

Section 45D.—New Markets Tax Credit

26 CFR 1.45D-1T: New markets tax credit.

New markets tax credit. This ruling holds that, for purposes of determining the new markets tax credit under the facts of the ruling, the amount of the qualified equity investment made by a limited liability company (LLC) classified as a partnership includes cash from a nonrecourse loan to the LLC that the LLC invests as equity in a qualified community development entity.

Rev. Rul. 2003-20

ISSUE

For purposes of determining the new markets tax credit allowable under § 45D of the Internal Revenue Code, does the amount of the qualified equity investment

made by a limited liability company (LLC) classified as a partnership include cash from a nonrecourse loan to the LLC that the LLC invests as equity in a qualified community development entity?

FACTS

In Year 1, *CDE*, a qualified community development entity under § 45D(c), receives a new markets tax credit allocation of $2,000x$ from the Secretary of the Treasury. In Year 2, *X*, a widely-held C corporation, contributes $792x$ for a 99-percent member interest in *LLC*, a limited liability company that is classified as a partnership for federal tax purposes. *Y*, a widely-held C corporation, contributes $8x$ for a 1-percent managing member interest in *LLC*. *LLC* borrows $1,200x$ from *Bank*, an unrelated third party. *LLC* contributes $2,000x$ for an equity interest in *CDE*, which is a limited liability company clas-

sified as a partnership for federal tax purposes. *CDE* designates *LLC*'s equity investment in *CDE* as a qualified equity investment under § 45D(b)(1)(C).

The \$1,200x loan from *Bank* is a non-recourse liability that is characterized as indebtedness of *LLC* for federal tax purposes. The loan is secured only by *LLC*'s interest in *CDE*. The loan is not secured by any assets of *CDE*. The full amount of the loan is repayable at the end of Year 9. The loan is not convertible into an equity interest in *LLC*.

On April 1 of Year 2, *CDE* lends the \$2,000x to a qualified active low-income community business, as defined in § 45D(d)(2)(A). This \$2,000x loan is repayable in full at the end of Year 9. Interest payments received by *CDE* from the qualified active low-income community business are distributed to *LLC*. *X* and *Y* retain their membership interests in *LLC*, and *LLC* retains its \$2,000x equity investment in *CDE*, until the end of Year 9. The entire \$2,000x loan by *CDE* remains outstanding, and the borrower continues to qualify as a qualified active low-income community business, until the end of Year 9.

LLC claims its qualified equity investment in *CDE* is \$2,000x on each credit allowance date and allocates the new markets tax credit with respect to this amount to *X* and *Y* in accordance with § 704(b).

LAW

Section 45D(a)(1) provides that for purposes of § 38, in the case of a taxpayer who holds a qualified equity investment on a credit allowance date (as defined in § 45D(a)(3)) of the investment which occurs during the taxable year, the new markets tax credit determined under § 45D for the taxable year is an amount equal to the applicable percentage (as defined in § 45D(a)(2)) of the amount paid to the qualified community development entity for the investment at its original issue. Section 7701(a)(14) defines the term "taxpayer" to mean any person subject to any internal revenue tax. Section 7701(a)(1) provides that the term "person" shall be construed to mean and include an individual, a trust, estate, partnership, association, company or corporation.

Section 45D(b)(1) defines the term "qualified equity investment" as any eq-

uity investment in a qualified community development entity if (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 qualified community development entity to make qualified low-income community investments, and (C) the investment is designated for purposes of § 45D by the qualified community development entity.

Section 45D(b)(2) provides that the maximum amount of equity investments issued by a qualified community development entity which may be designated under § 45D(b)(1)(C) by the entity shall not exceed the portion of the limitation amount allocated under § 45D(f) to the entity.

Section 45D(b)(6) defines the term "equity investment" as (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 a partnership.

Section 45D(c)(1) defines the term "qualified community development entity" as any domestic corporation or partnership if (A) the primary mission of the entity is serving, or providing investment capital for, low-income communities or low-income persons, (B) the entity maintains accountability to residents of low-income communities through their representation on any governing board of the entity or on any advisory board to the entity, and (C) the entity is certified by the Secretary for purposes of § 45D as being a qualified community development entity.

Section 45D(d)(1) defines the term "qualified low-income community investment" as (A) any capital or equity investment in, or loan to, any qualified active low-income community business, (B) the purchase from another qualified community development entity of any loan made by the entity which is a qualified low-income community investment, (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 qualified community development entity. Section 45D(d)(2)(A) defines the term "qualified active low-income community business" as any corporation or partnership that satisfies the requirements of § 45D(d)(2)(A)(i) through (v).

ANALYSIS

Section 45D(b)(1)(A) requires that a qualified equity investment be acquired by the taxpayer solely in exchange for cash. Section 45D does not prohibit a taxpayer (including any taxpayer who is a person as defined under § 7701(a)(1)) from using cash derived from a borrowing, including non-recourse borrowing, to make a qualified equity investment in a qualified community development entity. The facts of this revenue ruling state that the loan from *Bank* is characterized as indebtedness of *LLC* for federal tax purposes. The loan proceeds and the contributions by *X* and *Y* to *LLC* are used by *LLC* to make an equity investment of \$2,000x in *CDE*. The requirements of § 45D(b)(1)(A) are satisfied because *LLC* acquires its investment in *CDE* at its original issue solely in exchange for cash. The requirements of § 45D(b)(1)(B) are satisfied because *CDE* uses the entire equity investment of \$2,000x to make a qualified low-income community investment. The requirements of § 45D(b)(1)(C) are satisfied because *CDE* designates the equity investment of \$2,000x for purposes of § 45D. Accordingly, *LLC* is treated as having made a qualified equity investment of \$2,000x in *CDE* when *LLC* acquires its equity interest in *CDE*. *LLC* may claim a new markets tax credit on each credit allowance date in an amount determined under § 45D that is equal to the applicable percentage of the \$2,000x qualified equity investment in *CDE*. *LLC* may allocate to *X* and *Y* the amount of the new markets tax credit that *LLC* claims with respect to the \$2,000x qualified equity investment. This allocation must be made in accordance with § 704(b) (which provides rules regarding a partnership's allocation of income, gain, loss, deduction, or credit (or item thereof) among the partners).

HOLDING

Under the facts of this revenue ruling, for purposes of determining the new markets tax credit allowable under § 45D, the amount of the qualified equity investment made by an LLC classified as a partnership includes cash from a nonrecourse loan to the LLC that the LLC invests as equity in a qualified community development entity.

DRAFTING INFORMATION

The principal author of this revenue ruling is Michael J. Goldman of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Mr. Goldman at (202) 622-3080. For information regarding issues under § 45D, contact Gregory N. Doran of the Office of Associate Chief Counsel (Passthroughs and Special Industries) at (202) 622-3040. These are not toll-free calls.