

**DEPARTMENT OF THE TREASURY****Community Development Financial Institutions Fund****Guidance, New Markets Tax Credit Program**

**AGENCIES:** Community Development Financial Institutions Fund, Department of the Treasury.

**ACTION:** Guidance, New Markets Tax Credit Program.

**SUMMARY:** Title I, subtitle C, section 121 of the Community Renewal Tax Relief Act of 2000 (the "Act"), as enacted by section 1(a)(7) of the Consolidated Appropriations Act, 2001 (Pub. L. 106-554, December 21, 2000), amended the Internal Revenue Code (the "IRC") by adding IRC section 45D, New Markets Tax Credit. Section 45D requires the Secretary of the Treasury ("Treasury") to establish a program that will provide an incentive to investors in the form of a tax credit over seven years, which is expected stimulate investment in new private capital that, in turn, will facilitate economic and community development in distressed communities. Section 45D, among other things, also requires the Secretary to issue guidance on (i) how entities may apply to receive allocations of New Markets Tax Credits ("NMTCs"); (ii) the competitive procedure through which such allocations will be made; and (iii) the actions that will be taken to ensure that proper allocations are made to appropriate entities. The Secretary has delegated such authority to the Under Secretary (Domestic Finance), who has in turn delegated such authority to the Director of the Community Development Financial Institutions Fund (the "Fund"). Pursuant to section 121(f) of the Act, this document provides guidance on how an entity may apply to become certified as a "qualified community development entity" ("CDE"), how a CDE may apply to receive an allocation of NMTCs, the competitive procedure through which such allocations will be made, and the actions that will be taken to ensure that proper allocations are made to appropriate entities.

In addition, this Guidance seeks comment from the public as to certain application and allocation issues that the Fund may address in subsequent guidance (see Section VII, "Pending Issues," for further detail). All material submitted in response to this Guidance will be available at the Fund for public inspection and copying.

As provided by IRC section 45D(i), Treasury is authorized to prescribe

regulations relating to the NMTC Program as may be appropriate, including regulations that (i) limit NMTCs for investments that are directly or indirectly subsidized by other Federal tax benefits, including the Low-Income Housing Tax Credit under IRC section 42, and the exclusion from gross income for certain tax-exempt bond interest under IRC section 103; (ii) prevent abuse of the purposes of IRC section 45D; (iii) provide rules for determining whether the "Substantially All Test" found at IRC section 45D(b)(1)(B) is treated as met; (iv) impose appropriate reporting requirements; and (v) apply IRC section 45D to newly formed entities.

Simultaneously with the issuance of this Guidance, the Internal Revenue Service ("IRS") is issuing an Advance Notice of Proposed Rulemaking (the "ANPRM") that invites comments from the public on certain issues that the IRS may address in regulations relating to the NMTC Program and IRC section 45D.

The Fund has the authority to allocate to CDEs the authority to issue to their investors, for calendar year 2001, up to the aggregate amount of \$1 billion in equity as to which NMTCs may be claimed; for each of years 2002 and 2003, up to \$1.5 billion in equity as to which NMTCs may be claimed; for each of years 2004 and 2005, up to \$2 billion; and for each of years 2006 and 2007, up to \$3.5 billion. Amounts not allocated in any calendar year may be carried over to succeeding years, to the extent provided in IRC § 45D(f)(3).

This Guidance does not solicit applications either for CDE certification or allocations of NMTCs. The Fund expects, in the future, to issue additional guidance that will solicit CDE certification applications and applications for NMTC allocations.

**DATES:** Written and electronic comments on the issues set forth below in Section VII, "Pending Issues," must be submitted to the Fund by July 2, 2001.

**ADDRESSES:** Comments in response to the issues set forth below in Section VII, "Pending Issues," should be sent by mail to: Acting Director, Community Development Financial Institutions Fund, U.S. Department of the Treasury, 601 13th Street, NW., Suite 200 South, Washington, DC 20005; by e-mail to [cdfihelp@cdfi.treas.gov](mailto:cdfihelp@cdfi.treas.gov); or by facsimile at (202) 622-8244. This is not a toll free number.

