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Report to Congressional Committees

January 2004

NEW MARKETS TAX CREDIT PROGRAM

Progress Made in Implementation, but Further Actions Needed to Monitor Compliance

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GAO-04-326

January 2004

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Highlights

Highlights of GAO-04-326, a report to congressional committees

NEW MARKETS TAX CREDIT

Progress Made in Implementation, but Further Actions Needed to Monitor Compliance

Why GAO Did This Study

The Community Renewal Tax Relief Act of 2000 authorized up to $15 billion under the New Markets Tax Credit (NMTC) program to stimulate capital investment in low-income and economically distressed communities. The act mandated that GAO report to Congress on the NMTC program by January 31, 2004, 2007, and 2010.

Based on consultation with staff at appropriate congressional committees, this report (1) describes the status of the NMTC program, (2) profiles community development entities (CDE) that were selected to receive NMTC allocations in 2003, and (3) determines whether systems are in place or planned to ensure compliance and evaluate the success of the NMTC program.

What GAO Recommends

To ensure that compliance monitoring processes will be in place when needed, GAO recommends that the Community Development Financial Institutions (CDFI) Fund and Internal Revenue Service (IRS) develop plans, including milestones, for designing and implementing compliance monitoring processes for the NMTC program.

In commenting on a draft of this report, the CDFI Fund and IRS agreed with our recommendation and that they will work together to complete implementation of a comprehensive NMTC compliance program.

www.gao.gov/cgi-bin/getrpt?GAO-04-326.

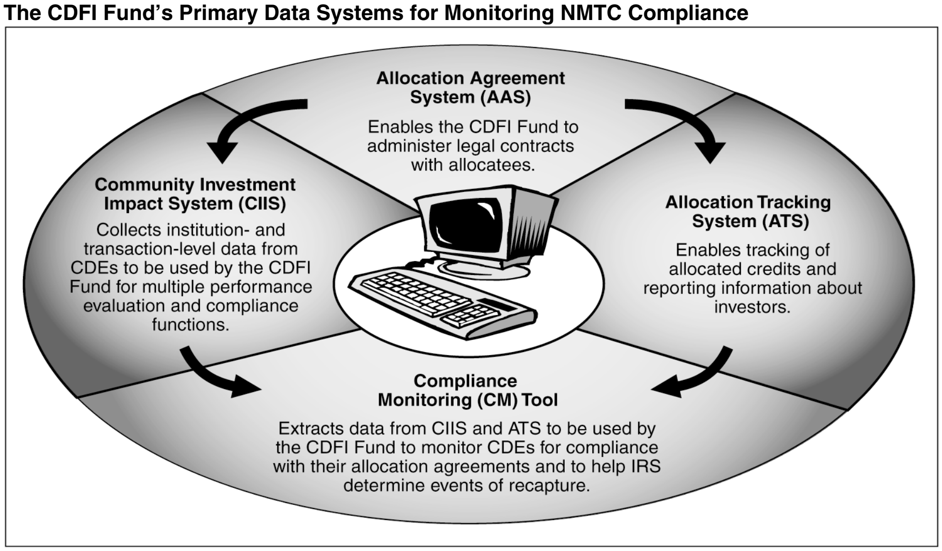
To view the full product, including the scope and methodology, click on the link above. For more information, contact Michael Brostek at (202) 512-9110 or brostekm@gao.gov.

What GAO Found

Although Congress authorized the NMTC program to provide credit against federal taxes for billions of dollars starting in 2001 to spur investments in community development projects, CDFI Fund officials said that it is unlikely that many projects had started by the end of 2003 and that they will not know the status of projects for all CDEs until early 2005. Progress was made in developing data systems, selection processes, and program rules, but allocations were delayed because of the various start-up tasks associated with a new program, especially in establishing the rules on using the allocated credits.

CDEs that received NMTC allocations (allocatees) proposed projects to serve urban, rural, and mixed areas, as well as local, state, multiple-local, multistate, and national areas. The distribution of state and local allocations was not concentrated in any one state or in a few states. All allocatees reported at least some prior experience in low-income communities, particularly in providing capital to low-income communities.

The CDFI Fund's Primary Data Systems for Monitoring NMTC Compliance



Source: The CDFI Fund and GAO.

The CDFI Fund and IRS have identified data with which to monitor compliance with allocation agreements and tax laws, and are developing systems to collect the data. However, many details remain to be settled on how the data will actually be used to monitor compliance. Agency officials believe they have time to devise their compliance monitoring processes. However, they do not have schedules or documented plans for ensuring that compliance monitoring processes will be in place when needed, and they have other tasks to complete. In terms of evaluating the NMTC program, the CDFI Fund intends to contract for an evaluation, and officials believe they are collecting significant amounts of data that will be useful for the evaluation and that CDEs will maintain additional relevant data.

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Abbreviations

AAS	Allocation Agreement System
ATS	Allocation Tracking System
CDE	community development entity
CDFI	Community Development Financial Institutions
CIIS	Community Investment Intelligence System
CM Tool	Compliance Monitoring Tool
IRS	Internal Revenue Service
NMTC	New Markets Tax Credit
QALICB	qualified active low-income community business
QEI	qualified equity investments
QLICI	qualified low-income community investments

January 30, 2004

Congressional Committees

Access to credit and investment capital is essential for creating and retaining jobs, developing affordable housing, revitalizing neighborhoods, and promoting the development of small businesses. However, such access through conventional sources is often limited for communities comprising large low-income populations or suffering from economic distress.

