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NEW MARKETS TAX CREDIT FACT SHEET

In December 2000, Congress enacted the New Markets Tax Credit (NMTC) as part of the Community Renewal Tax Relief Act of 2000. The NMTC will spur some \$15 billion in investments to promote economic development in rural and urban low-income communities.

On December 20, 2001, the Community Development Financial Institutions (CDFI) Fund issued guidance for Community Development Entity (CDE) certification. A CDE is the investment vehicle for the NMTC. On December 26, 2001, the Assistant Secretary of the Treasury for Tax Policy and the Internal Revenue Service (IRS) issued temporary, or interim, regulations implementing the NMTC program. On June 11, 2002, the CDFI Fund issued the notice of availability for NMTC allocations and the NMTC allocation application.

The NMTC will be available to taxpayers who make equity investments in CDEs – organizations with track records and expertise in promoting economic development in low-income communities. These investments, in turn, may be used to provide a range of financial and technical assistance to promote economic development in low-income communities.

In 2002 the CDFI Fund of the Department of the Treasury will allocate tax credit authority to certified CDEs to secure up to \$2.5 billion in equity qualifying for NMTCs.

<u>Fiscal Year</u>	<u>Amount of Investments Available for Credits</u>
2002	\$2.5 billion ¹
2003	\$1.5 billion
2004	\$2.0 billion
2005	\$2.0 billion
2006	\$3.5 billion
2007	\$3.5 billion
<u>Total</u>	<u>\$15.0 billion</u>

HOW THE NEW MARKETS TAX CREDIT WORKS

Program Administration. The CDFI Fund of the Treasury Department administers the NMTC program. Before applying for a NMTC allocation, a community development organization must apply to the CDFI Fund to be certified as a CDE with a primary mission of serving Low-income Communities and maintaining accountability to residents of those communities. The CDFI Fund will publish, at least annually, a notice requesting proposals for NMTC allocations. CDEs will apply to the CDFI Fund both to be certified as a CDE and to receive an allocation of NMTCs.

Requirements for Allocation of the Credit. The notice from the CDFI Fund will include application requirements, as well as standards by which applications will be evaluated. In determining allocation requests, the CDFI Fund will give equal weight to the following four factors: Business Strategy, Capitalization Strategy, Management Capacity, and Community Impact. Based on these factors, the

¹ The law provides \$1 billion in NMTC investments in 2001 and \$1.5 billion in 2002. No credit allocations were made in 2001 and thus \$2.5 billion are available in 2002.

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CDFI Fund will allocate NMTCs to CDEs. Under the law, a priority is given to CDEs with a track record or to CDEs proposing to make investments in businesses unrelated to the CDEs themselves.

Terms of the Credit. CDEs will use credits to attract Qualified Equity Investments from individual or corporate taxpayers. The term of the credit is seven years. Investors will be able to claim a tax credit of 5% for each of the first three years of the credit, 6% for each of the last four years. The net present value of the credit is 30%.

Investing in Communities. CDEs will have five years in which to place the credits. Funds derived from the NMTC will be used for providing financial and technical assistance (Qualified Low-income Community Investments) to eligible businesses. If at the end of that time a CDE has not used all its credits, the CDFI Fund may transfer the unused NMTCs to another CDE. Upon receiving Qualified Equity Investments, CDEs will have one year to place the funds in qualified investments. CDEs will be required to use at least 85% of the funds derived from the credits for qualified investments.

CERTIFIED COMMUNITY DEVELOPMENT ENTITIES

Certified CDEs can include community development organizations such as community development corporations, community development financial institutions, community development venture capital funds, small business investment corporations, community loan funds, specialized small business investment companies, and others.

In order to be certified by the CDFI Fund, an organization must be a corporation or partnership, have a primary mission of serving or providing investment capital for low-income communities or individuals, and maintain accountability to residents of low-income communities through representation on governing or advisory boards. The law deems Community Development Financial Institutions and Specialized Small Business Investment Corporations automatically eligible to be certified as CDEs – but they must register online at www.cdfifund.gov.

Nonprofit and for-profit CDEs may apply for a NMTC allocation. However, non-profit corporations cannot take on investors. Thus, a non-profit entity will have to set up a for-profit affiliate to take NMTCs. In this case, nonprofit CDEs may transfer their NMTC allocation to a for-profit affiliate with prior approval from the CDFI Fund.

ELIGIBLE AREAS

The NMTC is targeted to low-income communities. In general, a Low-income Community is a census tract with a poverty rate of at least 20% or with median income of up to 80% of area median or statewide median, whichever is greater, and, for a non-metro census tract, 80% of statewide median.

The NMTC may also be used in Target Areas. A Target Area is a community within a census tract that does not meet the poverty or median income standard. The Target Area provision allows certain communities located in ineligible census tracts to participate in the program. Such communities must have pre-existing boundaries such as established neighborhoods or political or geographic boundaries, meet the poverty rate or median income standard, and have a demonstrated lack of investment capital.

In seeking an allocation, a CDE may propose to serve one or more Low-income Communities or Target Areas.

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QUALIFIED INVESTMENTS

With funds derived from the NMTCs, CDEs may make available a range of financial and technical assistance (known as Qualified Low-income Community Investments) to private business enterprises in low-income communities. Qualified Low-income Community Investments may include: loans, equity investments, or capital to businesses; purchase of certain loans made by other CDEs; financial counseling and related services to businesses; and equity investment, loans, and counseling to other CDEs.

The law requires that Substantially All of the cash received by a CDE through the NMTC be used for Qualified Low-income Community Investments. To meet Substantially All, the temporary rule generally requires that either 85 percent of the cash received from the taxpayer in return for the tax credit must be directly traceable to Qualified Low-income Community Investments, or 85 percent of the aggregate gross assets of the CDE must be deployed in qualified activities. The temporary regulations also indicate that the government will only regulate cash received from a taxpayer in return for NMTCs. Interest income and profits from loans, equity investments, or capital are not included in the basis for the NMTC and are not part of the formula for Substantially All.

QUALIFIED BUSINESSES

Under the law, businesses eligible to receive such investments are those corporations or partnerships (including sole proprietorships or unincorporated trades or businesses) that are active and located in low-income communities. A Qualified Active Low-income Business must derive at least half its gross income from business in the eligible area. In addition, a substantial portion of its tangible property as well as services performed by employees of the business must be in an eligible community. CDEs may provide investments to Qualified Active Low-income Businesses that are owned in whole or in part by the CDE.

The CDFI Fund will interpret the gross income test to include products either manufactured or sold in a qualified area; the tangible property test will be interpreted so that a business that is located in a qualified area, but providing services elsewhere, will meet the test.

The regulations ease compliance issues by establishing a *reasonable expectations* test. A business should qualify as a Qualified Active Low-income Community Business throughout the entire period of the investment or loan if the CDE reasonably expects that, at the time that the CDE made the Qualified Low-income Community Investment in the business, it would meet the qualification requirements. (This provision will not apply in cases in which a CDE has ownership control over the business receiving a Qualified Low-income Community Investment.) The *reasonable expectations* test simplifies the task of compliance for the NMTC. The regulations do not prescribe the standards by which a CDE could meet the *reasonable expectations* test.

LIMITATIONS

In general, financing of low-income rental housing is not allowed under the NMTC, and NMTC may not be combined with other federal tax subsidies, including the Low-income Housing Tax Credit. Rental property that derives 80% or more of its income from residential tenants is not eligible. However, a mixed-use development, where less than 80% of the property's gross income is rental income from dwelling units, is allowed under NMTC.

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