**FOR FURTHER INFORMATION CONTACT:** Information regarding the Fund and its programs may be downloaded from the Fund's web site at <http://www.treas.gov/cdfi>.

**SUPPLEMENTARY INFORMATION:****I. Definitions**

*Allocation Agreement:* means a formal agreement, by and between the Fund and a CDE that has been provided with a NMTC allocation, that specifies the terms and conditions of such NMTC allocation.

*Community Development Entity or CDE:* see Qualified Community Development Entity, below.

*Community Development Financial Institution or CDFI:* means an entity that has been certified by the Fund as meeting the criteria set forth in section 103 of the Community Development Banking and Financial Institutions Act of 1994 (12 U.S.C. 4702). For further details, refer to the CDFI Program regulations set forth at 12 CFR 1805.201.

*Comprehensive Investment Plan:* means a document, to be included in a CDE's application for an allocation of NMTCs, that provides historical information and a minimum five-year investment strategy that offers a detailed discussion of (a) the applicant's track record in making investments and promoting community development; (b) the applicant's financial and operational capacity, including its ability to track NMTC investment proceeds; (c) the capacity, skills, and experience of its management team; (d) an analysis of its target market; (e) its plan for raising capital with a NMTC allocation; and (f) its strategy for using the proceeds from such an allocation (including its financial and community development underwriting criteria).

*Credit Allowance Period:* means the seven-year period beginning on the date on which a Qualified Equity Investment, as hereinafter defined, is initially made.

*Low-Income Community:* means any population census tract in which (A) the poverty rate is at least 20 percent, or (B)(i) in the case of a tract not located within a Metropolitan Area (as hereinafter defined), the median family income for such tract does not exceed 80 percent of statewide median family income, or (ii) in the case of a tract located within a Metropolitan Area, the median family income for such tract does not exceed 80 percent of the greater of statewide median family income or the Metropolitan Area median family income. With respect to (B) in the preceding sentence, possession-wide median family income shall be used (in lieu of statewide income) in assessing the status of census tracts located within a possession of the United States. Upon application by an entity for certification as a CDE, the Fund may designate under IRC section 45D(e)(2) an area within a census tract

as a Low-Income Community if (A) the boundary of the area is continuous; (B) the area would otherwise meet the definition of a Low-Income Community if it were a census tract; and (C) there is inadequate access to investment capital in the area (as demonstrated by studies, surveys, or other analyses provided by the applicant). In the case of an area that is not tracted for population census tracts, the equivalent county divisions (as defined by the Bureau of the Census for purposes of determining poverty areas) shall be used for purposes of defining poverty rates and median family incomes. For the purpose of determining whether a business meets the definition of Qualified Active Low-Income Community Business, as hereinafter defined, the CDE shall use the most recent census or other data that is available at the time of its investment in the business.

**Low-Income Persons:** means individuals residing in Low-Income Communities having an income, adjusted for family size, of not more than (i) for non-Metropolitan Areas, 80 percent of the statewide median family income; and (ii) for Metropolitan Areas, the greater of (A) 80 percent of the statewide median family income or (B) 80 percent of the Metropolitan Area median family income.

**Metropolitan Area:** means an area designated as such by the Office of Management and Budget pursuant to 44 U.S.C. 3504(e) and 31 U.S.C. 1104(d) and Executive Order 10253 (3 CFR 1949-1953 Comp., p. 758), as amended.

**Qualified Active Low-Income Community Business:** means, with respect to any taxable year, any corporation (including a nonprofit corporation) or partnership if, for such taxable year: (i) at least 50 percent of the total gross income of such entity is derived from the active conduct of a Qualified Business within any Low-Income Community; (ii) a substantial portion of the use of the tangible property of such entity (whether owned or leased) is within any Low-Income Community; (iii) a substantial portion of the services performed for such entity by its employees are performed in any Low-Income Community; (iv) less than five percent of the average of the aggregate unadjusted bases of the property of such entity is attributable to collectibles (as defined in IRC section 408(m)(2)) other than collectibles that are held primarily for sale to customers in the ordinary course of such business; and (v) less than five percent of the average of the aggregate unadjusted bases of the property of such entity is attributable to nonqualified financial

property (as defined in IRC section 1397C(e)). For this purpose, a proprietorship may be considered a Qualified Active Low-Income Community Business if the business would meet the requirements of the preceding sentence if it were incorporated. In addition, the term Qualified Active Low-Income Community Business includes any trade or business, including any program, department, or division of a business, that would qualify as a Qualified Active Low-Income Community Business if such trade or business were separately incorporated.