The Community Renewal Tax Relief Act of 2000[1] authorized up to $15 billion in equity that is eligible for tax credits under the New Markets Tax Credit (NMTC) program. This program is expected to stimulate capital investment in low-income communities. The Community Development Financial Institutions (CDFI) Fund[2] in the Department of the Treasury allocates the available tax credit authority to community development entities (CDE), which are entities that manage NMTC investments in low-income community development projects. In return for the tax credit, which may be claimed over 7 years, investors supply capital to the CDEs that are to invest the capital in low-income communities.

As we discussed in a previous report,[3] the CDFI Fund is to administer the NMTC program over annual increments of allocations and has been developing processes and systems to allocate the tax credits under allocation agreements, monitor compliance with allocation agreements and CDE certification requirements, and evaluate the program. In addition, the Internal Revenue Service (IRS) is responsible for overseeing taxpayer and CDE compliance with applicable provisions of the Internal Revenue Code.

[1] Pub. L. No. 106-554, December 21, 2000.

[2] The CDFI Fund was created in 1994 to expand the availability of credit, investment capital, and financial services in distressed communities. Beyond being the primary administrator of the NMTC program, it also provides financial and technical assistance and training to CDFIs and administers other programs, such as the CDFI, Bank Enterprise Award and Native American Training and Technical Assistance programs.

[3] U.S. General Accounting Office, *New Markets Tax Credit: Status of Implementation and Issues Related to GAO's Mandated Reports*, GAO-03-223R (Washington, D.C.: Dec. 6, 2002).

The act mandated that we report to Congress on the NMTC program by January 31, 2004, 2007, and 2010. Based on consultation with staff at cognizant congressional committees, this report (1) describes the status of the NMTC program (including the allocations), (2) profiles CDEs that were selected to receive NMTC allocations in 2003 by the issues raised most frequently by the congressional committee staffs (proposed geographical distribution, prior experience in low-income communities, and type of proposed service[4]), and (3) determines whether systems are in place or planned to ensure compliance and evaluate the success of the NMTC program in achieving its goals.

To accomplish the reporting objectives, we met with CDFI Fund and IRS officials and collected documents on the program status as well as on the status of data and systems to be used to monitor compliance and evaluate the program, collected data on the profile of CDE applicants based on the issues raised by congressional staff, and reviewed any plans for using the data and systems to monitor compliance and evaluate the NMTC program given the program goals. (Our scope and methodology section provides more details on how we did our work.)

Results in Brief

Although Congress authorized the NMTC program to provide credit against federal taxes for billions of dollars, starting in 2001, to spur investments in community development projects, CDFI Fund officials did not believe that many projects were started by the end of 2003. These officials said that they are unlikely to know the status of projects until early 2005. CDEs that received the NMTC allocations were not selected until March 2003, and the tax credits were not generally available to be released to investors until the last week in August 2003 at the earliest. Progress was made in developing various program rules and processes, but according to the CDFI Fund officials, the various start-up tasks associated with a new program, such as establishing program rules, delayed the NMTC allocations.

In profiling the CDEs that received NMTC allocations (allocatees), we found that they reflect variation among the areas of interest of the congressional committees. Allocatees proposed service to a variety of geographic areas, ranging from local to national areas and including both urban and rural areas. The distribution of state and local allocations was

[4] We could not analyze another frequently raised issue on size of the CDEs due to limitations in data.

not concentrated in any one state or in a few states. All allocatees reported at least some prior experience in low-income communities, particularly in providing capital to low-income communities. In addition, the allocatees proposed investments that cover a variety of services, most often development or rehabilitation of real estate projects.

The CDFI Fund and IRS have made progress in identifying data to use in monitoring NMTC compliance with the allocation agreements and tax laws, respectively, and in developing and implementing systems to collect these data. However, many details remain to be settled on how these data will actually be used to monitor compliance. Officials from both agencies believe that they have time to devise their compliance monitoring processes because some data required for compliance checks will not be available until 2005.

Even so, the agencies have not established schedules or documented plans for ensuring that compliance monitoring processes will be in place when needed. Such schedules and plans are important because previous self-imposed deadlines for selecting CDEs and finalizing allocation agreements have been missed, and other major tasks need to be done, such as those for the second round of allocations. In terms of evaluating the NMTC program, the CDFI Fund has decided to contract for an evaluation. CDFI Fund officials believe that the CDFI Fund is collecting significant amounts of data that will be useful for the evaluation and that CDEs will maintain additional relevant data.

We are making a recommendation on developing plans, including milestones, to ensure that compliance-monitoring processes are in place when needed. In commenting on a draft of this report, the CDFI Fund and IRS agreed with our recommendation and that they will work together to complete implementation of a comprehensive NMTC compliance program and to formalize appropriate information sharing arrangements.

Background

As discussed in our previous report, according to congressional supporters of the legislation, the goals of the NMTC program are to direct new business capital to low-income communities, facilitate economic development in these communities, and encourage investment in high-risk areas.[5] The program strives to meet these goals by providing tax credits as investment incentives to prompt investors to provide capital that in turn, will facilitate development in low-income communities and businesses.

