New Markets Tax Credit Program 101

The Basics

Making the New Markets Tax Credit Work in Native Communities

PRESENTED ON MAY 24, 2018
New Markets Tax Credit – 101

- Introduction to NMTC
- Program History & Overview
- NMTC Key terms
- CDE Certification
- How can NMTC work for your organization
The New Markets Tax Credit was authorized under the Community Renewal and Tax Relief Act of 2000, and has been subject to reauthorization since 2006.

Most recently, the Protecting Americans from Tax Hikes (PATCH) Act of 2015 extends the program through 2019, providing tax credit authority at $3.5 billion per year.

Earlier this month, we opened the CY2018 Round.
What is the New Markets Tax Credit?

- NMTCs provide a **credit** against Federal income taxes for **investors** that make *Qualified Equity Investments (QEIs)* in certified financial intermediaries called **Community Development Entities (CDEs)**.

- **CDEs**, in turn, use the proceeds of these QEIs to make *Qualified Low-Income Community Investments (QLICIs)*, such as business loans or equity investments, in **Low-Income Communities** into **Qualified Active Low Income Businesses (QALICBs)**.
The New Markets Tax Credit is taken over a 7-year period. The credit rate is:
- 5% of the original investment amount in each of the first three years; and
- 6% of the original investment amount in each of the final four years.

Total credit equals 39% of the original amount invested in the CDE.

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The CDFI Fund awards a tax credit allocation of $1 million to a CDE.

The CDE offers the tax credit to a single investor in exchange for a $1 million equity investment.

- Generates a $50,000 credit annually for the first three years;
- Generates a $60,000 credit annually for the final four years.

Total credit value over 7 years is $390,000.

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Key Terms

- Community Development Entity (CDE)
- Substantially All (Sub-All)
- Qualified Equity Investments (QEI)
- Qualified Low-Income Community Investments (QLICI)
  - Qualified Active Low-Income Community Businesses (QALICB)
  - Low-Income Community (LIC)
  - Financial Counseling and Other Services (FCOS)
  - Subsidiary Community Development Entity (Sub-CDE)
How does NMTC work?

• The NMTC Program encourages private-sector investment in Low Income Communities by providing a credit against Federal income taxes to investors that make Qualified Equity Investments (QEIs) into Community Development Entities (CDEs).

• CDEs must use **substantially all** of the QEI proceeds (cash) to make Qualified Low Income Community investments (QLICIs).
  - Provides access to capital in Low-Income Communities
  - Federal Government foregoes tax revenue to channel investment capital to achieve program goals.
What is a CDE?

- A Community Development Entity (CDE) is a domestic corporation or partnership that is an intermediary vehicle for the provision of loans, investments, or financial counseling in Low-Income Communities.

- To qualify as a CDE, a domestic corporation or partnership must apply for and receive certification from the CDFI Fund.
CDE Certification

- Legal Entity at time of Application
- Primary Mission of serving LICs
- Must be accountable to the LIC it serves.
  - Governing Board
  - Advisory Board
- Service Area - determine the service area it will serve
  - National, Multi-State, Statewide, Local
Qualified Equity Investment

- A CDE that receives an Allocation raises capital from an Investor.
- In order to claim the NMTCs, an investor must make an equity investment into a CDE – provide *cash* for either stock in a corporation or a capital interest in a partnership – in exchange for the credits.
- The equity investment must be designated by the CDE as a Qualified Equity Investment (QEI), using the CDFI Fund’s electronic tracking system.
- The QEI must remain invested in the CDE during the 7-year tax credit period from the date the investment was initially made.
“Substantially all” of QEI proceeds must be invested in Qualified Low-Income Community Investments (QLICIs) within 12 months:

- **Years 1 – 6**: Substantially All = 85% of amount paid by investor at original issue. Generally, returns of equity, capital or principal must be reinvested within 12 months.

- **Year 7**: Substantially All = 75%. Reinvestment is not required in the final year of the 7-year credit period.
What is a Low Income Community?

- LICs are census tracts
  - with at least 20% poverty rate; or
  - where the median family income does not exceed 80% of the area median family income; or
  - where the median family income does not exceed 85% of the area median family income, provided the census tract is located in a high migration rural county.

- Targeted Population- Businesses not located in LICs but that otherwise serve Targeted Populations may also qualify for NMTC-enhanced loans/investment. Targeted Populations include:
  - Low-Income Persons (e.g. family income no greater than 80% of the applicable area median family income), to the extent the project is located in a census tract with a median family income at or below 120% of the median family income.