**Qualified Business:** means any business that meets the definition found at IRC section 1397C(d), except that (i) in lieu of applying IRC section 1397C(d)(2)(B), the rental to others of real property located in any Low-Income Community shall be treated as a Qualified Business if there are substantial improvements located on such property, and (ii) IRC section 1397C(d)(3) (relating to the rental of tangible personal property) shall not apply. The rental to others of residential rental property (as defined in IRC section 168(e)(2)(A)) is not a Qualified Business.

**Qualified Community Development Entity or CDE:** means 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 Fund as a CDE. A CDE may also be a limited liability company ("LLC") that meets the above tests. SSBICs, as hereinafter defined, and CDFIs will be deemed to be CDEs in the manner hereinafter set forth.

**Qualified Equity Investment:** means any equity investment in a CDE if (A) such investment is acquired by the investor at its original issue (directly or through an underwriter) solely in exchange for cash; (B) substantially all of such cash is used by the CDE to make Qualified Low-Income Community Investments; and (C) the investment is designated by the CDE as a Qualified Equity Investment. Qualified Equity Investment also includes the purchase of a Qualified Equity Investment from a prior holder, to the extent provided in IRC section 45D(b)(4). Qualified Equity Investment does not include any equity investment issued by a CDE more than five years after the date the CDE receives a NMTC allocation. For purposes of this

Guidance, "equity investment" means (A) any stock (other than nonqualified preferred stock as defined in IRC section 351(g)(2)) in a corporation and (B) any capital interest in a partnership. An LLC shall be deemed to be either a corporation or a partnership, according to the LLC's treatment under federal tax law.

**Qualified Low-Income Community Investment:** means (A) any capital or equity investment in, or loan to, any Qualified Active Low-Income Community Business; (B) the purchase from a CDE of any loan made by such entity that is a Qualified Low-Income Community Investment; (C) financial counseling and other services to businesses located in, and residents of, Low-Income Communities; and (D) any equity investment in, or loan to, any CDE.

**Specialized Small Business Investment Company or SSBIC:** is defined in IRC section 1044(c)(3). For further information, contact Austin Belton, Small Business Administration ("SBA"), at 202/205-7027.

## II. The New Markets Tax Credit Program: How the Credit Works

By providing an incentive in the form of a tax credit over seven years, NMTCs are intended to stimulate the investment of \$15 billion in new private capital in CDEs that, in turn, will make investments in eligible businesses in distressed urban, rural, and Native American communities, thus facilitating economic and community development.

Through the NMTC Program, an entity may apply to the Fund to be certified as a CDE (see Section IV, "Eligibility," for further detail). Nonprofit entities and for-profit entities may be certified as CDEs by the Fund. Only CDEs that are for-profit entities are eligible to compete for, and receive, an allocation of authority to issue Qualified Equity Investments with respect to which investors will be entitled to claim NMTCs. A taxpayer (including, for example, individuals, corporations, partnerships, and investment funds) that makes a Qualified Equity Investment in a CDE that has received a NMTC allocation from the Fund may claim a five percent tax credit on the investment amount for each of the first three years and a six percent tax credit for each of the next four years. If the CDE fails to issue equity investments to use all or part of its NMTC allocation within five years from the date of the Allocation Agreement, the unused portion of the allocation will terminate. IRC section 45D(b)(1)(B) requires that the CDE use "substantially all" of the cash raised as a result of its NMTC

allocation to make Qualified Low-Income Community Investments (the "Substantially All Test"). The Substantially All Test will be treated as met if at least 85 percent of the aggregate gross assets of the CDE are invested in Qualified Low-Income Community Investments (the "Safe Harbor Test," found at IRC section 45D(b)(3)). If the Safe Harbor Test is met, the CDE need not trace the use of cash from the particular stock issuance (or other equity investment) with respect to which the NMTCs are claimed. The IRS may address issues related to the Substantially All Test in subsequent regulations.

