ID: CCA_2009063013514038

Office:

UILC: 45D.00-00

Number: **200944050**

Release Date: 10/30/2009

From:
Sent: Tuesday, June 30, 2009 1:51:42 PM
To:
Cc:
Subject: Recapture CCA

This Chief Counsel Advice responds to your request for assistance regarding § 45D of the Internal Revenue Code.

Legend:

CDE =

QALICB =

$a =
$b =
$c =
$d =
$e =
$f =
$g =

h =

Issue: Whether CDE's $a equity investment in, and $b loan to, QALICB are qualified low-income community investments under § 45D(d)(1)(A)?

Conclusion: No. QALICB is not engaged in the active conduct of a qualified business under § 45D(d)(2)(A)(i) and § 1.45D-1(d)(4)(i) because QALICB will not be treated as engaged in the active conduct of a trade or business under §1.45D-1(d)(4)(iv)(A). Therefore, CDE's equity investment and loan are not qualified low-income community investments under § 45D(d)(1)(A).

Law and Regulations:

Section 45D(a)(1) provides a new markets tax credit on certain credit allowance dates described in § 45D(a)(3) with respect to a qualified equity investment in a qualified community development entity described in § 45D(c).

Section 45D(b)(1)(B) provides that an equity investment in a qualified community development entity is a qualified equity investment if, among other requirements, substantially all of the cash is used by the qualified community development entity to make qualified low-income community investments.

Section 45D(b)(6) defines the term equity investment to mean (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 partnership.

Under § 45D(d)(1)(A), a qualified low-income community investment includes any capital or equity investment in, or loan to, any qualified active low-income community business (as defined in § 45D(d)(2)).

Under § 45D(d)(2)(A), a qualified active low-income community business is any corporation (including a nonprofit corporation) or partnership if for such year, among other requirements, (i) at least 50 percent of the total gross income of the entity is derived from the active conduct of a qualified business within any low-income community, (ii) a substantial portion of the use of the tangible property of the entity (whether owned or leased) is within any low-income community, and (iii) a substantial portion of the services performed for the entity by its employees are performed in any low-income community.

Section 1.45D-1(d)(4)(i) provides that the term qualified active low-income community business means, with respect to any taxable year, a corporation (including a non-profit corporation) or a partnership engaged in the active conduct of a qualified business if the requirements of § 1.45D-1(d)(4)(i)(A), (B), (C), (D), and (E) are met.

Section 1.45D-1(d)(4)(iv) provides that an entity will be treated as engaged in the active conduct of a trade or business if, at the time the CDE makes a capital investment in, or loan to, the entity, the CDE reasonably expects that the entity will generate revenues within 3 years after the date the investment or loan is made.

Section 1.45D-1(d)(5)(i) provides that the term qualified business means any trade or business.

Section 1.45D-1(d)(6)(i) provides that an entity is treated as a qualified active low-income community business for the duration of the CDE's investment in the entity if the CDE reasonably expects, at the time the CDE makes the capital or equity investment in, or loan to, the entity, that the entity will satisfy the requirements to be a qualified active low-income business throughout the entire period of the investment or loan.

Section 1.45D-1(d)(6)(ii)(A) provides that if a CDE controls or obtains control of an entity at any time during the 7-year credit period, the entity will be treated as a qualified active low-income community business only if the entity satisfies the requirements of § 1.45D-1(d)(4)(i) throughout the entire period the CDE controls the entity.

Section 1.45D-1(d)(6)(ii)(B) defines control to mean, with respect to an entity, direct or indirect ownership (based on value) or control (based on voting or management rights) of more than 50 percent of the entity. The term management rights means the power to influence the management policies or investment decisions of the entity.

Discussion:

If the facts are as you describe, QALICB should not be treated as engaged in the active conduct of a trade or business under

§ 1.45D-1(d)(4)(iv). QALICB's operating agreement included a projection of the sources of funds needed to complete the project in question, as well as how such funds would be spent on the completion of the project. The agreement projected that a total of $c would be needed to develop and rehabilitate the project; however, CDE's qualified low-income community investments in QALICB included only a loan of $b and an equity investment of $d minus a fee of $e to CDE for a total of $f. Once the qualified low-income community investments were received, QALICB repaid a mortgage loan of $b and liens totaling $g on the building. QALICB never received any other money to fund the actual rehabilitation and development of the project and, thus, it was not reasonable for CDE to expect QALICB to generate revenues within 3 years after the date the equity investment and loan were made. CDE knew, or should have known, at the time it made its equity investment and loan to QALICB that the project would not be engaged in the active conduct of a qualified business as required under § 45D(d)(2)(A)(i) and § 1.45D-1(d)(4)(i).

CDE is in control of QALICB for purposes § 1.45D-1(d)(6)(ii)(A). As stated above, control is defined in § 1.45D-1(d)(6)(ii)(B) as direct or indirect ownership (based on value) or control of more than 50 percent of the entity (based on voting or management rights). Here, CDE received a h% interest in QALICB when it invested $a in QALICB. Thus, CDE controls QALICB under § 1.45D-1(d)(6)(ii)(B). However, the 3-year rule in § 1.45D-1(d)(4)(iv) applies regardless of whether CDE controls QALICB under § 1.45D-1(d)(6)(ii). Section 1.45D-1(d)(4)(iv) is separate and distinct from the control rule found under § 1.45D-1(d)(6)(ii). Thus, as stated above, it was not reasonable for CDE to expect QALICB to generate revenues within 3-years after CDE made its qualified low-income community investments because the facts that you provided show that the project was severely undercapitalized from the onset.

If you have any further questions, please do not hesitate to call me at