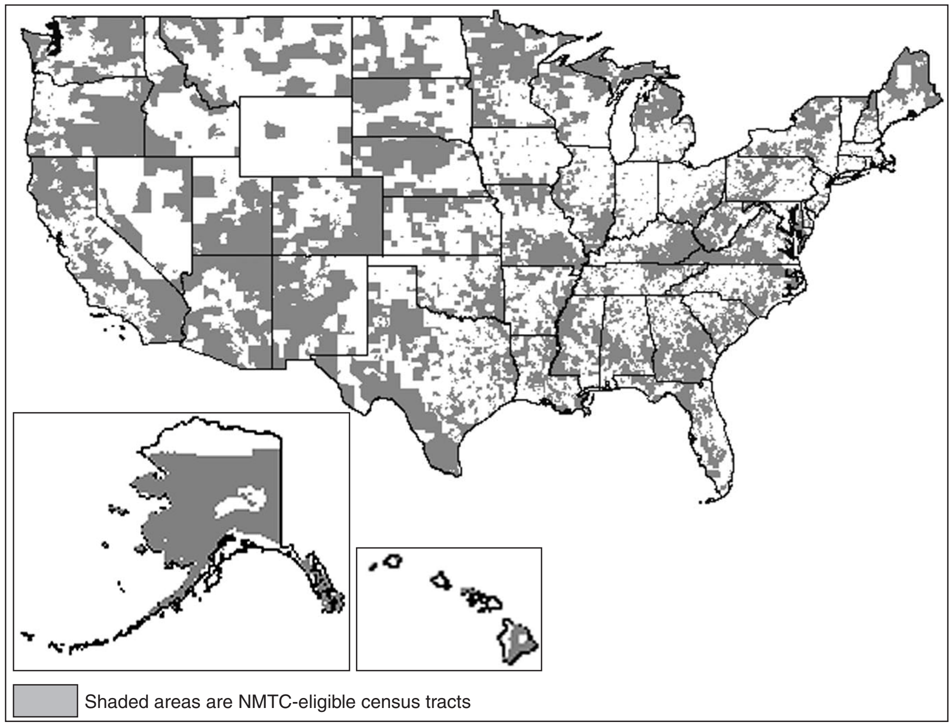
For purposes of the NMTC program, low-income communities generally are defined as census tracts[6] that meet specified poverty rate or median family income levels.[7] The darkened areas of figure 1 illustrate that census tracts qualifying for NMTCs are widely distributed across the nation. Specifically, about 39 percent of all census tracts qualify for NMTCs and 36 percent of the nation's population lives in these census tracts (see app. I for a table of NMTC eligibility as a percentage of state population and of state census tracts).

[5] GAO-03-223R.

[6] A census tract is a statistical subdivision of a county or statistically equivalent entity delineated for data presentation purposes under U.S. Census Bureau guidelines. Designed to be relatively homogeneous units with fairly stable boundaries over time, census tracts generally contain from 1,000 to 8,000 people.

[7] A low-income community is defined as a census tract (1) in which the poverty rate is at least 20 percent or (2) outside a metropolitan area in which the median family income does not exceed 80 percent of statewide median family income or within a metropolitan area in which the median family income does not exceed 80 percent of the greater of statewide or the metropolitan area median family income. The Secretary of the Treasury can designate an area within an otherwise nonqualified census tract as a low-income community if the area (1) has a continuous boundary, (2) would meet the definition of a low-income community if it were a census tract, and (3) has inadequate access to investment capital. As of December 2003, Treasury had approved one organization serving portions of three census tracts that do not otherwise qualify as low-income communities.

Figure 1: U.S. Census Bureau Tracts Eligible for NMTCs



Source: GAO analysis of CDFI Fund and U.S. Census Bureau data.

Certification and Allocation Process

The CDFI Fund has the authority to allocate NMTCs under the direction of the Secretary of the Treasury. The legislation limits the allocation of equity eligible for tax credits from 2001 through 2007 from $1 billion to $3.5 billion per year, totaling $15 billion over the 7 years.

The first step in the NMTC program is to apply to the CDFI Fund for certification as a CDE, which is an entity that manages investments for community development.[8] Nonprofit entities and for-profit entities may be certified as CDEs. To be certified, the CDE must be a domestic corporation or partnership, for federal tax purposes, and be duly organized under the

[8] As provided for in the NMTC statute, community development financial institutions and specialized small business investment companies automatically qualify as CDEs and only need to register as CDEs rather than apply for certification.

laws of the jurisdiction in which it is incorporated or established. A CDE must have a primary mission of serving or providing investment capital for low-income communities or low-income persons, and must maintain accountability to residents of these low-income communities by filling at least 20 percent of the CDE governing or advisory board positions with low-income community representatives.

The second step for a CDE is to apply for an allocation of tax credits from the CDFI Fund. CDEs are to use the tax credits allocated to attract investors. Both for-profit and nonprofit CDEs can apply for allocations of NMTCs. However, only a for-profit CDE may offer NMTCs to its investors while a nonprofit CDE must intend to transfer the allocation to one or more for-profit subsidiaries.[9] The application asks a series of questions about the CDE, its track record, the dollar amount of allocated tax credits being requested, and the plans for using the credits to support activities in low-income communities.

