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September 11, 2006

The Honorable Mark W. Everson
Commissioner of Internal Revenue
Internal Revenue Service
Room 5226
1111 Constitution Avenue, NW
Washington, DC 20224

CC:PA:LPD:PR (Notice 2006-65)
Room 5203
Internal Revenue Service
P.O. Box 7605
Ben Franklin Station
Washington, DC 20044

Re: Comments Concerning Notice 2006-65
(IRC §4695)

Dear Commissioner Everson:

Enclosed are comments concerning Notice 2006-65 as prepared by the below-identified members of the Tax Credit-Equity Financing and Nonprofit Organizations committees of the American Bar Association Forum on Affordable Housing and Community Development ("ABA Forum"). These comments represent the individual views of those members who prepared them and do not represent the position of the American Bar Association, ABA Forum or the ABA Forum's committees on Tax Credit-Equity Financing and Non-Profit Organizations.

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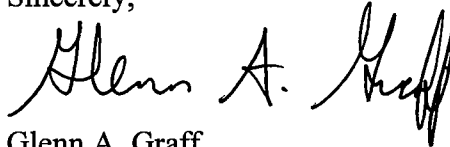
The Honorable Mark W. Everson

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I had principal responsibility for preparing these comments. Substantive contributions were made by Daniel L. Kraus, Past Chair, Tax Credit–Equity Financing Committee of the Committee of the ABA Forum and Forrest David Milder, Board of Governors of ABA Forum. The comments were reviewed by John H. Gadon, Chair - Exempt Organizations Committee of the Committee of the ABA Forum, and Richard W. Power – member of the Tax Credit–Equity Financing Committee of the ABA Forum.

Sincerely,

A handwritten signature in black ink that reads "Glenn A. Graff". The signature is written in a cursive style with a large, stylized initial "G".

Glenn A. Graff
Chair, Tax Credit–Equity Financing
Committee of the American Bar Association
Forum on Affordable Housing

I. Executive Summary

In Notice 2006-65, the Internal Revenue Service (“Service”) and the Department of Treasury (“Treasury”) requested public comments regarding the requirement of new Internal Revenue Code (the “Code”) § 4965 and amendments to §§ 6033(a)(2), 6011(g) and 6652(c)(3). The effect of these Code sections is to enact an excise tax on nonprofits and nonprofit managers that participate in certain types of reportable transactions. The following comments will address the application of the reportable transaction rules to transactions involving contractual protection where the refundable or contingent fee is related to the Low-Income Housing Tax Credit (“LIHTC”) under § 42 and the Historic Rehabilitation Tax Credit (“HTC”) under § 47 (together, the “Affected Credits”).¹

A. Major Recommendations in Regard to these Comments.

We applaud the Service and Treasury for providing explicit exceptions to transactions with contractual protection in Notice 2004-65 for work opportunity credit under § 51, the welfare-to-work credit under § 51A, and the Indian employment credit under § 45A(a). We recognize that the transactions included on the list of exceptions are transactions that Congress has indicated that it wished to encourage by providing tax as well as other economic incentives for taxpayers to undertake the transaction. We believe that transactions a primary purpose of which is to qualify for the Affected Credits have similar Congressional purposes. In addition, such Affected Credits transactions already have significant existing disclosure and governmental supervision. Finally, we believe that while such transactions do not fall within the literal meaning of transactions with contractual protection, the uncertainty in the area is unsettling and disruptive given the significant disclosure, reporting and excise tax implications if such transactions are deemed to be transactions with contractual protection. Therefore, we believe that the Service and Treasury should provide explicit guidance that for transactions in which the refundable or contingent fee is related to the Affected Credits, such transactions should not be taken into account in determining whether a transaction is a transaction with contractual protection under Treas. Reg. § 1.6011-4(b)(4).

B. Other Recommendations.

If it is decided that exemption from the definition of a transaction with contractual protection is not appropriate, we recommend that guidance be issued providing that such transactions are not subject to the excise tax of § 4965.

¹ Although beyond the scope of this letter, we note that much of the reasoning in this letter would also apply to many transactions employing the New Markets Tax Credit (“NMTC”) under § 45D. NMTCs are subject to a great deal of scrutiny by the Community Development Financial Institutions Fund (“CDFI”), which is part of Treasury, and many exempt organizations have already received allocations of NMTC. It does not appear that Congress had an intent to impair tax-exempt allocatees which have been approved in a competitive process through the CDFI.

