

NEW MARKETS TAX CREDIT COALITION

August 31, 2006

CC:PA:LPD:PR (Notice 2006-60)
Room 5203
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Dear Madam/Sir:

I am writing on behalf of the New Markets Tax Credit (NMTC) Coalition, to submit comments on Internal Revenue Notice (IRS) 2006-60 which provides guidance on how a business entity can be deemed a Qualified Active Low-Income Community Business (QALICB) under the New Markets Tax Credit program's Targeted Population designation under IRC Section 45D(e)(2).

The Coalition appreciates the opportunity to submit comments on the guidance and would like to commend the IRS and the CDFI Fund for crafting guidelines that protect the legislative intent of the Targeted Populations allowance.

The Coalition was the principal proponent of amending the statutory definition of low-income community to include Targeted Populations in addition to geographically defined low-income communities. This change was particularly important for community development entities (CDEs) working in rural communities where pockets of poverty are not apparent when looking strictly at the poverty rate or area median gross income of a census tract. The strict census tract targeting also created a problem for CDEs in urban areas where a business may be located just outside of a qualified low-income census tract through the business will clearly benefit a low-income population through employment and/or services.

Expanding the definition of low-income community to include Target Populations provides important flexibility to CDEs while at the same time preserving the principal objective of the NMTC, which is to increase private investment in businesses and economic development projects that benefit low-income communities and individuals.

The Coalition's comments on the guidance are directed both to the IRS as well as to the CDFI Fund and include recommendations on how the guidance should relate to the NMTC Allocation Application as well as the Allocation Agreement. The Coalition's comments fall into five basic categories:

- 1) Recommendations regarding the three-part Qualified Active Low-Income Community Business (QALICB) test;
- 2) Suggested proxies for documenting QALICBs with respect to Targeted Populations;
- 3) Suggested thresholds to measure "high distress" for QALICBs that benefit a Targeted Population;
- 4) Recommendation that all CDEs making QLICIs in the GO Zone be able to take advantage of the GO Zone Target Population criteria; and
- 5) Amending Allocation Agreements to accommodate QLICIs with respect to Targeted Populations.

1) Recommendations regarding the three-part QALICB test

The Coalition supports requirements that the guidance puts in place for QALICBs with regard to low-income Targeted Populations. We have several recommendations that are designed to strengthen the QALICB tests, guard against abuse and ensure that the rule allows CDEs to effectively serve low-income people.

First, within the ownership test there needs to be an accommodation for non-profit businesses that are not individually owned. There are non-profit businesses with governing boards that include low-income individuals as well as individuals that are representatives of a low-income community. A non-profit business entity should be able to satisfy the QALICB ownership test if at least 25 percent of its board, with a minimum of two board members, is low-income individuals or represent a low-income Target Population.

Second, with regard to the gross income test as well as the employee test, there must be an accommodation for start-up or expanding businesses looking to satisfy the QALICB requirement for Targeted Population. Current NMTC regulations, Section 1.45D(d)(4)(iv), accommodate the needs of start-up businesses in meeting the 'active conduct' test by requiring that a CDE, at the time they make a QLICI, reasonably expects that the entity will generate revenues within three years after the date the QLICI is made. This three-year 'reasonable expectation' period will be critical to CDEs that invest in start-up or expanding QALICBs with respect to satisfying the gross income or employee tests related to Targeted Populations. Such CDE would be expected to certify that they reasonably expect that within three years of making a QLICI, the new or expanding entity will meet the requirements of the gross income or the employee test as required of QALICBs with respect to Targeted Populations. While we believe the Notice allows for a QALICB benefiting a Targeted Population to take advantage of the 'reasonable expectation' period as provided in current regulations, we urge the IRS to clarify this point for the sake of CDEs and investors.

2) Suggested proxies for documenting QALICBs with respect to Targeted Populations

The Coalition recommends that the Fund consider accepting participation in other Federal programs targeted specifically to low-income individuals and families as a proxy for meeting QALICB requirements for low-income Targeted Populations. This would significantly ease the burden of compliance for CDEs and the administrative burden for the CDFI Fund.