Applications are then reviewed and scored by a mix of CDFI Fund staff and external reviewers who have experience in business, real estate, or community development finance.[10] The CDFI Fund considers reviewers' scores, reviews applications, and awards an amount of allocated tax credits to those applicants judged to be the most highly qualified. These decisions on scoring applications and awarding allocations are to be based on a range of criteria under which applicants can receive scores of up to 25 points in each of the four following areas:[11]

- community impact, which is the extent to which the applicant targets particularly economically distressed communities, has the active participation of community representatives in designing and

[9] The for-profit subsidiaries do not have to be formed when the nonprofit CDE applies for an allocation. However, the subsidiary must submit a CDE certification application to the CDFI Fund within 30 days of receiving a Notification of Allocation from the CDFI Fund and must be a certified CDE prior to entering into an allocation agreement. The CDFI Fund certified 400 nonprofit CDEs before announcing the first round of allocations in March 2003, of which 102 applied for NMTC allocations and 17 received allocations (see app. III, table 5).

[10] The CDFI Fund also has procedures to protect against real or potential conflicts of interest and misuse by reviewers of information related to applications.

[11] The CDFI Fund reserves the right to decide how much of the requested allocation to award to each applicant. It also reserves the right to reject applications that receive scores that are exceptionally weak in any one or more of the four application criteria.

implementing its business plan, and can demonstrate community development and economic impacts;

- business strategy, which is having prior performance providing similar kinds of products and services—applicants can score an additional 5 points by demonstrating a record of successful investment in disadvantaged communities or businesses and another 5 points by investing in businesses unrelated to the applicant;

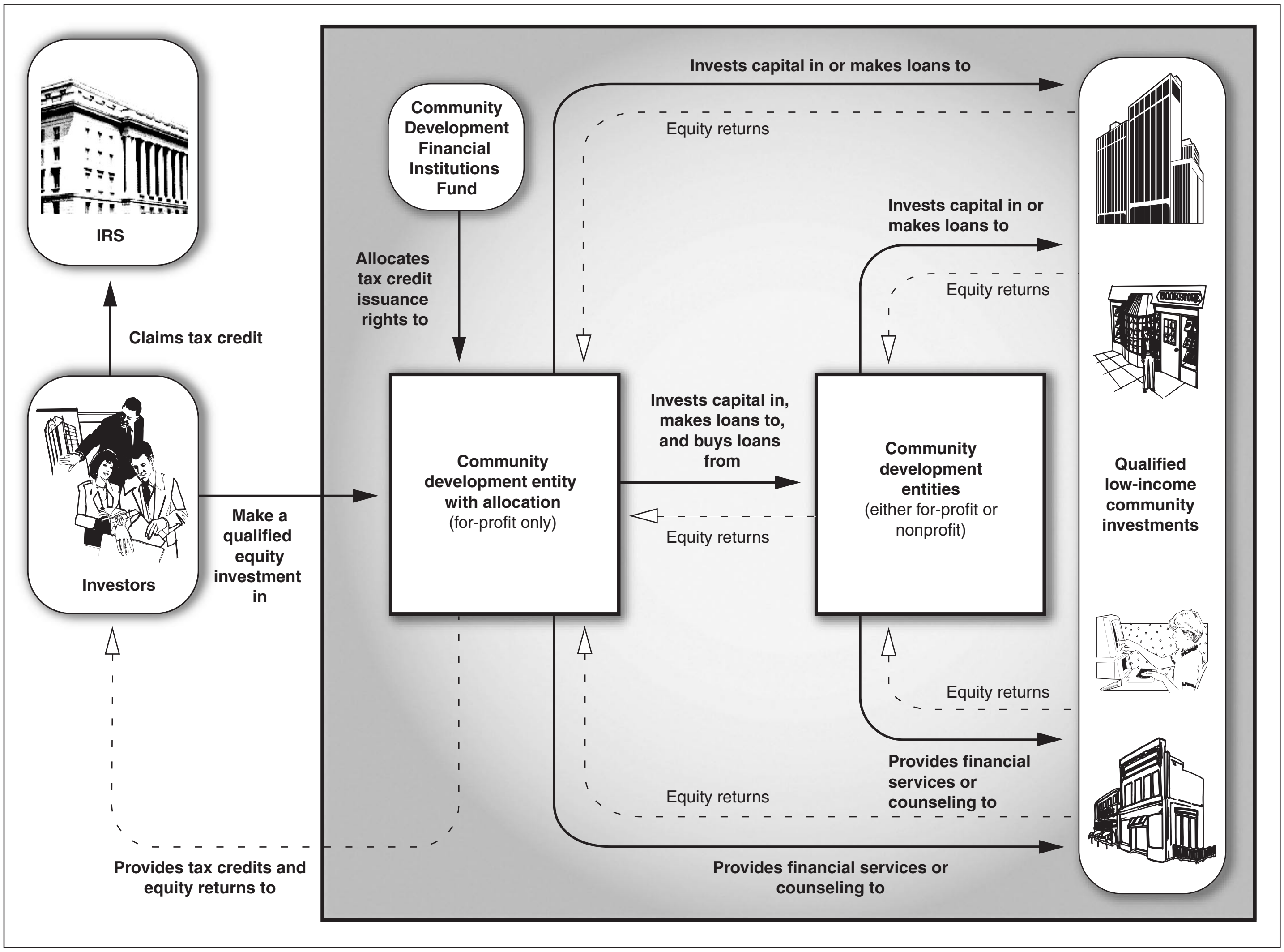
- capitalization strategy, which is securing investor commitments; and

- management capacity, which is experience investing in low-income communities.

