New Markets Tax Credits: Where Are We Now, Exiting or Restructuring Existing Deals, and Traps for the Unwary
Qualifying for Tax Credits and Meeting IRS Requirements When Structuring NMTC Deals

WEDNESDAY, MAY 14, 2014
1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today’s faculty features:

Michael I. Sanders, Partner, Blank Rome, Washington, D.C.
Brad Elphick, CPA, Partner, Novogradac & Company, Atlanta
Megan A. Christensen, Attorney, Blank Rome, Washington, D.C.

The audio portion of the conference may be accessed via the telephone or by using your computer’s speakers. Please refer to the instructions emailed to registrants for additional information. If you have any questions, please contact Customer Service at 1-800-926-7926 ext. 10.
Tips for Optimal Quality

Sound Quality
If you are listening via your computer speakers, please note that the quality of your sound will vary depending on the speed and quality of your internet connection.

If the sound quality is not satisfactory, you may listen via the phone: dial 1-866-871-8924 and enter your PIN when prompted. Otherwise, please send us a chat or e-mail sound@straffordpub.com immediately so we can address the problem.

If you dialed in and have any difficulties during the call, press *0 for assistance.

Viewing Quality
To maximize your screen, press the F11 key on your keyboard. To exit full screen, press the F11 key again.
Continuing Education Credits

For CLE purposes, please let us know how many people are listening at your location by completing each of the following steps:

• In the chat box, type (1) your **company name** and (2) the **number of attendees at your location**

• Click the SEND button beside the box

If you have purchased Strafford CLE processing services, you must confirm your participation by completing and submitting an Official Record of Attendance (CLE Form).

You may obtain your CLE form by going to the program page and selecting the appropriate form in the PROGRAM MATERIALS box at the top right corner.

If you'd like to purchase CLE credit processing, it is available for a fee. For additional information about CLE credit processing, go to our website or call us at 1-800-926-7926 ext. 35.
Program Materials

If you have not printed the conference materials for this program, please complete the following steps:

• Click on the ^ symbol next to “Conference Materials” in the middle of the left-hand column on your screen.
• Click on the tab labeled “Handouts” that appears, and there you will see a PDF of the slides for today’s program.
• Double click on the PDF and a separate page will open.
• Print the slides by clicking on the printer icon.
NEW MARKETS TAX CREDITS: WHERE ARE WE NOW, EXITING OR RESTRUCTURING EXISTING DEALS, AND TRAPS FOR THE UNWARY

Qualifying for Tax Credits and Meeting IRS Requirements While Structuring NMTC Deals

Presented by: Michael I. Sanders
Sanders@BlankRome.com
NMTC STRUCTURE OVERVIEW 2014

I. Introduction:

1. Opportunity for nonprofits to subsidize or provide gap financing for developments in a qualified census tract (low income, high unemployment).

2. Financial benefits to developers, businesses and charities.
3. Major investors such as Goldman, Bank of America, JP Morgan, US Bank or PNC buy credits for cash infusion to the development which may not be paid back at the end of the 7-year compliance period.