II. Discussion of Major Recommendation

A. Low-Income Housing Tax Credit

The LIHTC under § 42 was enacted in order to stimulate the private investment in housing for low-income persons by providing a tax credit for the provision of such housing. Low-income housing projects (“Projects”) are uneconomic without taking into consideration the credits available under § 42. This need for economic assistance was reflected in Treas. Reg. § 1.42-4(a), which provides that no profit motive needed for LIHTC transactions. In fact, § 42 specifically requires that the amount of LIHTC available to the Project is limited to an amount that will allow the Project to be “financially feasible.” LIHTC transactions are generally structured as limited partnerships² (each “Partnership”) with a sponsor or affiliate of the Sponsor (collectively, “Sponsor”) as the general partner and one or more for-profit corporate investors (“Investor”) as the limited partner.³ The Investor generally provides most or all the equity to the Partnership that is used, along with loans, to build the Project. In exchange for its equity investment, the Investor is allocated almost all of the LIHTC and other tax benefits generated by the Project. The Sponsor often also contracts with the Partnership to undertake the development and construction of the Project and receives a fee (“Developer Fee”) from the Partnership related to such work. The Sponsor is also the general partner and is in charge of the day-to-day operations of the Project and the Partnership and ensuring that the Project is run in compliance with the LIHTC rules under § 42 and the applicable Regulations. As the party responsible for ensuring the Project and the Partnership are run in compliance with the LIHTC rules, the Sponsor may agree to return to the Investor some or all of its equity in the event that the Project does not qualify for some or all of the anticipated LIHTC. Because the Sponsor is paid a Developer Fee, management fee, and/or some combination of fees, and because it may also agree to make additional capital contributions or a loan to the Partnership that would be used to make the payment to the Investor if less than all of the projected LIHTCs are allocable to the Investor, the transaction could be deemed to be a transaction with contractual protection under Treas. Reg. § 1.6011-4(b)(4).

In some structures (sometimes referred to as a guaranteed fund), investors with high quality credit will structure the transactions to bring in additional corporate investors. The credit worthy investor will guarantee that the anticipated LIHTCs will be delivered and, may also receive a fee related to the admission of the final credit user. Such structures make the LIHTC appealing to a broader number of investors, and this in turn contributes to a competitive marketplace for LIHTCs. Such a competitive marketplace ensures that the most equity is contributed to the LIHTC Partnerships in exchange for the LIHTC. This benefits the Projects and the low-income tenants by generating as much equity as possible. If more equity is raised,

² Limited liability companies are also commonly used. For simplicity of discussion, the term Partnership will refer to either limited partnerships or limited liability companies. The term general partner will refer to both general partners of limited partnerships and managing members of limited liability companies.

³ Corporate investors may invest directly in the LIHTC partnership or may invest through a syndicator. The syndicator will form a pass-through entity to act as the Limited Partner and the corporate investors would be members of the pass-through entity.

then less debt will be needed to fund construction of the Project. By decreasing the debt burden on the Partnerships that must be satisfied by tenant rent, it is possible to lower rent to the low-income tenants. In addition, the greater equity will also result in less debt being needed from the other source, such as state or local municipalities.

The interaction with the above structures with the reportable transaction rules comes from the fact that one of the requirements for a transaction with contractual protection is that there must be a potentially refundable fee paid to a party that makes a statement concerning the potential tax consequences that may result from the transaction. Treas. Reg. 1.6011-4(b)(4)(ii). However, this standard is so broad as to arguably include the mere fact that a Sponsor tells a potential investor that it wishes to build a Project that will qualify for LIHTC. Similarly, the credit worthy investor that seeks to bring in other investors into a guaranteed fund could be deemed to have triggered the contractual protection rules because the credit worthy investor tells the other investors that LIHTC will be available.

We believe that transactions in which the refundable or contingent fee is related to the LIHTC, such transactions should not be taken into account in determining whether a transaction is a transaction with contractual protection under Treas. Reg. § 1.6011-4(b)(4). In support of the exclusion of LIHTC transactions from the definition of transactions with contractual projection, we note the following:

1. LIHTC Transactions Are Already Sufficiently Disclosed to the Service

LIHTC transactions are already separately reported by the taxpayer on Form 8609, and by the various state credit allocation agencies on Form 8610. LIHTC transactions also have their own audit group that specializes in these transactions. The purpose of the reportable transaction rules was to provide disclosure to the Service of the various types of tax-motivated transactions. LIHTC transactions are already sufficiently disclosed.