Figure 2 shows what happens after the allocations are made to CDEs (i.e., CDE allocatees). The basic process is that investors acquire stock or capital interest in CDEs in order to receive the tax credits. In turn, these CDEs must use "substantially all"[12] of the proceeds in making qualified low-income community investments (QLICI). Eligible QLICIs might include loans or investments to businesses; development of commercial, industrial, and retail real estate projects; and development of for-sale housing in low-income areas.

[12] "Substantially all" means that CDEs use (within 12 months) at least 85 percent of investor proceeds in years 1 through 6 and 75 percent in year 7 of the investment. CDEs can satisfy this requirement by two methods: direct tracing of investments to specific QLICIs or by showing that at least 85 percent of their aggregate gross assets are invested in QLICIs.

Figure 2: NMTC Process for Using Allocated Tax Credits to Make QLICIs



Source: GAO.

Beginning with the first year of the investment in a CDE, investors are entitled to claim the tax credit over a 7-year period with 5 percent of the initial investment claimed for each of the first 3 years and 6 percent for each of the final 4 years, or a total of 39 percent over the 7 years. During the 7-year period, NMTCs could be subject to a recapture event if the CDE allocatee (1) ceases to be a CDE, (2) does not satisfy the "substantially all" requirement, or (3) redeems the investment.[13] In general, a recapture event means that investors in that CDE are required to increase their income tax liability by the credits previously used plus interest for each resulting underpayment of tax. The recapture of credits affects the investor who originally purchased the equity investment and subsequent holders. Investors cannot continue to claim the tax credit if their equity investment is returned to them before the end of the 7-year period. A CDE is required to provide notice, within a certain period, to (1) any investor who acquires a qualified equity investment (QEI) in the CDE that entitles the investor to claim the NMTC and (2) each current and prior holder of a QEI if a recapture event has occurred.[14]

NMTC Allocation Agreements

After being selected to receive an allocation, each CDE allocatee must sign an allocation agreement with the CDFI Fund before officially designating QEIs and offering tax credits to its investors. The agreement is to set forth the terms and conditions, such as the amount of NMTC allocation, approved uses of the allocation, approved service area, and reporting requirements. While most sections of the agreement are the same for every allocatee, other sections, such as the authorized uses of an allocation (e.g., loans to businesses and equity investments in other CDEs), are tailored to each CDE allocatee.

As specified in the IRS regulations, CDE allocatees must issue the NMTCs to investors within 5 years of receiving an allocation. CDEs that receive returns of capital from investing in QLICIs have 12 months to reinvest those funds in QLICIs; reinvestment is not required in the final year of the 7-year credit allowance period. CDEs also must agree to periodically report data on investors and project activities.

[13] 26 U.S.C. § 45D(g)(3). A recapture event may be avoided if a CDE that believes that it has "good cause" requests to waive a requirement or extend a deadline if the waiver or extension does not materially frustrate the purposes of the credit (Temp. Treas. Reg. § 1.45D-IT(e)(4)).

[14] Temp. Treas. Reg. § 1.45D-1T(g)(2)(i).

The rules also govern the types of businesses that can participate in NMTC projects. In general, a qualified active low-income community business (QALICB) is a corporation (including nonprofit corporations) or partnership that satisfies certain requirements, including the following:

- Gross income.[15] Generally, at least 50 percent of the total gross income must be derived from the active conduct of a qualified business within any low-income community.
- Tangible property.[16] At least 40 percent of the use of tangible property must be within a low-income community.
- Services performed.[17] At least 40 percent of the services performed by its employees must be performed in a low-income community.

Regulatory requirements preclude some types of business activities from qualifying as QALICBs (e.g., residential rental property, golf courses, massage parlors, liquor stores, race tracks or other gambling facilities, and farms).[18] In general, for a business to be treated as a QALICB, the CDE must have "reasonably expected" at the time of the investment that the business would remain in compliance with the QALICB requirements for the term of the investment.[19] Except for those requirements that affect a QALICB, the CDE is not required to monitor whether a business continues to comply with requirements after the initial investment is made.

As investors provide equity to CDEs and CDEs invest in low-income communities, the CDFI Fund is to monitor compliance with the allocation agreements. IRS is to monitor compliance with the tax consequences of NMTC allocations, focusing on whether CDEs met the "substantially all" requirement. If this requirement is not satisfied, the tax credits claimed by investors plus interest thereon are potentially subject to recapture.

[15] Temp. Treas. Reg. § 1.45D-1T(d)(4)(i)(A).

[16] Temp. Treas. Reg. § 1.45D-1T(d)(4)(i)(B).

[17] Temp. Treas. Reg. § 1.45D-1T(d)(4)(i)(C).

[18] Temp. Treas. Reg. § 1.45D-1T(d)(5)(ii) and (iii).

[19] Temp. Treas. Reg. § 1.45D-1T(d)(6)(i).

Scope and Methodology

To describe the status of the NMTC program, we interviewed various CDFI Fund and IRS officials tasked with program design and implementation. We reviewed CDFI Fund notices and planning documents on program milestones and implementation. We also attended conferences sponsored by the CDFI Fund and various industry groups to better understand the NMTC program implementation as it proceeded.