4. Under leverage structure, investor may receive in excess of 9 to 10 percent return after tax.

5. Will NMTC be extended beyond 2014?
## New Markets Tax Credit – A Government Sponsored Joint Venture Vehicle

### Basics:
$35 Billion in NMTC allocated through 2013; another $3.5 Billion to be announced in Spring 2014.

| Purpose: | The new markets tax credit (NMTC) serves as a way to provide subsidy or gap financing to real estate developments, business activities, or charitable operations planned in qualified census tracts (high unemployment or poverty rate, low median family income). |
| What does it provide? | 39% tax credit on the capital invested in a community development entity (CDE), over 7 years (5% in yrs 1-3; 6% in yrs 4-7). |
| Who benefits from the credit? | The investor (typically national banks, insurance companies) making an investment in a CDE gets a tax credit of $0.39 for every $1 invested and CRA credit, which under a “leveraged” structure yields in excess of a 10% after-tax return. The CDE directs capital into qualified projects or businesses. The investor is not repaid its equity investment. |
| Eligible Investments: | • Community businesses, including e.g. hospitals, charter schools.  
• Commercial or mixed-use real estate projects (at least 20% of gross income from commercial component). |
| Examples: | • 105-Unit, The Bradford -- $45M affordable housing and ground floor retail space in Bedford-Stuyvesant. Innovative structure allowed HDC and HPD financing to be used, with Goldman Sachs as the equity investor; BRP and Bedford-Stuyvesant Restoration Corp were the development partners.  
• $100M charter high school in Mott Haven, Bronx. Robin Hood Foundation was sponsor; JPMorgan Chase was investor. |
II. Unwind Exit Strategies: 7-Year Strategy: Put-Call Options, Planning Opportunities to Mitigate Burdens of Tax Consequences at Exit

1. At the end of the 7-year compliance period, when the investor has received all the NMTCs for which it is eligible, it, along with the CDE, will likely want to unwind the transaction and exit the structure.
2. This is typically accomplished through the use of a “put/call” technique that generates a subsidy or grant equivalent to the QALICB.

- There is often tension manifested between the equity investor and the QALICB in negotiating the put/call structure. Equity investors are interested in protecting the value of their cushion while the QALICB is interested in “assurance” that the investor will indeed exercise the put and may attempt to use techniques that would devalue the call (through the use of a fair market value formula, annual interest accruals and a significant partial payment in year 7). The investor, however, wants to be assured that it will be treated as the owner of the equity piece.
• Under one version of this technique, the investor has the right to require the QALICB, over a specified period, to purchase the investor’s interest in the Fund for a specified price (the “put”). In the event the put is not exercised, the QALICB (or an affiliate) has the right to purchase the investor’s interest in the Fund over a specified period for fair market value (the “call”).
The put and call will likely be priced substantially below the investor’s original investment in the Fund.

If either the put or the call are exercised, the investor would be removed from the structure. An affiliate of the QALICB typically would be substituted in place of the investor, thereby controlling the Fund, and would take steps to redeem the managing member of the CDE. The result here is a net benefit to the project measured by the amount of the investor’s original funds less fees, professional and administrative costs and the price of the put/call.
3. After the investor is removed, the QALICB may then cause the Fund to liquidate the CDE, often using the QLICI “A” Note previously held by the CDE to repay the leverage lender, and subsequently liquidate the Fund, leaving the QALICB on its own and the leverage lender holding the A Note.
• In the event that the leverage lender is controlled by a §501(c)(3) entity or is itself a charity, it may decide to forgive all or a portion of the leverage loan at the end of the compliance period, but it must not be legally obligated to do so at inception.
4. The QALICB may repay or “refinance” the property and use the funds it receives to repay to the CDE the QLICI note that mirrors the leverage loan (but not the QLICI note that mirrors the investor’s equity). The CDE will then use the funds received from the QALICB to repay the leverage lender.
5. There is additional concern at the QALICB level that there could be a change of administration and attitude by the investor at the end of the compliance period as compared to its present intent, especially by an institutional investor, who may decide not to exercise the put.
6. Cancellation of Indebtedness – COD Income

- Discharge of indebtedness: under Section 61(a)(12) a discharge of indebtedness, for example, by the debtor's acquisition of its own debt for less than the principal amount of the debt, constitutes gross income to the debtor. Under Code Section 108(e)(4)(A) for purposes of determining income of the debtor of the discharge of indebtedness the acquisition of debt by a party “related” to the debtor is considered to be the acquisition of indebtedness by the debtor.
• If the QALICB has operating losses, it may offset COD ordinary income.
• If not, the B Note could be payable in 25-30 years which would defer the taxability. However, the QALICB would need to pay interest annually during the life of the Note.
• Related party acquisition uses the attribution and constructive ownership rules under Section 267(b) or 707(b)(1).
• Exception for qualified real property business indebtedness which would allow income realized pursuant to the related party rule to be excludable from gross income to the extent provided in Section 108(a), whereby gross income does not include discharge from indebtedness income if a taxpayer is not a C-corporation and the discharge indebtedness is “qualified real property business indebtedness.”
• Use of equity rather than debt.
• Use of nonprofit as QALICB or leverage lender: no UBIT realized if project is substantially related to the exempt function, such as relief of the poor, underprivileged, relieves the burden of government, etc.

