LLC may claim a new markets tax credit on each credit allowance date in an amount determined under § 45D that is equal to the applicable percentage of the \$2,000x qualified equity investment in CDE. LLC may allocate to X and Y the amount of the new markets tax credit that LLC claims with respect to the \$2,000x qualified equity investment. This allocation must be made in accordance with § 704(b) (which provides rules regarding a partnership’s allocation of income, gain, loss, deduction, or credit (or item thereof) among the partners).

HOLDING

Under the facts of this revenue ruling, for purposes of determining the new markets tax credit allowable under § 45D, the amount of the qualified equity investment made by an LLC classified as a partnership includes cash from a nonrecourse loan to the LLC that the LLC invests as equity in a qualified community development entity.

DRAFTING INFORMATION

The principal author of this revenue ruling is Michael J. Goldman of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling contact Mr. Goldman on (202) 622-3080. For information regarding issues under § 45D contact Gregory N. Doran of the Office of Associate Chief Counsel (Passthroughs and Special Industries) on (202) 622-3040. These are not toll-free calls.