Using such eligibility proxies would be particularly useful to CDEs that are investing in community facilities as QALICBs. Many of these community facilities – which include day care centers, charter schools and community health centers - provide services to low-income families and individuals that are beneficiaries of Federal assistance programs and thus already collect information regarding income and eligibility.

Under the NMTC a low-income individual is defined as an individual with a family income that is at or below 80 percent of the area median family income. However, many of the Federal eligibility guidelines look to the family income as it compares to the federal poverty guidelines. Therefore it is important to note that the national median family income for a family of four in FY2006 is \$59,600 – meaning a family at 80% of the area median would have an income of \$47,680. This income corresponds to roughly 238% of the Federal Poverty Guidelines according to HHS for a family of four – a difference sufficiently great to accommodate variations in area median incomes from the national level.

The following is a list of Federal programs that target low-income individuals and families and are therefore consistent with the targeting objectives of NMTC. All of the programs listed have eligibility guidelines targeting families with incomes that are between 100% to 200% of the national poverty rate. This is not intended to be a complete list of Federal proxies but rather an illustrative list that includes programs that many CDEs, particularly those with non-profit parents, are familiar with and utilize in providing services to low-income communities and populations.

Department of Agriculture - National School Lunch Program (42 USC 1751 et seq.)

Department of Agriculture – Food Stamp Program (7 USC 2011 et seq.)

Health and Human Services – Community Health Centers (42 USC 254b)

Health and Human Services – Medicaid (42 USC 1396a)

Health and Human Services – Child Care and Development Block Grant (42 USC 9858).

Department of Treasury – Worker Opportunity Tax Credit (IRC Sec. 51)

There are also state and local assistance programs targeted to low-income individuals, including child care subsidies and school vouchers, which we encourage the Fund to consider using as proxies.

Documenting the employee test in a manner that will satisfy a NMTC investor while at the same time not placing an unreasonable burden on a QALICB employer is a significant challenge. We suggest looking to the Worker Opportunity Tax Credit (WOTC) as a model system that the IRS

already has in place to monitor compliance. The WOTC statute (IRC Sec. 51) includes a list of federally defined categories of economic distress that includes individuals that are long-term TANF recipients, Supplemental Security Income recipients, Food Stamp recipients and select residents of a federally designated Enterprise Zone or Empowerment Community. In order to take advantage of the WOTC an employer must fill in a form to verify that they employ individuals that belong to at least one of these “targeted groups”. We suggest that a similar form be developed for the NMTC program to verify that a QALICB’s employees are low-income at the time they are hired, either by using some form of proxy such as WOTC eligibility, TANF, or simply verifying that the employees’ incomes do not exceed 80% of the median income. The Coalition would like to work with the IRS and the CDFI Fund in developing a system that meets the needs of CDEs, QALICBs, and investors.

3) Suggested thresholds to measure “high distress” for QALICBs that benefit a Targeted Population

In applying for an allocation of Credits, a CDE applicant is asked to indicate what percentage of its QLICIs will be used to finance activities that are in one or more areas of economic distress as defined by the Fund. The Round IV application listed 14 indicators of community economic distress. According to the Fund’s Round IV debriefing document, a successful applicant indicated that at least 80% of its activities would be provided to geographic areas of high distress and they would commit that 75% of its activities would be in specific areas of high economic distress.

The Fund should develop a set of criteria designed for CDEs that plan to invest in QALICBs that target benefits to “high distress” Targeted Populations. These thresholds need to ensure that CDEs using the Targeted Populations allowance will be able to compete successfully in the allocation process with CDEs that are strictly targeting QLICIs to census tracts with high levels of economic distress.

The Coalition suggests that there are two ways through which a QALICB benefiting a Targeted Population can demonstrate that it is exceeding the baseline targeting requirements and reaching a higher economic distress benchmark – either by benefiting a greater percentage of low-income individuals or by benefiting individuals with a higher level of poverty than required by law.

The Coalition recommends that a QALICB demonstrate that it is targeting a greater percentage of low-income individuals by meeting one or more of the following tests which exceed the baseline QALICB thresholds:

(i) at least 60% of the entity’s total gross income for any taxable year is derived from sales, rentals, services, or other transactions with individuals who are low-income persons for purposes of Sec. 45hD(e)(2);

(ii) at least 50% of the entity’s employees are individuals who are low-income persons for purposes of Sec. 45D(e)(2); or

(iii) at least 60% of the entity is owned by individuals who are low-income persons for purposes of Sec. 45D(e)(2).