1. Historic Boardwalk Case
2. Prohibition on the use of “calls”
3. Section 4.01 Equity Investor Limitation
• Historic Boardwalk Case: Third Circuit was concerned about no real prospect for an upside and investor was protected from any downside through guarantees, etc.
• Prohibition on the use of “calls”. Prior to the issuance of Rev. Proc. 2014-12, it was common in HTC transactions as well as NMTC transactions, to have puts and calls whereby a put was at the option of the equity investor to exit a transaction and a call was at the option of the developer or QALICB to acquire the investor’s partnership interest.

• Rev. Proc. 2014-12 eliminates the developer’s right to have a call option although it allows the investor to have a put option which cannot exceed the fair market value.
• Section 4.01 Equity Investor Limitation. Section 4.01 of the Safe Harbor provides that an investor can not invest in both the master tenant partnership and the developer partnership “other than through an in-direct interest” unless there is a “separately negotiated, distinct economic arrangement.”

• Will this provision effect the structure of new market tax credit transactions, in which equity investors typically make both an historic investment, using master tenant structure, and another, using new markets tax credit on the developer QALICB landlord side?

• There is no clarity as to how to demonstrate that there are two separate arms-length investments, that is, two separate economic deals. Treasury wants the investment for each component to be separately determined, which may be easier said than done.
IV. Qualified Active Low-Income Community Business: Non Qualified Financial Property: Construction Safe-Harbor

In general, a qualified active low-income community business (QALICB) includes any corporation (including a nonprofit corporation), partnership, or LLC if with respect to any taxable year less than 5 percent of the average of the aggregate unadjusted basis of the property of such entity is attributable to nonqualified financial property.
There is a specific rule that provides an exception to the definition of nonqualified financial property relating to the construction of real property, provided that the proceeds of a capital or equity investment or loan by a CDE is expended for construction of real property within 12 months after the date the investment or loan is made; in such a case, the expenditure will be treated as a “reasonable amount of working capital.”
Many commentators believe that the aforesaid exception is a “safe harbor” rule, although others conclude that the above-described language sets forth a “bright line.” Because the construction of real property often extends well beyond 12 months to perhaps 18 to 24 months – the regulatory language presently is a disincentive to CDEs to make qualified low-income community investments to fund many legitimate projects because the construction period extends beyond the limits.
If a CDE intends to make a loan to a QALICB involved in the construction of real estate and anticipates that the construction period will exceed 12 months, it generally has two options:
1. The CDE can receive the QEI from their investor, but defer up to 12 months to advance the money to the QALICB. If the cash is retained by the CDE, then the CDE may incur negative interest rate arbitrage by holding the funds at the CDE level and then lending the money to the QLICI over the next 12 months. Furthermore the CDE will incur transaction costs as it makes each disbursement.
2. The investor may make multiple QEIs over a span of 12 to 24 months. If the CDE accepts multiple QEIs, then the CDE may avoid negative interest rate arbitrage by holding the funds at the CDE level, but will incur additional transaction costs with each QEI it receives, in addition to the actual transaction costs as it disbursers the funds to the CDE. (However, when the dollars are held in escrow at the QALICB level, they provide added assurance to other lenders and potentially reduce borrowing costs.)
Pursuant to Treas. Reg. §1.45(D)-1(d)(4)(iv), a QALICB has 3 years to generate revenue after the investment is made. Such a rule contemplates newly formed businesses and implicitly recognizes that some QALICBs have longer start-up periods, including the real estate construction period with multi-year construction periods.
V. Tax Credit Recapture Risk

1. Under present law there is a full recapture risk, plus interest and penalties, during the 7-year term of the investment. The NMTC program has a level of compliance and transaction structuring unrivaled by any other tax program.
2. A proportionate reduction in the tax credit recapture risk during the full term of the investment would lower the discount of the NMTC applied by investors and broaden the type of investments that tax credit investors would be willing to make, including non-real estate QALICBs.

