Part III - Administrative, Procedural, and Miscellaneous

Section 45D.—New Markets Tax Credit

Notice 2006-60

SECTION 1. PURPOSE

The purpose of this notice is to announce that the Treasury Department and Internal Revenue Service will amend § 1.45D-1 of the Income Tax Regulations to provide guidance on how an entity meets the requirements to be a qualified active low-income community business when its activities involve certain targeted populations under § 45D(e)(2) of the Internal Revenue Code. Taxpayers may rely on this notice until the regulations are issued.

SECTION 2. BACKGROUND

.01 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 (CDE) described in § 45D(c).

.02 Section 45D(b)(1) provides that an equity investment in a CDE is a “qualified equity investment” if, among other requirements: (A) the investment is acquired by the taxpayer at its original issue (directly or through an underwriter) solely in exchange for cash; (B) substantially all of the cash is used by the CDE to make qualified low-income community investments; and (C) the investment is designated for purposes of § 45D by the CDE.

.03 Under § 45D(b)(2), the maximum amount of equity investments issued by a CDE that may be designated by the CDE as qualified equity investments shall not exceed the portion of the new markets tax credit limitation set forth in § 45D(f)(1) that is allocated to the CDE by the Secretary under § 45D(f)(2).

.04 Section 45D(c)(1) provides that an entity is a CDE only if, among other requirements, the entity is certified by the Secretary as a CDE.

.05 Section 45D(d)(1) provides that the term "qualified low-income community investment" (QLICI) means: (A) any capital or equity investment in, or loan to, any qualified active low-income community business (QALICB) (as defined in § 45D(d)(2)); (B) the purchase from another CDE of any loan made by the entity that is a QLICI; (C) financial counseling and other services specified in regulations prescribed by the Secretary to businesses located in, and residents of, low-income communities; and (D) any equity investment in, or loan to, any CDE.

.06 Under § 45D(d)(2), a QALICB is any corporation (including a nonprofit corporation) or partnership if, 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.

.07 Under § 45D(d)(3), with certain exceptions, a qualified business is any trade or business. The rental to others of real property is a qualified business only if, among other requirements, the real property is located in a low-income community.

.08 Section 221 of the American Jobs Creation Act of 2004 (P.L. 108-357) amended § 45D(e)(2) to provide that the Secretary shall prescribe regulations under which one or more targeted populations (within the meaning of § 103(20) of the Riegle Community Development and Regulatory Improvement Act of 1994 (12 U.S.C. 4702(20))) may be treated as low-income communities. The regulations shall include procedures for determining which entities are QALICBs with respect to those populations.

.09 The term "targeted population," as defined in 12 U.S.C. 4702(20) and 12 C.F.R. 1805.201, means individuals, or an identifiable group of individuals, including an Indian tribe, who (A) are low-income persons; or (B) otherwise lack adequate access to loans or equity investments. Under 12 U.S.C. 4702(17) as interpreted by 12 C.F.R. 1805.104, the term "low-income" means having an income, adjusted for family size, of not more than (A) for metropolitan areas, 80 percent of the area median family income; and (B) for non-metropolitan areas, the greater of (i) 80 percent of the area median family income; or (ii) 80 percent of the statewide nonmetropolitan area median family income.

.10 Section 101(a) of the Gulf Opportunity Zone Act of 2005 (Pub. L. 109-135) (the Act) added new § 1400M(1), which provides that the Gulf Opportunity Zone (GO Zone) is that portion of the Hurricane Katrina disaster area determined by the President to warrant individual or individual and public assistance from the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act by reason of Hurricane Katrina.

.11 Section 1400M(2) provides that the Hurricane Katrina disaster area is an area with respect to which a major disaster has been declared by the President before September 14, 2005, under section 401 of the Act by reason of Hurricane Katrina. After determination by the President that a disaster area warrants assistance pursuant to the Robert T. Stafford Disaster Relief and Emergency Assistance Act, the Federal Emergency Management Agency (FEMA) makes damage assessments. The categories for damage assessment in the wake of a hurricane are: flooded area, saturated area, limited damage, moderate damage, extensive damage, and catastrophic damage.

.12 Under § 1400N(m)(1), a CDE shall be eligible for an allocation under § 45D(f)(2) of the increase in the new markets tax credit limitation described in § 1400N(m)(2) only if a significant mission of the CDE is the recovery and redevelopment of the GO Zone. Section 1400N(m)(2) provides that the new markets tax credit limitation otherwise determined under § 45D(f)(1) shall be increased by an amount equal to $300,000,000 for 2005 and 2006 and $400,000,000 for 2007, to be allocated among CDEs to make QLICIs within the GO Zone. CDEs may make such QLICIs under the existing rules of § 1.45D-1 or using the guidance contained in this notice.