To profile CDEs that received NMTC allocations based on the issues raised most frequently by the staff of congressional committees, we analyzed both certification and allocation application data provided by the CDFI Fund.[20] We identified the issues and counted their frequency based on interviews with majority and minority staff at seven congressional committees and subcommittees as we prepared our 2002 report[21] (see app. II). We could not analyze one of the issues on the size of the CDEs because of concerns about the data reported.[22] The identified issues that we could analyze were as follows:

- geographic distribution of the community development projects proposed by CDE allocatees, including the scope of the area to be served ranging from local to national, the type of community served such as urban or rural, and the specific states to be served;
- experience in serving low-income communities; and
- type of service activity proposed for the community development project.

Because the data on these issues came from proposals made in applications filed by the 66 CDE allocatees rather than the signed allocation agreements, we cannot say that the CDEs will actually serve the geographic areas or provide the types of service proposed. Much of the data on actual investments and projects will not be known until later in

[20] We performed no reliability assessment of the data.

[21] GAO-03-223R.

[22] One issue raised was whether smaller entities were excluded in the distribution of NMTC allocations. However, the data cannot be used to accurately represent the size of the CDE. For example, a large organization might establish a small CDE only for the NMTC program. Analyzing the total assets of the CDE might not accurately reflect the true size of the underlying organization.

2004. To better understand the issues and data, we interviewed officials from five CDEs in the Washington, D.C., area that had received NMTC allocations and from groups representing venture capitalists, community development corporations, and historic preservation interests.

To determine whether the CDFI Fund and IRS have systems in place or planned to ensure compliance with the NMTC program and to evaluate the success of the NMTC program in achieving its goals, we interviewed various CDFI Fund and IRS officials on the systems for obtaining the data to be used for compliance monitoring and evaluation. We reviewed the NMTC legislation and our 2002 NMTC report to determine the goals of the NMTC program. We reviewed the CDFI Fund's 2003-2008 Strategic Plan to help determine overall CDFI Fund goals related to the NMTC program. We reviewed various CDFI Fund notices and Treasury regulations and rulings on NMTC provisions that may affect NMTC compliance. We met with CDFI Fund and IRS officials about the data they intend to collect and their strategies for identifying noncompliance. We reviewed draft versions of the CDFI Fund's data collection instruments to identify the data to be captured for compliance monitoring and program evaluation. To gain understanding of evaluation approaches and issues, we reviewed literature on economic development evaluation and reviewed our previous reports and other government documents on economic development evaluation.

We did our work at the CDFI Fund's and IRS's offices in Washington, D.C., from June 2003 through December 2003 in accordance with generally accepted government auditing standards. We requested written comments on a draft of this report from the CDFI Fund and IRS; their comments are reprinted in appendixes IV and V.

Initial NMTC Investments in Community Development Projects Were Unlikely Until Late 2003 due to NMTC Program Start-up Delays

Although Congress authorized billions of dollars in annual NMTC allocations beginning in 2001 to spur investments in community development projects, it is unlikely that many investments had been made as of December 2003, according to CDFI Fund officials. The CDEs were not notified of their allocation awards until March 2003, and according to CDFI Fund officials, very few CDEs had offered credits to investors until the last week in August 2003. According to CDFI Fund officials, they made the allocations to CDEs in 2003 instead of 2001 because of the time taken for various start-up tasks for the new program, such as establishing the rules for using the allocations.

Most NMTC Investments Were Just Being Initiated by December 2003

Congress provided a schedule limiting the annual NMTC allocation for calendar years 2001 through 2007. Table 1 shows this schedule of NMTC limitations.

Table 1: NMTC Limitation on Amount of Investments by Calendar Year

Year	Dollars
2001	1.0 billion
2002	1.5 billion
2003	1.5 billion
2004	2.0 billion
2005	2.0 billion
2006	3.5 billion
2007	3.5 billion
Total	**$15.0 billion**

Source: IRC Section 45D(f).

Note: Unallocated investment authority can be carried over to future years through 2014.

The CDFI Fund allocated to CDEs the authority to issue to their investors up to the aggregate amount of $2.5 billion in equity for which NMTCs may be claimed (the authority includes the aggregate amounts of $1 billion for calendar year 2001 and $1.5 for 2002); it plans to allocate up to the aggregate amount of $3.5 billion for 2003 and 2004 in April 2004. After the March 2003 allocations, the CDFI Fund generated allocation agreements for the 66 CDEs that received the allocations. These agreements govern the use of the allocations and the actions to be taken by CDEs to stay in compliance with the NMTC program. Once agreements have been properly executed and notification is provided to the allocatees, the CDEs can offer tax credits in negotiating with investors on community development projects. The CDFI Fund finished these agreements by September 2003 and CDEs had 60 days to sign them. By January 21, 2004, 57 of the 66 CDEs had signed their agreements. CDFI Fund officials expected that the other 9 CDEs would sign by the end of January 2004.[23]

[23] CDFI Fund officials stated the Fund has not penalized allocatees that missed their 60-day deadline for returning allocation agreements because, in almost all cases, they have been in communication with the Fund and are making efforts to obtain proper approvals and legal opinions so that the document may be signed and returned to the CDFI Fund.