3. Compare recapture in the event of low income housing transaction and historic tax credits to rules affecting new market tax credits.
4. There is an increased risk where investors’ QEI is used for non-real estate investments in a QALICB, which is an operating business: shorter term for investment.

5. Whether an investment is triggered by redemption or failure of the substantially all test, the risk is that a $1 mistake could cause total recapture. The answer would be a new proportionate calculation rather than total recapture.
VI. Reasonable Expectation Test and Control

1. Reliance on the “reasonable expectations” test by the CDE will encourage CDEs to make majority equity investments in QALICBs.

2. The CDFI Fund made changes to allow a CDE to make a majority equity interest investment without violating its allocation agreement so long as it had committed to investing substantially all its proceeds in entities that were considered “unrelated” before they invested.
3. However, there is still a potential problem, that is, being able to satisfy the “reasonable expectation” test in the Treasury Regulations.

4. The Regulations provide that if a CDE reasonably expects at the time it makes a capital or equity investment in, or a loan to, the QALICB, that the QALICB will be treated as satisfying the regulatory requirements [for the term of the investment] so as to continue to be deemed to be a QALICB, even if it falls out of compliance at a later time. This permits the CDE to avoid suffering a recapture event if the QALICB ceases to qualify during the recapture period for reasons that are outside the control of the CDE.
The Regulations further require that if the CDE has or obtains control of the QALICB, it generally must ensure that the entity remains a QALICB for the entire 7-year compliance period and cannot rely on the reasonable expectation test. In view of the definition of “control” under the reasonable expectation test, investors in the current market are unlikely to allow the CDE to acquire a majority equity interest in the QALICB since the compliance risk is too great!
Equity investments are generally the most “patient” form of capital. The current definition of control in the Treasury Regulations means “direct or indirect ownership (based upon value) or control (based on voting management rights of more than 50 percent of the entity).” There is no clear guidance on how to calculate direct or in-direct ownership “based on value.”

The general view of the practitioners is that the concept of control should be based solely on the CDE’s ability to control the QALICB’s status through voting or management rights, such as causing the QALICB to take actions that result in its failing to remain a QALICB or allow the CDE to override or block its actions. Other issues should not bear on whether the CDE should be allowed to rely on its own reasonable expectation of compliance as a safe harbor.
Impact of CDE being able to remove for cause a managing member or general partner, etc.
VII. Tenant Excluded Businesses

1. The Treasury Regulations provides that a CDE’s investment in or loan to a business engaged in the rental of real property is not a QLICI to the extent the lessee is involved in one of the prohibited businesses. It is unclear whether the lessee must be engaged “exclusively” or “primarily” in a prohibited business or whether any engagement in such business will actually trigger this provision.
2. An example would be a hotel that includes a day spa that offers massage services and includes a sun tanning booth. The primary business of the hotel is to provide lodging and convention facilities as evidenced based upon square footage and income generated from these activities. The massage service and sun tanning booth generate an extremely small portion of the hotel’s overall income.
3. It is unclear under the Regulations how to determine how much of the QLICI would be disqualified, if, and to what extent, a lessee is engaged in any of such “sin” businesses.

4. Does the language in the Regulations have the effect of bypassing the reasonable expectation safe harbor? This is so because the tenants engagement in a prohibited business impacts QLICI status directly without reference to QALICB status.
New Markets Tax Credits: Meeting IRS Requirements When Structuring NMTC Deals

Brad Elphick, CPA
Novogradac & Company LLP
Brad.Elphick@novoco.com
NMTC Recapture Issues

