

NEW MARKETS TAX CREDIT COALITION

March 23, 2010

Michael Mundaca
Acting Assistant Secretary for Tax Policy
U.S. Department of Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Dear Secretary Mundaca:

I write to follow-up on our recent meeting on the New Markets Tax Credit. The New Markets Tax Credit Coalition appreciates the Administration's support of the Credit and the efforts of Secretary Geithner and the Department of the Treasury to support this important revitalization tool for urban and rural America.

In his announcement of February 19, 2010, the Secretary noted that :

“ The seven-year term of the NMTC matches poorly with the length of typical small business loans, which are usually much shorter in duration. Because current rules generally require that CDEs have “substantially all” of their NMTC investments be deployed at all times, they are hesitant to make investments that must be paid “early.”

We agree with the Secretary.

The principal barrier preventing more NMTC investing in operating businesses is the seven-year term of NMTC. The 7-year term, coupled with reinvestment and ‘substantially all’ requirements(IRC 45D -1(c)(5)), create a risk that investors are unwilling to take, thus limiting a CDE's ability to offer the flexible financing products that operating businesses need and that are becoming more difficult to secure through conventional lenders.

Operating businesses customarily need financing for loans or investments with terms shorter than the 7-year NMTC credit period. However, in cases in which principal is returned or repaid to a CDE during the seven-year Credit period, a CDE is required to redeploy that capital within a certain specified time period or trigger recapture. The pressure and uncertainties related to reinvestment of principal on strict time limits has given investors pause and steered them away from CDEs financing operating businesses.

The Coalition believes it is critical that Treasury intentionally target the needs of all ‘operating businesses’ and not just ‘small businesses’ in part because there is no agreed upon definition of “small business” but also so CDEs can respond to the full range of businesses needing capital whether it be a \$500,000 loan to a timber mill in rural West Virginia to purchase equipment or a \$5,000,000 line of credit to a specialty foods venture in Portland, Maine that had its bank credit line cancelled and is unable to finance inventory. Our intent is to find ways that CDEs and

investors can work to direct NMTC financing to operating businesses, specifically non-real estate businesses as defined by the CDFI Fund.

To facilitate this, we ask that Treasury provide a special rule, or safe harbor protection, for any CDE organized to make Qualified Low Income Community Investments (QLICIs) in operating businesses (Qualified Active Low Income Community Businesses or QALICBs). This would include CDEs with amended operating agreements as well as newly formed entities. To take advantage of the special rule of safe harbor protection, a CDE would have to:

- 1) Satisfy the substantially all test as defined in paragraph 1.45D-1(c)(5), with the initial deployment of the Qualified Equity Investment into one or more QLICIs made in one or more QALICBs as long as the operating business was established for a purpose other than the developing or leasing of a real estate project or projects; and
- 2) Any amounts received by the CDE as a return of capital, equity or principal with respect to such a QLIC must either be reinvested in another qualified non-real estate business or retained by the CDE for the remaining term of the 7-year credit period.

If a CDE, including a single purpose CDE, can satisfy both of the above described tests it would be protected by a safe harbor throughout the 7-year term. This will ease investor concerns about recapture and would have a salutary effect on investor interest in investing CDEs that offer flexible financing products to operating businesses.

Our purpose in proposing this safe harbor is to promote lending and investing in operating businesses. To implement this safe harbor provision, we recommend that the CDFI Fund amend its Allocation Agreement to ensure that any CDE using the safe harbor is required to make a reasonable effort to re-deploy any principal that is returned within the regulatory period and present evidence of such effort. Existing IRS anti-abuse provisions would also be applied to any CDE transactions.

Investors in a CDE that fails the proposed test would not be subject to recapture. However, the CDE would be subject to the range of remedies set forth in that agreement, which could include disbarment from receiving further NMTC allocations and/or participating in other CDFI Fund programs.

We would be happy to provide with any other information you may need and hope you will feel free to contact the Coalition on this.

Thank you for taking the time to meet with us and your attention to this matter.

Sincerely,



Robert A. Rapoza