Under IRC section 45D(d)(1)(A), Qualified Low-Income Community Investment includes any capital or equity investment in, or loan to, any Qualified Active Low-Income Community Business. Please note, however, that under IRC section 45D(f)(2)(B), the Fund will give priority when evaluating whether to award a CDE with a NMTC allocation to any CDE that intends to satisfy the Substantially All Test by making Qualified Low-Income Community Investments in one or more businesses in which persons unrelated to the CDE (within the meaning of IRC section 267(b) or section 707(b)(1)) hold the majority equity interest (see Section V, "Evaluation," below).

If selected for an allocation of NMTCs, a CDE will receive a Notice of NMTC Allocation, which will set forth the amount of the CDE's NMTC allocation and describe the general terms and conditions that will govern said allocation. The general terms and conditions will include, among others, the requirement that the CDE enter into an Allocation Agreement with the Fund for the duration of the Credit Allowance Period and comply with certain reporting requirements so that the Fund can monitor the CDE's compliance with IRC section 45D, this Guidance, and subsequent guidance and/or regulations. The CDE may not issue Qualified Equity Investments to its investors until such time as the Fund and the CDE have executed the Allocation Agreement.

Under IRC section 45D(g)(3), the following constitute events of recapture: (i) the CDE ceases to qualify as a CDE; (ii) the CDE ceases to meet the Substantially All Test; or (iii) the CDE redeems Qualified Equity Investments during the Credit Allowance Period. The IRS may address recapture issues in subsequent regulations.

### III. Applications

At a future date, the Fund will make available two application forms: (i) An

application for CDE certification and (ii) an application for an allocation of NMTCs. An entity may submit these applications concurrently or separately (provided, however, that if they are submitted separately, the CDE certification application must be submitted prior to the submission of an allocation application). The CDE certification application form will require that the applicant provide, among other items, specific information relating to its primary mission and its accountability to residents of Low-Income Communities, as described below. The NMTC allocation application form will require that the applicant provide, among other items, a Comprehensive Investment Plan. Further details regarding eligibility and other program requirements will be set forth in the application packets, which will be made available at a future date.

### IV. Eligibility

IRC section 45D(c) specifies the eligibility requirements that each entity must meet in order to be certified by the Fund as a CDE. At the time an entity submits its CDE certification application, the entity must be a duly organized and validly existing legal entity under the laws of the jurisdiction in which it is incorporated or otherwise established. As described above, a CDE is any domestic corporation or partnership (including LLCs) 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 Fund as a CDE.

SSBICs and CDFIs are automatically eligible to be designated as CDEs, but must complete abbreviated application materials in order to receive a CDE designation from the Fund. Any entity, regardless of tax status, may apply to the Fund for designation as a CDE; however, only for-profit CDEs are eligible to apply for allocations of NMTCs.

To comply with the primary mission requirement, an entity must (a) provide organizational documents that, in the opinion of the Fund, clearly evidence a mission of directly serving or providing investment capital for Low-Income Communities or Low-Income Persons; and (b) be able to demonstrate that at least 60 percent of its activities are dedicated to directly serving Low-Income Communities or Low-Income Persons. In order to be certified as a CDE, an entity must demonstrate that it

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. In the case where a CDE is a limited partnership or an LLC, this accountability requirement may be met if residents of Low-Income Communities are represented on the governing or advisory board of the entity's managing general partner or other controlling entity (such as a nonprofit CDFI). A CDE may maintain accountability to residents of Low-Income Communities by having board members who are directly representative of the Low-Income Community (i.e., they are Low-Income Persons or other residents of the Low-Income Community).