1. “Substantially-All” Test

2. Redemption Test
Substantially All Test

<table>
<thead>
<tr>
<th>Year</th>
<th>Requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>≥85%</td>
</tr>
<tr>
<td>2</td>
<td>≥85%</td>
</tr>
<tr>
<td>3</td>
<td>≥85%</td>
</tr>
<tr>
<td>4</td>
<td>≥85%</td>
</tr>
<tr>
<td>5</td>
<td>≥85%</td>
</tr>
<tr>
<td>6</td>
<td>≥85%</td>
</tr>
<tr>
<td>7</td>
<td>≥75%</td>
</tr>
</tbody>
</table>

Low-Income Community

CDE

QALICB

$≥85\%$

≥85% Year 1
≥85% Year 2
≥85% Year 3
≥85% Year 4
≥85% Year 5
≥85% Year 6
≥75% Year 7
QEIs & Substantially All

• Safe Harbor Test
  – At least 85% of the CDE’s *aggregate gross assets* (not per investment) on a cost basis are invested in eligible activities (i.e., QLICIs).
  – Under this test, the CDE does not need to trace the use of QEIs to eligible activities.
QEIs & Substantially All

• Direct Tracing Test
  - At least 85% of the proceeds of the specific QEIs can be traced to eligible investments (i.e., QLICIs).
  - Under this test, the CDE is free to engage in other non-NMTC related activities without impairing the substantially-all test.
QEIs & Substantially All

- **Reinvestment**
  - Repayments to a CDE of capital, equity or principal from qualified investments must be reinvested in another QLICI within 12 months
    - Special rule for loans
      - Scheduled periodic payments of principal must be reinvested by the end of the following year
    - Repayments received in year 7 are not required to be reinvested
Distributions vs. Redemptions

Treasury Regulation 1.45D-1(e)(2)(iii):

An event of recapture occurs if an equity investment is redeemed or cashed out by CDE
Cash Distribution

Partnerships

• No definition of Redemption

• Safe Harbor for Cash Distributions
  – If a pro rata distribution does not exceed the CDE’s operating income, it is not treated as a redemption, and
  – Non-pro rata de minimus cash distributions are not treated as a redemption
    • May not exceed lesser of 5% of CDE’s operating income or 10% of the partners capital interest
Cash Distribution

Partnerships

• Operating Income is calculated as:
  – Current Year Taxable Income
  – Plus
    • Amortization
    • Depreciation
    • QLICI Loan Losses
  – Equals Current Year Operating Income
Cash Distribution

Partnerships

• Distributions must be made during the tax year

• Operating Income is current year operating income (not cumulative)

• Distributions outside safe harbor are not automatically redemptions
Community Development Entity

Investment Fund

Leveraged Lender

Tax Credit Investor

$9m

$22.5m

$31.5m

Qualified Equity Investment

CDE Fees $1.5m

Qualified Low-Income Community Investment ($"Substantially ALL")

Qualified Active Low-Income Community Business

Low-Income Community

$22.5m QLICI A

$7.5m QLICI B

$30m
Alternative One

$4 million Payment & Cancel Remainder of Debt
Tax Credit Investor $9m Investment Fund $22.5m Leveraged Lender

Qualified Equity Investment $31.5m

CDE Fees $1.5m

Community Development Entity $4m

Low-Income Community

Business
Substantially-All Calculation

QEI = $31.5m
Sub-All % = 85%
Required QLICIs = $26,775,000

<table>
<thead>
<tr>
<th>QALICB Debt</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>QLICI A- Principal</td>
<td>$22.5m</td>
</tr>
<tr>
<td>QLICI B- Principal</td>
<td>$7.5m</td>
</tr>
<tr>
<td>Accrued Interest</td>
<td>$1m</td>
</tr>
<tr>
<td></td>
<td>$31m</td>
</tr>
<tr>
<td>Payment</td>
<td>&lt;$3m&gt;</td>
</tr>
<tr>
<td>Discharged Debt</td>
<td>&lt;$27m&gt;</td>
</tr>
</tbody>
</table>

Sub-All:

“Worthless” QLICI $27m
QEI $31.5m = Sub-All % = 85.7
Alternative Two

Modify Notes – Current Pay Tranche & Cash Flow Pay Tranche
Community Development Entity (CDE) provides $1.5m in fees to the Investment Fund.