2. LIHTC Transactions Are Monitored by the States

Most LIHTCs are allocated to each state from the Federal government and each state then allocates LIHTCs to individual Projects. LIHTC may also be created through the use of tax-exempt financing subject to the volume cap rules of § 146. In either case, before a Project receives LIHTCs, the Project must be reviewed by the state to determine that the Project complies with the state's § 42 required qualified allocation plan and the state must also determine that the LIHTCs are necessary for the financial feasibility of the Project. After completion of construction, the states monitor LIHTC Projects throughout the life of the Project, and are required to report to the Service any non-compliance issues. Therefore, no LIHTCs are generated without significant state oversight and involvement, and without disclosure to the Service of any compliance failures.

3. LIHTC Transactions Serve a Congressional Purpose

As discussed above, LIHTC transactions are furthering the express purpose of Congress to create private investment in low-income housing in exchange for tax credits. These types of transactions are not the types of tax shelters that Congress was attempting to identify in passing

the reportable transaction rules. This conclusion is supported by the recent revisions to Circular 230 which addresses tax shelter tax opinions. Section 10.35(b)(10) of Circular 230 provides that “the principal purpose of a partnership or other entity, investment plan or arrangement, or other plan or arrangement is not to avoid or evade Federal tax if that partnership, entity, plan or arrangement has as its purpose the claiming of tax benefits in a manner consistent with the statute and Congressional purpose.” It seems clear that LIHTC transactions would fall within this exception to the principal purpose category of transaction under Circular 230. For similar reasons, LIHTC transactions should be excluded from the definition of transactions with contractual protection.

4. LIHTC Transaction Do Not Fit the Definition of a Transaction with Contractual Protection

The Code and Treasury Regulations refer to a refund of the fees paid for tax advice rendered in connection with a transaction. However, under the typical LIHTC transaction, the Investor’s contractual protection⁴ is not limited to, or measured in any way by, the amount of fees the Investor is paying to the General Partner, Sponsor, or any other party⁵. There is no direct or indirect obligation to refund the fees paid for rendering the tax advice. Rather, any payments to an Investor that are derived from the General Partner or Sponsor to an Investor represent a guaranteed payment to the Investor of its capital contribution, plus a guaranteed return. Although such a payment to the Investor could include all amounts paid by the Investor (plus its return), and such payment therefore might be deemed to compensate the Investor for the fees the Partnership paid to such General Partner or Sponsor, the payments are not necessarily tied to the fee. Because any such payment would not be a rebate of the fee, as a matter of commercial practice, it would be similar to a tax indemnity payment that should not be considered a transaction with contractual protection under the Treasury Regulations. Support for the position that tax indemnity payments are not to be treated as a rebate of fees can be found in a change to the relevant Treasury Regulation that was made in 2003. Prior to February 3, 2003, under Temporary Regulations, a transaction with contractual protection included: (i) a transaction in which the taxpayer had a right to a full or partial refund of the fees paid, (ii) a transaction in which the fees were contingent on the taxpayers realization of tax benefits from the transaction, and (iii) a transaction with insurance or indemnity protection with respect to the tax treatment of the transaction. In making a change to the definition of a transaction with contractual protection to include only those transactions in which a fee can be refunded or is contingent, the Treasury Department indicated that it was responding to complaints that “it is inappropriate to require the reporting of a transaction for which the taxpayer obtains tax insurance.” The Preamble to the Final Regulations on this point states: “In response to these [commentators’] comments [concerning non-abusive, legitimate business transactions], the IRS

⁴ Nonprofit Sponsor guarantees are generally structured as an obligation of the Sponsor to make a capital contribution or loan to the Partnership in an amount sufficient to allow the Partnership to make the necessary payment to the Investor.

⁵ In some cases, the guaranties of the Sponsor are limited to the amount of the Developer Fee received by such Sponsor. This limitation is one of the items listed in the safe harbor guidelines set forth in the Service’s Memorandum dated April 25, 2006 with respect to the processing of applications for recognition of tax-exempt status by organizations serving as general partners of LIHTC partnerships.

and Treasury Department changed the focus of the contractual protection factor to whether fees are refundable or contingent.” While a Sponsor capital contribution or loan which is then used by the Partnership to make a payment to the Investor is not the same as a tax insurance payment because the Sponsor is receiving back an economic benefit from the capital or loan, we believe that they are similar enough that the reasoning for the exemption for tax insurance should also apply such guarantees by Sponsors.