- Refer to IRS and CDFI Fund guidance for additional details.
Qualified Low Income Community Investment

QLICIs include:

• Any capital or equity investment in, or loan to, a “Qualified Active Low-Income Community Business” (QALICB).

• Purchase of a loan from another CDE if the loan is a QLICI.

• Any equity investment in, or loan to, a CDE.

• “Financial Counseling and Other Services” (FCOS) to businesses located in, or residents of, Low-Income Communities (LICs).
A QALICB must meet these requirements:

- At least 50% of the total **gross income** is from the active conduct of a qualified business in Low-Income Communities (LICs); and
- At least 40% of the **use of tangible property** of the business is within LICs; and
- At least 40% of the **services preformed** by the business’ employees are performed in LICs; and
- **Less than 5%** of the average of the aggregate unadjusted basis of the property is attributable to **collectibles** (e.g. art and antiques), other than those held for sale in the ordinary course of business; and
- **Less than 5%** of the average of the aggregate unadjusted basis of the property is attributable to **non-qualified financial property** (e.g. debt instruments with a term in excess of 18 months).
Investing in Other CDEs

- Investment may be made through multiple layers of CDEs (e.g. up to 4 CDEs).
- The last CDE recipient needs to demonstrate that it used those dollars to:
  - Make loans to, or investments in QALICBs; and/or
  - Provide FCOS to businesses or residents of LICs.
- All time limits must be met as if the CDE with the allocations directly made the QLICI
## Ineligible Activities

- **Residential rental property**
  - Buildings or structures that derive 80% or more of their gross rental income from renting dwelling units.

- **Certain types of businesses:**
  - Golf courses
  - Race tracks
  - Gambling facilities
  - Certain farming businesses
  - Country clubs
  - Massage Parlors
  - Hot tub facilities
  - Suntan facilities
  - Stores where the principal business is the sale of alcoholic beverages for consumption off premises

Refer to IRS regulations for additional details.
Recapture

- NMTCs may be **recaptured** from investors during the 7 year credit period under certain conditions.
- Events triggering recapture include:
  - The QEI fails the **“substantially-all”** requirement.
    - Failure to **invest 85% of original QEI**; or
    - Failure to meet **“Qualified Active Low-Income Business” (QALICB)** requirements; or
    - Failure to meet **one-year investment/ reinvestment requirement**
  - The CDE **redeems the investment** before the 7 year credit period has ended.
  - The CDE **ceases to qualify** as a CDE.
CDEs must make QLICIs within **12 months** of receipt of Investor QEIs

- Investing in or Lending to QALICBs
- Purchasing Loans from CDEs
- Financial Counseling
- Investing in or Lending to CDEs

CDE must offer credits to investors within **5 years**

- Private Investors

QEI must stay invested in CDE for **7 years**

Community Development Entity (For-profit* only)
The CDFI Fund

- Co-administers the NMTC Program with the IRS
- CDFI Fund's mission is to expand economic opportunity for underserved people and communities by supporting the growth and capacity of a national network of community development lenders, investors, and financial service providers.
- Certifies Community Development Entities
- Manages the competitive Allocation Award process

Internal Revenue Service

- NMTC Investments must comply with regulations outlined in Section 45D of the Internal Revenue Code.
Since the first round CY2002, the CDFI Fund has awarded $54 billion in Allocation Authority, including:

- $7 billion for the Combined CY2015-16 round
- $3.5 billion for the CY2017 Round

$41.9 billion in Loans and equity investments (2003-2015)
NMTC investments in Native Communities (2003-2015)

- $991 MM** invested in Native Communities
- 94 projects
- Examples:
  - Seafood Processing Plant, Platinum, AK
  - Administrative Building, Chinle, AZ
  - Water & Waste Water Treatment System, Laguna, NM
  - Health Center Kailua Kona, HI
  - Hotel, Choctaw, MS
  - Telecomm, Standing, ND
  - Aircraft Engine Parts Manufacturing, Bristown, OK
  - Tribal Headquarters, Nespelem, WA
  - Dental Clinic, Odanah, WI
NMTC – a community development tool

• It’s a flexible tool that can be used for a variety of different projects from day care centers to manufacturing/industrial facilities.

• Projects must be of a certain size in order to make NMTC feasible.

• NMTC is intended to serve as gap financing
  – Need other sources of financing as part of the capital stack

• IRS Regulations require that QLICIs be loans (true debt) or equity investments. QLICIs are not grants.
Little Big Horn College Health and Wellness Center – Crow Agency, MT

- NMTC Closing – 2011, Date Completed - 2012
- Higher education institution of the Crow Tribe of Indians.
- Provides education programs and exercise facilities.
- Total project cost: $10.3 million
- NMTC Equity: $2.4 million

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