



CC:PA:LPD:PR (REG-114206-11)
Room 5205
Internal Revenue Service
PO Box 7604
Ben Franklin Station
Washington, DC 20044

Dear Madam/Sir:

We are writing in response to the IRS' Advanced Notice of Proposed Rulemaking (ANPR) requesting suggestions on how to amend the New Markets Tax Credit (NMTC) (IRC Section 45D) program regulations to encourage non-real estate investments.

Cohen & Company, Ltd and Ariel Ventures, LLC (Cohen-Ariel) is a joint venture full service tax credit syndication and consulting firm. We have been consulting QALICBs, CDEs, and investors since the NMTC program originated back in 2001 and have provided CPA tax and audit services, deal structuring, financial and compliance advisory services for over \$1.5 billion in NMTC, historic tax credits (HTCs), renewable energy credits, and other public-private financing transactions. In addition to our consulting services, we jointly own a CDE that has received \$95 million in NMTC allocation, so we are particularly interested in this new proposed regulation.

In response to the proposed regulation, below we have addressed the specific questions posed by the IRS and the Department of Treasury. We also offer our own recommendations for your consideration.

A. Streamlined Substantiation Requirements for Second Tier CDEs Making Small Loans to Non-Real Estate Businesses.

1. Would simplifying the substantiation requirements in the manner proposed facilitate greater new markets tax credit investment in non-real estate businesses? Are there other areas where §1.45D-1 could be modified to achieve a similar outcome?

The ANPR referenced simplifying the substantiation rules in cases where the second CDE uses the NMTC proceeds to make smaller-sized loans to non-real estate businesses. In this case, neither the second CDE nor the non-real estate business receiving the NMTC proceeds is affiliated with the primary CDE or the qualified equity investment investors; and the second CDE demonstrates that, at the time of initial investment in the non-real estate business, the non-real estate business receiving the NMTC proceeds met some basic qualifying requirements.

We do not feel that this approach would adequately address investor risk up front in the NMTC transaction and, as such, the primary CDE still would incur costs to ensure the NMTC investor is adequately protected.

Even if the second CDE's substantiation requirements were simplified, the primary CDE would be obligated to the investor to ensure the second CDE met the substantially-all test. This would result in additional fees to the primary CDE in order to do so.

An alternate approach would be to provide a safe harbor provision that the primary CDE could meet upon deployment of the initial qualified equity investment. The safe harbor provision would provide the investor with more certainty regarding the recapture risk. This safe harbor is explained in greater detail in the recommendations section of this comment letter.

2. The Treasury Department and the IRS believe that, if there is to be a simplification of the substantiation requirements for these transactions, there may need to be a cap on the total transaction size. Is \$250,000 the appropriate cap to put on the initial loan size? Should special considerations be made for follow-on investments and/or lines of credit? For example, should there be a cap on the total aggregate investment in one business? If so, what should that cap be?

We do not feel that putting a cap on the total transaction size to allow for simplified substantiation requirements would yield the desired result as intended by the provision. The intention of the proposed regulation is to encourage greater use of NMTC in non-real estate businesses. By inserting a cap on the transaction size, it may make it more difficult for CDEs to deploy NMTC investments into non-real estate businesses, because the pool of eligible businesses may be substantially reduced by this limitation. In addition, based on the up-front fees (costs) associated with NMTC deals, it is cost prohibitive to fund very small deals that would fall under the cap. Providing the simplified substantiation provisions would alleviate a portion of the up-front costs, but would not eliminate a substantial portion of the legal, consulting, and accounting costs associated with the development of the complex financial structures seen in most NMTC deals. In addition, there are significant ongoing compliance costs during the seven-year credit period that would not be significantly impacted by the introduction of the simplified substantiation provisions.

Also, as stated above, unless a safe harbor provision is created, the primary CDE still will incur costs on future deployments in order to provide investors with certainty regarding the risk of recapture.

3. What are the appropriate minimum requirements that a non-real estate business should satisfy in order for the second CDE to be able to take advantage of the simplified substantiation requirements (for example, the business must be located in a low-income community, employ community residents, etc. at the time of initial investment)? How should this be measured (for example, that substantially all of the real property is located in a low-income community)?

We believe that second CDEs should satisfy the same requirements as primary CDEs. Providing a lower threshold of program requirements to a smaller size of loans may result in abuse of the program.

4. Should the Treasury Department and the IRS consider additional limitations (other than those specified) on unaffiliated CDEs or businesses? For example, should the regulations require that the second CDE be a non-profit entity or the affiliate of a non-profit entity?

We do not believe the treasury department/IRS should consider additional limitations on unaffiliated CDEs or businesses. Doing so may decrease the size of eligible CDEs for this program.

