New Market Tax Credits

PRIMER

INTRODUCTION TO NEW MARKET TAX CREDITS

New Market Tax Credits (NMTCs) are provided to individual and corporate tax payers. Credits are provided against federal income taxes for taxpayers that make certain investments. Qualifying taxpayers make a "Qualified Equity Investment" (QEI) in a "Qualified Community Development Entity" (CDE). Typically the investments are expected to create jobs or provide measureable improvements in lives of residents in low-income communities or targeted populations. The federal government defines the areas for which the investment qualifies; the investment must be in a low-income community or for targeted populations, defined as a U.S. Census tract with a poverty rate of at least 20 percent or with median family incomes that do not exceed 80 percent of area median incomes.[1] Capital investments examples include mixed use residential, office space, retail centers, schools, hospitals, and community centers.

The U.S. Department of the Treasury Community Development Financial Institutions Fund (The Fund) awards NMTCs to the CDEs. Investors receive tax credits for the value of investments equal to 39 percent over seven years; five percent a year for the first three years and six percent a year for the last four years. To receive the tax credit, the CDE must apply for and the tax credit has to be awarded to the applicant. The Fund has a specific allocation of tax credit available for allocation in each calendar year allocation round that is announced in the Federal Register; typically applicants to The Fund exceed the amount available.

USE OF NEW MARKET TAX CREDITS

Developers may choose to form or connect with an existing CDE in order to advance economic development projects using new market tax credits. These credits become part of the financial package in making the project advantageous for development. In partnering with state and local governments, the developer may then seek economic development incentives in a variety of forms. Potential partners may also seek specific capital project or other development agreements with state and local governments, arguing that their cost of development is lower with NMTC as a part of their financial packages than a governments' cost of financing or development.

The U.S. Department of the Treasury permits NMTC to be allocated for investments in all 50 states, the District of Columbia, Puerto Rico, and certain U.S. Territories. GFOA recommends that with any economic incentive program, finance directors consult state and local laws to ensure compliance with their use and state and local programs.

[1] IRS Notice 2006-60 includes additional information regarding targeted populations.

QUESTIONS FINANCE DIRECTORS SHOULD ASK ABOUT NEW MARKET TAX CREDITS

The finance officer should be able to answer the following questions if presented with an opportunity to partner with a developer or partner for a project, operating or capital lease, or economic development incentive agreement conditioned on potential New Market Tax Credits:

» Who is the CDE and how much, if any, sponsor Fees are included in the cost of Financing or Development? What experience does the CDE have with other projects using New Market Tax Credits?

» Is the local government considered a partner in the application for New Market Tax Credits? What support will be requested of the local government as a partner or otherwise by the CDE on behalf of its application to The Fund?

» What is the risk for project completion if the Tax Credits are not obtained?

» How will costs be borne by the developer if New Market Tax Credits are not awarded? GFOA recommends that the project proposer bear any costs associated with not obtaining the New Market Tax Credits and that these costs not be borne by the local or state government.

» How will proof of the New Market Tax Credit be obtained? Will annual monitoring of tax credits and proof of application of the tax credit be required?

OUTSIDE RESOURCES FOR NEW MARKET TAX CREDITS

» The U.S. Department of the Treasury Community Development Financial Institutions Fund:
https://www.cdfifund.gov/programs-training/Programs/new-markets-tax-credit/Pages/default.aspx

» Internal Revenue Service:
https://www.irs.gov/businesses/new-markets-tax-credit-1#2

New Market Tax Credits are just a tool in reviewing overall public private partnership and economic incentive agreements. GFOA recommends that other best practices be reviewed in conjunction with this introductory primer on New Market Tax Credits when reviewing proposals that involve New Market Tax Credits. Other best practices include:

» Public-Private Partnerships (P3)
http://gfoa.org/public-private-partnerships-p3

» Evaluating Data and Financial Assumptions in Development Proposals
http://gfoa.org/evaluating-data-and-financial-assumptions-development-proposals

» Evaluating and Managing Economic Development Incentives
http://gfoa.org/evaluating-and-managing-economic-development-incentives