.13 On May 24, 2005, the Community Development Financial Institutions (CDFI) Fund published an advance notice of proposed rulemaking (ANPRM) (70 FR 29658) to seek comments from the public with respect to how targeted populations may be treated as eligible low-income communities under § 45D(e)(2). In response to the ANPRM, comments have been received making various suggestions relating to the definition of the term “targeted populations” and proposing amendments to the requirements to be a QALICB under § 1.45D-1.

.14 In conjunction with the publication of Income Tax Regulations specifying how an entity meets the requirements to be a QALICB when its activities involve certain targeted populations under § 45D(e)(2), the CDFI Fund shall provide additional guidance with respect to: (A) the definition of such targeted populations; and (B) administrative procedures relating to the certification of CDEs wishing to serve such populations. Taxpayers may rely upon this notice until such guidance is issued.

SECTION 3. DISCUSSION

.01 Notice of Proposed Rulemaking. The Treasury Department and Internal Revenue Service are developing regulations to provide guidance on how an entity meets the requirements to be a QALICB when its activities involve certain targeted populations under § 45D(e)(2). Taxpayers may rely on this notice until the regulations are issued. Based upon the statutory changes made by the American Jobs Creation Act of 2004 and in response to comments received in response to the CDFI Fund ANPRM, the Treasury Department and Internal Revenue Service expect to amend § 1.45D-1 to provide guidance consistent with this notice.

.02 Low-Income Community. Section 1.45D-1 will be amended to provide that, for purposes of § 45D(e)(2), targeted populations that will be treated as a low-income community are individuals, or an identifiable group of individuals, including an Indian tribe, who are low-income persons as defined in section 3.03 of this notice or who are individuals who otherwise lack adequate access to loans or equity investments as defined in section 3.04 of this notice.

.03 Low-Income Persons.

(1) Definition. For purposes of § 45D(e)(2), an individual shall be considered to be low-income if the individual's family income, adjusted for family size, is not more than (A) for metropolitan areas, 80 percent of the area median family income; and (B) for non-metropolitan areas, the greater of (i) 80 percent of the area median family income; or (ii) 80 percent of the statewide nonmetropolitan area median family income.

(2) QALICB Requirements for Low-Income Targeted Populations.

(a) In general. Section 1.45D-1(d)(4)(A), (B), and (C) will be amended to provide that a QALICB for low-income targeted populations, with respect to any taxable year, is a corporation (including a nonprofit corporation) or a partnership engaged in the active conduct of a qualified business as defined in § 1.45D-1(d)(5) if:

(i) at least 50 percent 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 § 45D(e)(2),

(ii) at least 40 percent of the entity's employees are individuals who are low-income persons for purposes of § 45D(e)(2), or

(iii) at least 50 percent of the entity is owned by individuals who are low-income persons for purposes of § 45D(e)(2).

(b) Employee. The determination of whether an employee is a low-income person must be made at the time the employee is hired. If the employee is a low-income person at the time of hire, that employee is considered a low-income person for purposes of § 45D(e)(2) throughout the time of employment, without regard to any increase in the employee's income after the time of hire.

(c) Owner. The determination of whether an owner is a low-income person must be made at the time the QLICI is made. If an owner is a low-income person at the time the QLICI is made, that owner is considered a low-income person for purposes of § 45D(e)(2) throughout the time the ownership interest is held by that owner.

(3) 120-Percent-Income Restriction.

(a) In general.

(i) In no case will an entity be treated as a QALICB under section 3.03 of this notice if the entity is located in a population census tract for which the median family income exceeds 120 percent of:

(A) in the case of a tract not located within a metropolitan area, the statewide median family income, or

(B) in the case of a tract located within a metropolitan area, the greater of statewide median family income or metropolitan area median family income (120-percent-income restriction).

(ii) The 120-percent-income restriction shall not apply to an entity located within a population census tract with a population of less than 2,000 if such tract is not located in a metropolitan area.

(iii) The 120-percent-income restriction shall not apply to an entity located within a population census tract with a population of less than 2,000 if such tract is located in a metropolitan area and more than 75 percent of the tract is zoned for commercial or industrial use.

(b) Population Census Tract Location.