A CDE is not limited in the number of Low-Income Communities that it may serve or propose to serve.

A CDE certification will last for a period of 15 years unless it is revoked or terminated by the Fund. To maintain its CDE certification, a CDE must certify annually during this period that the CDE has continued to meet CDE certification requirements.

Previous awardees under the Fund's Community Development Financial Institutions Program (the "CDFI Program") and/or the Bank Enterprise Award Program (the "BEA Program") are eligible to apply for allocations of NMTCs, but such applicants are not ensured NMTC allocations. Further, the Fund reserves the right, in its sole discretion, to declare a NMTC Program applicant to be ineligible for a NMTC allocation if the applicant is an awardee under the CDFI Program and/or the BEA Program and is out of compliance with the agreements governing said award(s). Similarly, the Fund reserves the right, in its sole discretion, after consultation with the SBA, to declare a NMTC applicant to be ineligible for a NMTC allocation if the applicant is no longer certified as a CDE by virtue of it no longer being deemed a SSBIC by the SBA.

A CDE that is an insured depository institution may not receive a BEA Program award for the provision of any financial assistance or services that are also Qualified Low-Income Community Investments if such assistance or services were provided with cash proceeds of a Qualified Equity Investment for which the investor received the benefits of NMTCs. A CDE that is an insured depository institution may not receive both a BEA Program award and a NMTC allocation for the same equity investment in a CDE.

## V. Evaluation

All applications for allocations of NMTCs will be reviewed for eligibility and completeness. If determined to be eligible and complete, each application for a NMTC allocation will be evaluated by the Fund on a competitive basis to determine the applicant's ability and strategy for carrying out its Comprehensive Investment Plan and the extent to which the applicant will maximize the effective use of the NMTC allocation. The Fund will conduct the substantive review of said applications in accordance with the criteria and procedures described in this Guidance, and subsequent guidance or regulations that the Fund may issue, which will include a description of the scoring system to be used by the Fund in the evaluation of applications.

### Phase One

In Phase One of the substantive review, each Fund reader will evaluate applications for NMTC allocations and award points to be distributed among the following categories of information (or others that the Fund deems appropriate):

- (a) Institutional investment and community development track record;
- (b) Financial and operational capacity;
- (c) Capacity, skills and experience of the management team;
- (d) Market analysis;
- (e) Capitalization strategy;
- (f) Investment strategy;
- (g) Projected community development activities and projected impact.

In addition, as provided by IRC section 45D(f)(2), the Fund will give preference to any CDE that (i) has a record of having successfully provided capital or technical assistance to disadvantaged businesses or communities, or (ii) intends to satisfy the Substantially All Test by making Qualified Low-Income Community Investments in one or more businesses in which persons unrelated to the CDE (within the meaning of IRC section 267(b) or section 707(b)(1)) hold the majority equity interest. For purposes of (i), the Fund will also consider the record of the entity controlling the CDE. A record of having successfully provided capital or technical assistance to disadvantaged businesses or communities may be demonstrated either by the past actions of the CDE itself or by an entity controlling the CDE (e.g., where a new CDE is established by a nonprofit corporation with a history of providing assistance to disadvantaged communities, or where the new CDE is controlled by a CDFI or SSBIC).

### Phase Two

Once the initial evaluation is completed, the Fund will determine which applications will receive further consideration for allocations based on application scores, written recommendations of individuals who performed initial reviews based on the above stated categories of information, and the amount of NMTCs available. Applicants that advance to Phase Two may receive a site visit and/or an interview (by telephone or in person) by a Fund reviewer for the purpose of obtaining clarifying or confirming information. At this point in the process, applicants may be required to submit additional information about their applications in order to assist the Fund with its final evaluation. After conducting such site visits and/or telephone interviews, the Fund reviewers will evaluate all applications in accordance with the evaluation criteria outlined above and prepare recommendation memoranda containing recommendations on the amount of the NMTC allocation, if any, that should be provided to each applicant.