As a result of the timing of the NMTC allocation agreements and investments, CDFI Fund officials did not anticipate that many NMTC community development projects would start in 2003. The CDFI Fund is prepared to start receiving data about specific investor activities in CDEs. In contrast, according to a CDFI Fund official, because CDE allocatees are required to report project-level data annually (through the Community Investment Impact System) at the end of their fiscal years, it is unlikely that significant QLICI activities will be reported until their fiscal year 2004 reports are submitted, which in most cases will not be until the first part of calendar year 2005.

The CDFI Fund Attributes Delays in Initiating Investments to NMTC Program Start-up Tasks and Points Out Efforts to Overcome the Effects of Delays

CDFI Fund officials said that various NMTC program start-up tasks contributed to the delays in meeting self-imposed deadlines for making allocations and finalizing the allocation agreements. Officials have taken steps, like combining the allocation limitations for the first 4 years into 2, which they believe will mitigate any adverse effects of the delays.

To prepare to make the allocations and negotiate the allocation agreements, the CDFI Fund used a three-phased approach that started after Congress authorized the NMTC program in December 2000. These phases implemented a variety of tasks, as follows:

- Phase 1 on Initial Policy and Regulatory Development (January 2001 to December 2001): The CDFI Fund developed program guidance, certification applications, and other documents; assisted IRS in developing regulations; and reached out to CDEs and other stakeholders.
- Phase 2 on Policy Refinement and Award Implementation (January 2002 to March 2003): The CDFI Fund certified 1,021 CDEs, developed applicant selection policies, reviewed 345 allocation applications, and announced the allocations in March 2003.
- Phase 3 on Ongoing Allocations, Post-Award Activities, and Compliance Monitoring (March 2003 projected through July 2004): The CDFI Fund negotiated allocation agreements and debriefed the 279 applicants that did not receive allocations in round one. It is continuing to develop processes to monitor NMTC compliance.

At the same time that the CDFI Fund is doing phase 3 tasks, it is also doing tasks for the second round of allocations and making refinements as needed. For example, it is continuing to certify new CDEs, refine allocation materials and selection policies, and work with IRS on resolving rule making and other issues.

CDFI Fund officials said that delays in meeting self-imposed deadlines on making the NMTC allocations and finalizing the allocation agreements could be attributed to the many start-up tasks for a new program, such as developing application documents and processes, writing rules and regulations, and addressing comments. For example, CDFI Fund officials noted that they had hoped to make the allocation decisions for 2001 and 2002 during 2002 rather than in March 2003, but they experienced delays in publishing the application announcement, developing the application review system, and dealing with a larger pool of applicants than anticipated. Similarly, CDFI Fund officials said they had hoped to have allocation agreements ready about the same time as the allocation announcement in March 2003 rather than in September 2003 but were delayed due to the longer than anticipated time to publish the initial document; delays in developing and clearing the document; and handling comments from allocatees, investors, and attorneys on the program's rules and processes.

It is not clear whether the 3-year period between program authorization and the first potential NMTC investments had any effects beyond delaying the projects to assist low-income communities and persons. CDFI Fund officials believe that delays have not hurt the program and that they took some steps to minimize any effects. For example, the CDFI Fund released multiple draft versions of the allocation agreement template, in part so that investors wishing to make investments into CDEs in advance of the allocation agreements being finalized would better understand the terms and conditions of those aggreements. Also, the first four annual rounds were aggregated into two multiyear rounds—$2.5 billion for 2001 and 2002 and $3.5 billion for 2003 and 2004. The CDFI Fund has legislative authority to carry over unused limitations on annual allocations. [24] Additionally, given the delays in

[24] 26 U.S.C. § 45D (f)(3) provides for the carryover of these unused limitations on allocation amounts from one calendar year to the succeeding calendar year. No amount can be carried over past calendar year 2014.

finalizing the allocation agreements and application system, the CDFI Fund extended the deadline for CDEs allocatees in the first round to prove their eligibility for the second allocation round from February 17, 2004, to March 5, 2004.[25]

Profile of CDE Allocatees Indicates Variation in Proposed Projects and Experience

The profile of the 66 CDE allocatees reflected variation among the issues we analyzed—geographical distribution in areas to be served by community development projects, type of proposed service, and experience with low-income communities.[26] Geographically, allocatees proposed community development projects that served areas ranging from local to national in scope, all types of communities (e.g., urban and rural), and at least 20 states. Also, the proposed projects covered all types of services listed in the allocation application. Finally, all allocatees reported at least some experience in assisting low-income communities.

Allocatee Profile by Geographic Distribution

The 66 allocatees had the following profiles for the three geographical issues—service area, type of community, and states served by proposed projects (see app. III for details).

Proposed service area:[27] Table 2 shows the number of CDE allocatees and amount of equity that is eligible for credits by the area an allocatee proposed to serve. Of the 66 allocatees, 54, or 82 percent, proposed projects that serve local, state, or national service areas. The remaining proposed projects covered multiple-local areas or multiple states. In terms of the $2.5 billion in equity eligible for NMTC allocated to CDEs, nearly $1.2 billion, or nearly half of the total, went to allocatees with proposed projects having a national scope.

[25] First round CDE allocatees can only apply for the second round if they show that they have issued at least half of their QEIs from the first round of allocations.

[26] The data analyzed on the proposed projects were self-reported on the allocation applications. Profile results on the projects could change as the allocation agreements are finalized and projects are designed.

