Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Interpretive Letter #984
February 2004
12 USC 2901

December 17, 2003

Subject: New Markets Tax Credits

Dear [ ]:

This letter responds to your inquiry whether a financial institution's investment in connection with the New Markets Tax Credit (NMTC) Program in a "Community Development Entity" (CDE), or a loan by a financial institution CDE to a "Qualified Active Low-Income Community Business" (QALICBs) or another CDE, would receive consideration as a qualified investment or a community development loan, respectively, when the institution's Community Reinvestment Act (CRA) performance is evaluated. We conclude that such investments and loans would be favorably considered under the CRA.

New Markets Tax Credit Program

The NMTC Program (Program) was a part of the Community Renewal Tax Relief Act of 2000.[1] The Program was expected to stimulate investments that, in turn, would facilitate economic and community development in distressed communities.[2]

The Program created a tax credit for taxpayers' "Qualified Equity Investments" (QEIs) in CDEs.[3] A 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" (LICs).[4] CDEs must demonstrate that they (1) have a primary mission of serving, or providing investment capital for, LICs or low-income persons and (2) are accountable to residents of the LICs that they serve. CDEs are required to invest "substantially all" (generally 85 percent) of the proceeds of

[1] H.R. 5662, introduced on Dec. 14, 2000. Section 121(a) of Subtitle C of Title I of H.R. 5662 was enacted by section 1(a)(7) of the Consolidated Appropriations Act of 2001, Pub. L. 106-554 (Dec. 21, 2000).
[2] *See, e.g.,* Guidance, New Markets Tax Credit Program, 66 Fed. Reg. 21,846 (May 1, 2001).
[3] See 26 U.S.C. § 45D. Over a seven-year period, an investor may claim a tax credit of 39 percent (30 percent in present value terms) of the amount of its QEI.
[4] LICs are census tracts with a poverty rate of at least 20 percent, or census tracts where the median family income is below 80 percent of the area median family income.

the QEIs into LICs, including loans or investments in QALICBs.[5] In addition to investments in QALICBs, other "Qualified Low-Income Community Investments" (QLICIs) for CDEs are equity investments in, or to, another CDE; the purchase of a QLICI loan from another CDE; and financial counseling and other services to businesses located in, or residents of, LICs.

Community Development Financial Institutions and Specialized Small Business Investment Companies are automatically eligible to be designated as CDEs, but must complete an abbreviated application. Insured depository institutions with a primary mission of serving LICs or low-income persons, and with accountability to the LIC,[6] also may be designated as CDEs.

Community Reinvestment Act

Community development loans and qualified investments are important considerations in financial institutions' CRA performance evaluations. For larger banks, which are evaluated under the lending, investment and service tests, examiners routinely evaluate both community development loans and qualified investments. For smaller institutions, community development loans are routinely included when determining an institution's loan-to-deposit ratio, while qualified investments that are lending-related are considered along with an institution's loans. In addition, examiners will consider a small institution's other qualified investments if a small institution wishes to be considered for an "Outstanding" rating. Along with community development services, community development loans and qualified investments comprise the basis for the CRA performance evaluation for wholesale and limited purpose institutions that are evaluated under the community development test. Finally, institutions that are evaluated under an approved strategic plan may include community development loans and qualified investments in their measurable goals.

A "community development loan"

- has a primary purpose of community development; and,
- except in the case of wholesale or limited purpose banks,

---

[5] In order to qualify as a QALICB, and therefore be eligible to receive CDE investments, a business must meet the following criteria:

- At least 50 percent of the total gross income is from the active conduct of a qualified business in LICs;
- At least 40 percent of the use of the tangible property of the business is located in LICs;
- At least 40 percent of the services provided by the business' employees are performed in LICs;
- Less the five percent of the average of the aggregate unadjusted bases of the property is attributable to collectibles (e.g., art and antiques), other than those held for sale in the ordinary course of business (i.e., inventory); and
- Less than five percent of the average of the aggregate unadjusted bases of the property is attributable to nonqualified financial property (e.g., debt instruments with a term in excess of 18 months).

(The gross income test is deemed to be met if <u>either</u> the tangible property <u>or</u> the services test is at 50 percent or higher.)

[6] "Accountability" to the LIC may be demonstrated, for example, through representation by residents of the LIC on a governing board or advisory board of a corporate CDE.

- has not been reported or collected by the institution or an affiliate for consideration in the institution's assessment as a home mortgage, small business, small farm, or consumer loan, unless it is a multifamily dwelling loan; and
- benefits the institution's assessment area(s) or a broader statewide or regional area that includes its assessment area(s).[7]

A "qualified investment" is a "lawful investment, deposit, membership share, or grant that has as its primary purpose community development."[8]

"Community development" means:

1. Affordable housing (including multifamily rental housing) for low- or moderate-income individuals;
2. Community services targeted to low- or moderate-income individuals;
3. Activities that promote economic development by financing businesses or farms that meet the size eligibility standards of the Small Business Administration's Development Company or Small business Investment company programs (13 CFR 121.301) or have gross annual revenues of $1 million or less; or
4. Activities that revitalize or stabilize low- or moderate-income geographies.[9]

Discussion

<u>Would a financial institution's investment in a CDE receive consideration as a qualified investment during the institution's CRA evaluation?</u>

An institution's equity investment in a CDE would receive consideration as a qualified investment if the investment benefits the institution's assessment areas or a broader statewide or regional area that includes its assessment areas. Such investments may be considered to have a community development purpose under two prongs of the "community development" definition. First, to the extent that the CDE loans or invests in small businesses or farms, the qualified investment in the CDE promotes economic development by financing small businesses or farms. Second, because the primary mission of the CDE is to serve LICs, the loans and investments made by the CDE generally would help to revitalize or stabilize low- or moderate-income geographies.

<u>Would a loan by a financial institution CDE to a QALICB or to another CDE receive consideration as a community development loan?</u>

As long as a loan by a financial institution CDE to a QALICB or to another CDE has not been reported or collected by the institution or an affiliate for consideration in the institution's

[7] 12 C.F.R. § 25.12(i).
[8] 12 C.F.R. § 25.12(s).
[9] 12 C.F.R. § 25.12(h). Low- or moderate-income individuals have income that is less than 80 percent of the area median income. Low- or moderate-income geographies have a median family income that is less than 80 percent of the area median income.

assessment area as a home mortgage, small business, small farm, or consumer loan (unless it is a multifamily dwelling loan), the loan would receive consideration as a community development loan.[10] Loans under $1 million to a QALICB or CDE by a retail institution would be reported as small business loans. However, larger loans would be considered community development loans because the loans have a primary purpose of community development, as discussed above.[11] For wholesale and limited purpose institutions, which are not evaluated on their small business lending, loans of any amount to a QALICB or CDE would be considered community development loans.

I trust this letter responds to your inquiry. I have shared this response with my colleagues at the other bank and thrift regulatory agencies, and they concur with this analysis. If you have further questions, please contact me at (202) 874-5750.

Sincerely,

-signed-

Michael S. Bylsma
Director
Community and Consumer Law Division

[10] Of course, for retail institutions, the loan would also need to benefit the institution's assessment areas or a broader statewide or regional area that includes its assessment areas.

[11] The analysis whether a loan by any retail institution to a CDE would be a community development loan would be the same – if the loan is not reported or collected as a home mortgage, small business, small farm or consumer loan (unless it is a multifamily dwelling loan), it would receive consideration as a community development loan.