(i) For purposes of the 120-percent-income restriction, an entity will be considered to be located in a population census tract for which the median family income exceeds 120 percent of the applicable median family income under section 3.03(3)(a)(i)(A) or (B) of this notice (non-qualifying population census tract) if:

(A) at least 50 percent of the total gross income of the entity is derived from the active conduct of a qualified business (as defined in § 1.45D-1(d)(5)) within one or more non-qualifying population census tracts (non-qualifying gross income amount);

(B) at least 40 percent of the use of the tangible property of the entity (whether owned or leased) is within one or more non-qualifying population census tracts (non-qualifying tangible property usage); and

(C) at least 40 percent of the services performed for the entity by its employees are performed in one or more non-qualifying population census tracts (non-qualifying services performance).

(ii) The entity is considered to have the non-qualifying gross income amount if the entity has non-qualifying tangible property usage or non-qualifying services performance of at least 50 percent instead of 40 percent.

(iii) If the entity has no employees, the entity is considered to have the non-qualifying gross income amount as well as non-qualifying services performance if at least 85 percent of the use of the tangible property of the entity (whether owned or leased) is within one or more non-qualifying population census tracts.

(4) <u>Rental of Real Property for Low-Income Targeted Populations</u>. In addition, § 1.45D-1(d)(5)(ii) will be amended to provide that the rental to others of real property for low-income targeted populations that otherwise satisfies the requirements to be a

qualified business will be treated as located in a low-income community if at least 50 percent of the entity's total gross income is derived from rentals to individuals who are low-income persons for purposes of section 45D(e)(2) and/or to a QALICB that meets the requirements for low-income targeted populations under section 3.03(2)(a)(i) or (ii) and 3.03(2)(b) of this notice.

.04 Individuals who Otherwise Lack Adequate Access to Loans or Equity Investments.

(1) In general. Section 3.04 of this notice may be applied only with regard to QLICIs made under the increase in the new markets tax credit limitation pursuant to § 1400N(m)(2). Therefore, only CDEs with a significant mission of recovery and redevelopment of the GO Zone that receive an allocation from the increase described in § 1400N(m)(2) may make QLICIs from that allocation pursuant to the rules in section 3.04 of this notice.

(2) GO Zone Targeted Population. For purposes of targeted populations under § 45D(e)(2), an individual is considered to otherwise lack adequate access to loans or equity investments only if the individual was displaced from his or her principal residence as a result of Hurricane Katrina and/or the individual lost his or her principal source of employment as a result of Hurricane Katrina (GO Zone Targeted Population). In order to meet this definition, the individual's principal residence or principal source of employment, as applicable, must have been located in a population census tract within the GO Zone that contains one or more areas designated by FEMA as flooded, having sustained extensive damage, or having sustained catastrophic damage as a result of Hurricane Katrina.

(3) QALICB Requirements for the GO Zone Targeted Population.

(a) In general. Section 1.45D-1(d)(4)(A), (B), and (C) will be amended to provide that a QALICB for the GO Zone Targeted Population, with respect to any taxable year, is a corporation (including a nonprofit corporation) or a partnership engaged in the active conduct of a qualified business as defined in § 1.45D-1(d)(5) if:

(i) at least 50 percent of the entity's total gross income for any taxable year is derived from sales, rentals, services, or other transactions with the GO Zone Targeted Population, low-income persons as defined in section 3.03 of this notice, or some combination thereof;

(ii) at least 40 percent of the entity's employees consist of the GO Zone Targeted Population, low-income persons as defined in section 3.03 of this notice, or some combination thereof; or

(iii) at least 50 percent of the entity is owned by the GO Zone Targeted Population, low-income persons as defined in section 3.03 of this notice, or some combination thereof.

(b) Location.

(i) In general. In order to be a QALICB under section 3.04(3) of this notice, the entity must be located in a population census tract within the GO Zone that contains one or more areas designated by FEMA as flooded, having sustained extensive damage, or having sustained catastrophic damage as a result of Hurricane Katrina (qualifying population census tract).

(ii) Determination.

(A) For purposes of the preceding paragraph, an entity will be considered to be located in a qualifying population census tract if:

(1) at least 50 percent of the total gross income of the entity is derived from the active conduct of a qualified business (as defined in § 1.45D-1(d)(5)) within one or more qualifying population census tracts (gross income requirement);

(2) at least 40 percent of the use of the tangible property of the entity (whether owned or leased) is within one or more qualifying population census tracts (use of tangible property requirement); and

(3) at least 40 percent of the services performed for the entity by its employees are performed in one or more qualifying population census tracts (services performed requirement).