Tax Credit Investor provides $9m to the Investment Fund.

Leveraged Lender provides $22.5m to the Investment Fund.

Qualified Equity Investor provides $31.5m to the Investment Fund.

The Investment Fund invests $22.5m into NEW QLICI A and NEW QLICI B.

Low-Income Community receives the investment, which is intended to support businesses in the community.
Substantial Modification of a debt instrument

• Issue: Does the modification constitute an “exchange” for tax purposes?

• New debt instrument (QLICIs) issued in exchange of old debt instruments (QLICIs)

• In order for a modification to be an exchange, the modification needs to be a “substantial modification”
Modification

- Means any “alteration, including any deletion or addition, in whole or part, of a legal right or obligation of the issuer or a holder of a debt instrument, whether the alteration is evidenced by an express agreement (oral or written), conduct of the parties, or otherwise.” (Treasury Regulation Sec 1.1001-3(c)(1))
Significant Modification

- General Rule-
  - “If and only if, based on all facts and circumstances, the legal rights or obligations that are altered and the degree to which they are altered are economically significant.” (Treas. Reg. 1.1001-3(e)(1))
  - All modifications are considered collectively.
Significant Modification

• Specific Rule-

1) Change in yield (does not apply to contingent payment notes)

   ▪ If change in yield varies from annual yield on old note by more than the GREATER of:

   • ¼ of one percent (25 basis pts); or

   • 5% of the annual yield of old note (ie. .05 times annual yield/rate)
Significant Modification

• Specific Rule- (cont.)

2) Change in timing of payments that is a material deferral of scheduled payments

- Applies to extension of maturity date
- Applies to deferral of payments prior to maturity
- Facts and circumstances test
- Safe-harbor test:
  - Deferral of one or more scheduled payments is not material if deferred payments are within the *safe harbor period*
  - Safe harbor period – begins original due date of first deferred payment through a period equal to the lessor of 5 yrs or 50% of the original term of the note
Significant Modification

3) Change in obligor or security

- New obligor
- Change in security or credit enhancement
- Change in priority
- Change in payment expectation
Significant Modification

• Specific Rule- (cont.)

  4) Change in nature of debt instrument
    ▪ Property not debt
    ▪ Change in recourse nature

*Accounting or financial covenant changes—are not significant modifications*
Alternative Three

Foreclosure/Deed in Lieu
Tax Credit Investor

$9m

Investment Fund

$22.5m

Leveraged Lender

Qualified Equity Investment

$31.5m

Community Development Entity

CDE Fees $1.5m

Business

Low-Income Community
Community Development Entity (CDE)

Investment Fund

$9m

$22.5m

Leveraged Lender

Tax Credit Investor

$31.5m

Qualified Equity Investment

CDE Fees $1.5m

Community
Development Entity

Low-Income Community

Equity

Business
Alternative Four

Do Nothing
Tax Credit Investor

Investment Fund

$9m

Community Development Entity

$22.5m

Qualified Equity Investment

$31.5m

$22.5m QLICI A
$7.5m QLICI B
$30m
$1m Accrued Interest
$31m

CDE Fees $1.5m

Low-Income Community

Business
OID considerations in NMTC structuring

Original Issue Discount- IRC Section 1273(a)(1)- OID is the “excess (if any) of a debt instrument’s stated redemption price at maturity” is over its “issue price”
Typical A/B leveraged NMTC structure

- Tax Credit Investor
- Investment Fund
- Leveraged Lender
- CDE Fees $1.5m
- Community Development Entity
- Qualified Equity Investment $31.5m
- Qualified Low-Income Community Investment $22.5m QLICI A
- Qualified Low-Income Community Investment $7.5m QLICI B
- Qualified Active Low-Income Community Business
- Low-Income Community