A final review panel of Fund staff will consider the reviewers' recommendation memoranda and make final recommendations to the Fund's selecting official. In making its recommendations, the final review panel also may consider the institutional diversity (e.g., size, type, focus, affiliation), geographic diversity of applicants, and other factors that the Fund deems appropriate.

In the case of an applicant that has previously received financial or technical assistance awards from the Fund under the CDFI Program or the BEA Program, the Fund will consider the applicant's level of success in meeting its performance goals (if applicable), financial soundness covenants (if applicable), and other requirements contained in its existing award agreement(s) with the Fund.

The Fund's selecting official will make the final allocation determination based on the applicant's file, including, without limitation, reader and reviewer recommendations and the panel's recommendation, and the amount of NMTCs available.

In the case of regulated CDEs, the Fund's selecting official reserves the right to take into consideration the views of the appropriate Federal banking agencies. In the case of applicants that are also SSBICs, the Fund reserves the right to consult with the SBA.

The Fund reserves the right to change these evaluation procedures, upon

public notice, if the Fund deems it appropriate.

## VI. Monitoring

The Fund will collect information, on at least an annual basis, from each CDE that is a recipient of a NMTC allocation and/or a Qualified Low-Income Community Investment, including such audited financial statements and opinions of counsel as the Fund deems necessary or desirable, in its sole discretion. The Fund shall use such information to monitor each CDE's compliance with the Fund's requirements for certification as a CDE and the CDE's compliance with the provisions of its Allocation Agreement, and to determine, among other matters, whether substantially all of the CDE's equity raised through its NMTC allocation is used to make Qualified Low-Income Community Investments. The Fund will also use such information to assess the impact of the NMTC Program on Low-Income Communities. The Allocation Agreement shall include provisions setting forth the CDE's reporting requirements.

## VII. Pending Issues

In developing guidance to assist potential applicants to the NMTC Program, the Fund has identified certain issues that may be addressed in additional guidance and/or regulations. The Fund invites comments from the public on these and any other issues on which the public believes guidance is particularly needed.

1. IRC section 45D(f)(2) requires that in making allocations of NMTCs, priority be given to: (a) any applicant that has a record of having successfully provided capital or technical assistance to disadvantaged businesses or communities or (b) any applicant which intends to satisfy the Substantially All Test by making Qualified Low-Income Community Investments in one or more businesses in which persons unrelated to the CDE hold a majority equity interest.

(a) How should the Fund implement this policy? For instance, should the Fund incorporate preference points into the scoring? Should the Fund make awards to organizations that are deemed competitive and meet one or both of these criteria before providing an allocation to any other applicant?

(b) What specific factors should the Fund consider when evaluating whether an applicant meets the requirements for priority treatment?

(c) Should more weight be given to one priority category over the other and should an applicant be allowed to

receive preference points under both priority categories?

2. Should there be limits as to the amount of a NMTC allocation that may be awarded to an applicant in a calendar year?

3. During the evaluation process of NMTC applications, the Fund will request that applicants provide information on their track records for providing capital or technical assistance to Low-Income Communities and disadvantaged businesses and the effect that such investment/technical assistance has had on such Low-Income Communities or businesses. Applicants may also be required to describe the social underwriting criteria that they

will use when deciding which companies to invest in. If an applicant receives a NMTC allocation, it will be required to report to the Fund on the ways in which the Qualified Equity Investments are used to benefit Low-Income Communities.

(a) What indicators should the Fund assess when evaluating the community development impact of an applicant's prior activities or the social underwriting criteria of its loan policies?

(b) On what basis should the Fund judge how "successfully" capital or technical assistance has been provided?

(c) What information should the Fund request from allocation recipients as

indicators for evaluating the effectiveness of the NMTC Program (e.g., number of jobs created or retained, increases in revenues of businesses receiving Qualified Low-Income Community Investments, rates of return to investors from Qualified Equity Investments, or number of clients served at facilities that are developed)?

**Authority:** Consolidated Appropriations Act of 2001, Pub. L. 106-554.

Dated: April 20, 2001.

**Jeffrey C. Berg,**

*Acting Director for the Community Development Financial Institutions Fund.*

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