A CDE could also demonstrate that it is reaching a “higher distress” Target Population by documenting that a percentage of the individuals being served are individuals with a higher level of poverty than required by law. A QALICB could be asked to satisfy at least one of the following:

(i) at least half of the entity’s low-income employees are members of a ‘targeted group’ as defined by the Worker Opportunity Tax Credit (WOTC); or

(ii) at least 10% of the Targeted Population with respect to gross income, employees or ownership consisted of individuals whose income in the prior tax year was 70% or less of the area median gross income as opposed to the baseline 80%.

Finally, while not a measurement of “high distress”, a QALICB that provides increasing wages, incomes, and benefits to its low-income employees is going above and beyond what is required by law and applicant CDEs that plan to invest in such QALICBs should be able to secure a competitive edge in the application process. We recommend that the Allocation Application be amended to include a question directed specifically to CDEs that plan to invest in QALICBs that will employ low-income persons. The question could be an expanded version of Question 33(b) from the Round IV allocation application which asked about increasing wages and incomes for low-income employees. CDE applicants would be asked to describe the wages and other benefits that its QALICB investees would provide to low-income employees. CDE applicants could also be asked to describe what if any systems its QALICB investees had or would put in place to advance low-income employees and move them up on a career ladder.

4) Recommend that all CDEs making QLICIs in the GO Zone be able to take advantage of the GO Zone Target Population criteria

The Coalition suggests that the guidance is too restrictive in limiting the “GO Zone Targeted Population” allowance only to CDEs that receive an allocation pursuant to the Gulf Opportunity Zone Act of 2005.

There has been very little NMTC activity in Mississippi or Alabama to date. Of the 13 Allocatees awarded \$600 million in Credits targeted to the GO Zone in May, 2006 only one is based in Mississippi and none in Alabama. That said, there are a number of regional and national CDEs committed to using their NMTC allocations in the GO Zone though their allocations were not derived from the \$1 billion reserved for the region.

In order to encourage activity in the GO Zone, we suggest that any CDE that invests in a QLICI in the GO Zone, whether or not the CDE is using an allocation derived from the \$1 billion provided through the Gulf Opportunity Zone Act of 2005, should be allowed to target the benefits of its investments to the “GO Zone Targeted Population”.

5) Applying the Targeted Population guidance to CDEs with signed or pending Allocation Agreements

The guidance indicates that taxpayers can apply the Targeted Population guidance and the QALICB requirements for low-income Targeted Populations to all QLICIs made on or after October 22, 2004 which is the date that the American Jobs Creation Act of 2004 was signed into law.

However, NMTC Allocatees that have signed Allocation Agreements (AAs), including all Round I, II, and III Allocatees, are held to the requirements of their AAs which make no allowance for Targeted Populations. These existing AAs require that an Allocatee direct a designated percentage of its QLICIs to certain areas of high economic distress geographic areas and there is no accommodation made for Allocatees that may now choose to target a percentage of the QLICIs to Target Populations of high distress. We understand that these NMTC Allocatees are eligible to make investments in or loans to qualified businesses for low-income Targeted Populations, but must continue to satisfy the geographic area based high distress requirements.

The Coalition encourages the Fund to allow Allocatees to revise existing Allocation Agreements and accommodate plans for taking advantage of the Targeted Populations guidance. We also encourage the Funds to consider this issue as they negotiate Round IV Allocation Agreements with new Allocatees.

Thank you for the opportunity to comment on the Targeted Population guidance. I hope the Coalition's suggestions are useful as you move forward in refining the guidance and developing a system for documenting compliance. The Coalition is committed to working with the IRS and others on the Treasury Department's New Markets Tax Credit team to develop these systems and see the Targeted Population guidance put into practice.

I would be happy to follow up on any questions you might have regarding this letter or other issues related to Targeted Populations.

Sincerely,



Robert A. Rapoza

cc: Arthur Garcia, CDFI Fund