($22.5m $9m $31.5m $1.5m)
OID Issues

1) “Substantially-All” and Allocation agreement compliance – deemed principal payments versus interest payments
2) Redemption – Recapture risk!
   a. Safe harbor test – distributions cannot exceed operating income
      i. Operating income – taxable income plus certain add-backs (amortization, depreciation, Sec 165 losses, etc.)
      ii. If payments are deemed to be principal payments vs. interest payments, they are not included in operating income test
      iii. Cash may not be able to be distributed to pay leveraged loan
OID Considerations in NMTC Structuring

• B loan – Parties prefer to keep interest rate as low as possible with generally longer terms (ie. 30 yrs)

• A loan - Terms are based on underlying leveraged debt

• Issue—debt instruments issued in connection with the same transaction (or related transactions) are treated as a single debt instrument for purposes of IRC and related regulations
  
  – Thus—differing interest rates with different terms and/or payment schedules can trigger OID
OID Considerations in NMTC Structuring

Issues-

• Multiple sources of Leveraged Loans
• Deemed Exchange of QLICIs in debt restructuring
OID Considerations in NMTC Structuring

Issues -

• Upfront loan fees paid to Sub CDE
  1) Can be deemed to reduce issue price which impacts yield to maturity calculation and may cause OID issue

• Ongoing CDE asset management or other fees
  1) Often fees are tied to allocation size and are paid outside of interest
  2) If such fees are “re-characterized” as loan payments and included in stated redemption price at maturity calculation, OID may be triggered
New Markets Tax Credits: Restructuring/Workouts During 7-Year Compliance Period

Megan Christensen
Blank Rome LLP
600 New Hampshire Avenue, NW
Washington, DC 20037
Christensen@BlankRome.com
May 14, 2014
7-Year Compliance – What is Really Locked In?

§45D(g)(1) & Treas. Reg. §1.45D-1(e)(1) provide for recapture of the credits and the payment of tax and interest in the event there is a “recapture event” during the 7-year period beginning on the date of the original issue of a QEI.
Recapture Events - §45D(g)(3); Treas. Reg. §1.45D-1(e)(2)

- CDE ceases to qualify as a community development entity;
- Substantially-All Requirement is not met (85% of QEI used in QLICI); or
- QEI is redeemed or otherwise cashed out by the CDE. (Treas. Reg. §1.45D-1(e)(3)
Leverage Lender

• Outside of NMTC Structure
• Options
  – Loan Acquisition (e.g., Day Loans)
  – Repayment
• No statutory/regulatory requirement to remain in transaction; may have contractual obligations.
Investor

• Treas. Reg. §1.45D-1(c)(7) re QEIs: Subsequent purchasers: A QEI includes any equity investment that would be a QEI in the hands of the taxpayer if it was a QEI in the hands of the prior holder.

• QEI = equity investment in CDE; for cash; substantially all used in QLICI; and designation.
Investor Consequences

• Credit taken on date of QEI & on each anniversary date for 6 years.

• Prior to 6th Anniversary
  – Investor foregoes remaining credits; taken by new Investor/Purchaser

• After 6th Anniversary
  – All credits already taken; Purchaser only gets residual cash flow, if any.

• Assumes no Redemption of QEI.
CDE

• Section 45D(d)(1)(B): A QLICI includes the purchase from another CDE of any loan made by that CDE which is a QLICI (at time loan was made or at time of purchase).

• QLICI includes:
  – Loan to any QALICB; and
  – Any loan to a qualified CDE.

• Reinvestment requirement

• Intermediary CDEs
QALICB

• Repayment of QLICIs to CDE
  – CDE must reinvest within 1 year.
• QALICB owners sell interests in QALICB
• New QALICB acquires the project and assumes the QLICIs
New QALICB

- In the event of the incorporation of new QALICB - representations and warranties that there are no existing recapture defaults
- Impact of potential COD income on note modification
- Reexamination of NQFP tests
- New QALICB/QLICI opinion
Other Issues In Workouts/Loan Modification

- Review of Tax Credit Indemnifications
- Attract new equity
- Valuation (tax opinion – true debt)
- Viability of Project in hands of new QALICB
- Control