(B) The entity is deemed to satisfy the gross income requirement if the entity meets either the use of tangible property requirement or the services performed requirement of at least 50 percent instead of 40 percent.

(C) If the entity has no employees, the entity is deemed to satisfy the services performed requirement as well as the gross income requirement if at least 85 percent of the use of the tangible property of the entity (whether owned or leased) is within one or more qualifying population census tracts.

(4) 200-Percent-Income Restriction.

(a) In general.

(i) In no case will an entity be treated as a QALICB under section 3.04 of this notice if the entity is located in a population census tract for which the median family income exceeds 200 percent of:

(A) in the case of a tract not located within a metropolitan area, the statewide median family income, or

(B) in the case of a tract located within a metropolitan area, the greater of statewide median family income or metropolitan area median family income (200-percent-income restriction).

(ii) The 200-percent-income restriction shall not apply to an entity located within a population census tract with a population of less than 2,000 if such tract is not located in a metropolitan area.

(iii) The 200-percent-income restriction shall not apply to an entity located within a population census tract with a population of less than 2,000 if such tract is located in a metropolitan area and more than 75 percent of the tract is zoned for commercial or industrial use.

(b) Population Census Tract Location.

(i) For purposes of the 200-percent-income restriction, an entity will be considered to be located in a population census tract for which the median family income exceeds 200 percent of the applicable median family income under section 3.04(4)(a)(i)(A) or (B) of this notice (non-qualifying population census tract) if:

(A) at least 50 percent of the total gross income of the entity is derived from the active conduct of a qualified business (as defined in § 1.45D-1(d)(5)) within one or more non-qualifying population census tracts (non-qualifying gross income amount);

(B) at least 40 percent of the use of the tangible property of the entity (whether owned or leased) is within one or more non-qualifying population census tracts (non-qualifying tangible property usage); and

(C) at least 40 percent of the services performed for the entity by its employees are performed in one or more non-qualifying population census tracts (non-qualifying services performance).

(ii) The entity is considered to have the non-qualifying gross income amount if the entity has non-qualifying tangible property usage or non-qualifying services performance of at least 50 percent instead of 40 percent.

(iii) If the entity has no employees, the entity is considered to have the non-qualifying gross income amount as well as non-qualifying services performance if at least 85 percent of the use of the tangible property of the entity (whether owned or leased) is within one or more non-qualifying population census tracts.

(5) Rental of Real Property for the GO Zone Targeted Population. In addition, § 1.45D-1(d)(5)(ii) will be amended to provide that the rental to others of real property for the GO Zone Targeted Population that otherwise satisfies the requirements to be a qualified business will be treated as located in a low-income community if at least 50 percent of the entity's total gross income is derived from rentals to the GO Zone Targeted Population, low-income persons as defined in section 3.03 of this notice, or some combination thereof and/or to a QALICB that meets the requirements for the GO Zone Targeted Population under section 3.04(3)(a)(i) or (ii) of this notice.

SECTION 4. EFFECTIVE DATE

The regulations will be revised to incorporate the guidance set forth in this notice. Taxpayers may rely on this notice for designations made by the Secretary after October 22, 2004. Therefore, taxpayers may apply section 3.03 of this notice for all

QLICIs made on or after October 22, 2004, and may apply section 3.04 of this notice for all QLICIs made by CDEs from allocations under § 1400N(m).

SECTION 5. REQUEST FOR COMMENTS

.01 The Internal Revenue Service and Treasury Department invite taxpayers to submit written comments on issues relating to § 45D(e)(2) and this notice. In particular, the Internal Revenue Service and Treasury Department encourage taxpayers to submit written comments regarding circumstances under which an entity can be a QALICB when its activities involve individuals, or an identifiable group of individuals, including an Indian tribe, who otherwise lack adequate access to loans or equity investments under 12 U.S.C. 4702(20).

.02 Send comments to: CC:PA:LPD:PR (Notice 2006-XX), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (Notice 2006-XX), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Submissions may also be sent electronically via the Internet to the following e-mail address: Notice.comments@irscounsel.treas.gov. Include the notice number (Notice 2006-XX) in the subject line. Comments must be received on or before August 31, 2006.

SECTION 6. DRAFTING INFORMATION

The principal author of this notice is Lauren Ross Taylor of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Ms. Taylor on (202) 622-3040 (not a toll-free call).