NEW MARKETS TAX CREDIT COALITION

July 21, 2009

Internal Revenue Service
Room 5203
PO Box 7604
Ben Franklin Station
Washington DC 20044

Re: Request for Guidance regarding Portfolio Credit

On behalf of the New Markets Tax Credit Coalition, a 150-member organization that advocates on behalf of the New Markets Tax Credit ("NMTC") Program, we request that the Internal Revenue Service issue guidance regarding the treatment under the passive activity rules of Internal Revenue Code Section 469 of tax credits generated by the New Markets Tax Credit Program, Internal Revenue Code Section 45D.

The purpose of the New Markets program is to promote the flow of private sector capital to low income communities. Under the NMTC Program, Community Development Entities (CDEs) are the investment vehicle. A CDE can be a partnerships or a limited liability corporation, and is typically affiliated with a non-profit or for-profit entity with a history of lending or investing in low income communities. CDEs seek allocations of New Markets Tax Credits from the CDFI Fund. Upon receiving an allocation, a CDE markets to the Credits to federal income taxpayers. Upon receiving an investment from a taxpayer, the CDE uses the funds to make a qualified investment – loans or equity investments -- to a qualified business in a low income community.

From its first award round in 2002 through the present, the NMTC program has been able to generate $13.7 billion in investment activity. It is a testament to the power of this tax credit that investments in businesses in low income communities have proceeded so quickly. However, with the economy suffering, CDEs are trying to broaden their investor base to attract new investors to the program. The new investor groups include S Corporations and individuals. Their interest in participating in the program is diminished by the lack of guidance in this area.

<u>Passive Activity Guidance Request</u>
Internal Revenue Code ("IRC") Section 469 limits the ability of certain taxpayers to use losses and tax credits generated from passive activities. However, it is currently unclear as to how the passive activity rules apply to NMTCs generated from an investment in a Community Development Entity ("CDE"). If the CDE is a C corporation, then presumably the NMTC would be a portfolio credit, as dividends generated from the C corporation would be portfolio income, and gains or losses from the sale of C corporation stock would be portfolio gains or losses.

The question is more complicated if the CDE is a flow-through entity. We believe that since the credit is generated through investment in a CDE, and the act of investing is a portfolio activity, the credit is not a passive activity credit. The type of activity the CDE is engaged in should not impact its treatment, under Section 469, even if the CDE is a flow-through entity.

Although some might argue that directly tracing the investment made to the qualified active low-income businesses to determine the nature of the activity would yield the most exact answer, we believe the most exact answer is the credit should not be considered a passive activity credit. Unlike the low-income housing tax credit or the investment tax credit, the NMTC arises from the investment in a CDE, not from activity of the underlying business. This view also avoids the logistical nightmare and the increased administrative and financial burden of the CDE that would result if the use of the investment by the CDE impacted the determination.

The NMTC Coalition believes that guidance is needed from the IRS regarding the treatment of the NMTC as an active credit, passive credit or portfolio credit. In order to create increased interest in the NMTC, we recommend that the IRS consider characterizing the NMTC as a portfolio credit. Since the NMTC program is designed to spur investment activity, treatment of the NMTC as a portfolio credit in all circumstances would be consistent with the objectives of the NMTC Program.

Please do not hesitate to contact us if you have any questions regarding our request.

Sincerely,

Robert A. Rapoza

CC: NMTC Coalition Board of Directors
Donna J. Gambrell, Director, CDFI Fund
Matthew Josephs, Program Manager, NMTC Program, CDFI Fund
Paul Handelman, Esq.