B. Historic Rehabilitation Tax Credits

The HTC was enacted in order to provide a tax credit for rehabilitating historic structures. Congress was concerned that it could be more expensive to rehabilitate a historic structure than to demolish it and build a new building in its place. Congress deemed that the preservation of historic structures was important and enacted the HTC to provide a tax credit to lessen the economic incentive to demolish existing historic buildings. See, e.g. General Explanation of the Tax Reform Act of 1986 (P.L. 99-514) prepared by the staff of Congress's Joint Committee on Taxation (“[Historic Tax Credits] are needed because the social and aesthetic values of rehabilitating and preserving older structures are not necessarily taken into account in investors' profit projections. A tax incentive is needed because market forces might otherwise channel investments away from such projects because of the extra costs of undertaking rehabilitations of older or historic buildings.”)

Similar to LIHTC transactions, HTC transactions are commonly structured as partnerships between a Sponsor and an Investor where the Sponsor contracts to provide development services in exchange for a fee, and the Investor will make a substantial equity contribution as a limited partner and receive some guarantees from the Sponsor that the anticipated HTC will be available. For the reasons below, we believe that HTC transactions should not be considered transactions with contractual protection:

1. HTC Transactions Are Already Sufficiently Disclosed to the Service

HTC transactions are already separately reported as an investment tax credit on Form 3468. HTC transactions also have their own audit group that specializes in these transactions. The purpose of the reportable transaction rules was to provide disclosure to the Service of the various types of tax-motivated transactions. HTC transactions are already sufficiently disclosed to the Service.

2. HTC Transactions Are Monitored by the National Park Service and the States

In order to receive the 20% HTC, the building must be deemed historically significant and the rehabilitation of the building must be in compliance with the standards of the Secretary of the Interior. The qualification of the Project as historically significant and the determination of whether the appropriate rehabilitation standards have been met both require the approval of the National Park Service and the state historic preservation office. Thus no HTCs will be generated without significant government oversight and involvement.

3. HTC Transactions Serve a Congressional Purpose

As discussed above, HTC transactions are furthering the express purpose of preserving historic structures. For example, Revenue Ruling 86-49, 1986-1 C.B. 243, describes the importance of preserving historic structures as follows:

The Historic Preservation Act of 1966 (16 U.S.C. §§461, 470) provides that it is a national policy to preserve for public use historic sites, buildings, and objects of national significance for the inspiration and benefit of the people of the United States. The Act further states that the historical and cultural foundations of the nation should be preserved as a living part of our community life and development to give a sense of orientation to the American people.

While the Historic Preservation Act of 1966 did not establish the HTC, the HTC is an outgrowth of the continued Congressional purpose of maintaining important historic structures. The HTC serves the purpose of preserving historic structures and we believe that transactions involving the HTC are not the types of tax shelters that Congress was attempting to identify in passing the reportable transaction rules.

4. HTC Transaction Do Not Fit the Definition of a Transaction with Contractual Protection

The discussion in Section II.A.4 above applies equally to HTC transactions.

III. Discussion of Other Recommendation

In the event that it is decided that Affected Credits transactions should not be exempted from the definition of transactions with contractual protection, we believe that such transactions should at a minimum be exempted from the new excise tax under § 4695. Section 4695 provides for the application of an excise tax on tax-exempt organizations that participate in certain types of reportable transaction, including transactions with contractual protection. We believe this excise tax should not apply to tax-exempt organizations that participate in transactions with contractual protection that utilize the Affected Credits.

A. Low-Income Housing Tax Credit

The imposition of an excise tax on participation in a LIHTC partnership will negatively impact the desire of nonprofits organizations to participate in LIHTC Projects. However, § 42(h)(5) requires that 10% of the LIHTC allocated to each state be set-aside for Projects involving qualified nonprofit organizations that are exempt from tax under § 501(c)(3) or (c)(4). Thus the imposition of the excise tax would frustrate the Congressional desire for tax-exempt organizations to participate in LIHTC transactions. Therefore, we recommend that the excise tax not apply to tax-exempt organizations participating in LIHTC transactions.