B. Encouraging Equity Investments in Non-Real Estate Businesses.

1. What non-statutory requirements in §1.45D-1 can be revised to encourage CDEs to make equity investments in non-real estate businesses?

Modifying the applications and allocation agreements to provide for a certain threshold or percentage of loans/investments to non-real estate businesses would result in greater activity in this area. The applications/allocation agreements drive the type of activity that treasury desires because it holds CDEs to specific standards. Providing greater weight for CDEs that provide loans/investments to non-real estate businesses would result in an obligation for CDEs to provide capital to non-real estate businesses.

2. If consideration is given to potential changes to the reasonable expectations test of §1.45D-1(d)(6)(i), what modifications would be most effective in encouraging equity investments in non-real estate businesses, while still preserving the purpose of the existing limitations on the reasonable expectations test?

Regulation §1.45D-1(d)(6)(ii) results in significant costs to CDEs if they make equity investments, because they would be required to continue to ensure that the business of the qualified low-income community investment remained a qualified active low-income community business during the seven-year credit period.

We recommend removing indirect ownership from the definition of control under §1.45D-1(d)(6)(ii)(B). This would allow CDEs to make equity investments in a QALICB and still not meet the definition of control. In addition, we recommend safe harbors specifying that non-voting ownership would not result in control regardless of the percentage such ownership may constitute of the overall ownership of the QALICB.

We also recommend that the percentage of ownership be increased to 80% under §1.45D-1(d)(6)(ii)(B). This increase in ownership percentage would exclude a significant number of CDEs from having to apply the rules under §1.45D-1(d)(6)(ii)(A).

The intention of the reasonable expectations rule, which is to put the responsibility on the CDE as it relates to the qualifications of the QALICB, falls more in line with the restrictions under §1563(controlled group rules) rather than the related party rules under §267.

Cohen-Ariel Recommendations:

We respectfully submit the following recommendations regarding this provision:

Reducing investor risk:

One of the issues with using NMTC to invest in operating businesses is the risk of recapture due to amortizing loans. Investor risk increases the fees involved in providing investors with protection against recapture.

To provide the investor with more certainty, we recommend that a safe harbor provision be added to the proposed regulation. The safe harbor provision would provide that the substantially-all test would be met if:

1. The CDE satisfies the substantially-all requirements under Treas. Reg. §1.45D-1(c)(5) upon the initial qualified equity investment into a non-real estate business, and
2. Amounts received by the CDE as a return of capital, equity, or principal must be reinvested or held by the CDE during the remaining seven-year credit period.

Applying the safe harbor provision up front and throughout the entire seven-year credit period would provide the investor with greater protection and confidence that risk of recapture would not occur. It also would provide the CDE with the flexibility of using other investment vehicles to allow the leveraged model to be used for transactions with non-real estate businesses.

Increasing Investor Pool:

In order for CDEs to encourage investment in non-real estate NMTC transactions, there will be a need to expand the current investor pool. This will allow investors with appetites for smaller tax credit transaction deals as well as venture capital funds to participate in the NMTC program. The main restriction that has prevented these types of investors in participating in the NMTC program is the AMT.

In order to expand the investor pool, modifications will need to be made to allow NMTC to be offset against AMT. We recommend that modification is made to §38(c)(4)(B) to include NMTC. Below is the specific text to modify.

x. the credit determined under section 45D

Additionally, for venture capital funds where the owner/members/partners are comprised of both taxpaying investors and tax-exempt investors, providing an exception that allows the fund to specially allocate the NMTC to taxable “partners”—without violating the substantially-all test, as

long as reductions in basis are reflected in the partners capital—would encourage mixed investor funds to participate in NMTC deals.

Sinking Fund:

If the regulations could provide that the QALICB itself could establish a sinking fund at the CDFI, which would be used at the end of the credit period to retire the loans from the CDE, and allow a third-party leverage lender to maintain a security interest in this sinking fund, that situation could expand the lending efforts by CDEs to non-real estate QALICBs. This would require regulations to exclude such sinking fund from the non-financial assets calculation.

We appreciate the opportunity to submit these comments. We commend the IRS and the Department of Treasury’s efforts in providing this proposed regulation with the hopes of increasing the NMTC program to non-real estate businesses. We look forward to working with IRS on future discussions regarding this specific provision and other items related to the NMTC program.

Very truly yours,

COHEN & COMPANY, LTD.
Certified Public Accountants


ARIEL VENTURES, LLC



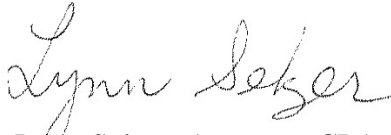
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