[27] “National” means projects proposed in seven or more states or territories not in a region, “multistate” means projects in from two to six states or territories, “multiple-local” means projects in more than one local area across states, “local” means projects in a local area, and “state” means projects in a state.

Table 2: NMTC Allocations by Proposed Service Area

Proposed service area	Number of allocatees	Percentage of allocatees	Equity that is eligible for NMTCs (dollars in millions)	Percentage of NMTC value
Local	22	33.3%	$591	23.6%
Multiple-local	5	7.6%	176	7.0%
State	17	25.8%	344	13.8%
Multistate	7	10.6%	198	7.9%
National	15	22.7%	1,192	47.7%
Totals	**66**	**100.0%**	**$2,500**	**100.0%**

Source: GAO analysis of CDFI Fund data.

Note: Columns may not sum to totals due to rounding.

Proposed type of community: The 66 allocatees proposed projects that focused more on urban areas (70 percent) than rural areas or mixed/suburban areas. Of the $2.5 billion in equity eligible for NMTCs, the urban projects received 86 percent while rural and mixed/suburban areas received the rest. However, CDEs proposing to serve predominantly urban areas might also serve some rural areas, and vice versa.

State and local allocations across states: Of the 66 CDE allocatees, 39 proposed local or single state projects. These 39 projects covered 20 states and the District of Columbia. California and Ohio had the highest number of allocatees. An Arizona allocatee received the largest allocation while the smallest allocation went to a Pennsylvania allocatee. Table 3 shows the number of CDEs receiving allocations and the total amount of equity that is eligible for NMTCs only for projects proposed within one state.[28]

[28] Allocatees with a national, multiple-local or multistate scopes of service are not included because we could not attribute the allocation to one state.

Table 3: NMTC Allocatees Proposing Projects Serving One State or Only Local Areas

State	Number of allocatees	Equity that is eligible for NMTCs
Alabama	1	$40,000,000
Alaska	1	5,000,000
Arizona	1	170,000,000
California	6	192,000,000
Delaware	1	15,000,000
District of Columbia	2	86,000,000
Illinois	2	14,000,000
Indiana	2	9,000,000
Kentucky	4	24,000,000
Louisiana	1	50,000,000
Maryland	1	10,000,000
Massachusetts	2	26,000,000
New Jersey	1	15,000,000
New York	1	21,000,000
Ohio	6	82,000,000
Oklahoma	2	134,000,000
Pennsylvania	1	500,000
Tennessee	1	1,000,000
Virginia	1	15,000,000
West Virginia	1	4,000,000
Wisconsin	1	21,000,000
Total	**39**	**$934,500,000**

Source: GAO analysis of CDFI Fund data.

CDE Allocatee Profile by Experience with Low-Income Communities and Proposed Type of Services

The profile of experience in low-income communities and the proposed services to be provided among the 66 CDE allocatees follows.

Experience serving low-income communities: Prior experience in serving low-income communities was common among allocatees. All 66 allocatees reported that they have successfully deployed capital to low-income communities and 61 reported successfully providing financial counseling and other services or technical assistance to disadvantaged businesses or communities.

Proposed types of services in projects: The proposed projects cover the five types of services included in the NMTC allocation application, as shown in table 4. Some of the 66 CDE allocatees proposed more than one service, which resulted in 171 proposed types of services. Of the 66 CDEs, 78 percent proposed development or rehabilitation of real estate (e.g., retail, manufacturing, office, and community facilities) and 61 percent proposed financial counseling or advice on organizing or operating a business.

Table 4: Types of Services Proposed by Allocatees in 2002

	Proposed service type			
Non-real estate investments	Development or rehabilitation of real estate	Investments in, or loans to, other CDEs	Purchase of loans from other CDEs	Financial counseling and advice
48 (72.7%)	52 (77.8%)	18 (27.3%)	13 (19.7%)	40 (60.6%)

Source: GAO analysis of CDFI Fund data.

Note: The allocation application asked applicants to check all types of services that applied to their proposals. The 66 allocatees checked a total of 171 services. As a result, the percentages should not be added because they relate to the portion of the 66 CDEs that checked that service as being provided in their projects.

Data Have Been Identified for Monitoring Compliance, but How the Data Are to Be Used Is Not Defined; a Contractor Is to Evaluate the NMTC Program

CDFI Fund and IRS officials have made progress in identifying the data for monitoring NMTC compliance, and the CDFI Fund has developed systems to collect some of these data. However, a number of details remain to be settled on how the data will actually be used to monitor compliance. Officials believe they still have adequate time to complete their plans for monitoring compliance. However, previous deadlines in implementing the NMTC have been missed, many other tasks have to be done, and the agencies have not established schedules or documented plans for ensuring that compliance monitoring processes will be in place when needed. CDFI Fund officials intend to use contractors to evaluate the effectiveness of the NMTC program. The CDFI Fund and CDEs are expected to have significant amounts of data that should be useful for the evaluation.

Progress Made in Identifying Compliance Monitoring Data and Developing Systems to Collect the Data, but Methods for Using the Data Are Not Developed

CDFI Fund and IRS officials have identified data for monitoring compliance with NMTC provisions, and the CDFI Fund has made progress in implementing data collection systems. These officials also mentioned various methods for how the data could be used to monitor compliance. However, many details remain to be settled on which methods will be used and how. Officials from both agencies believe they have time to complete their plans for monitoring compliance, but they do not have schedules or documented plans for ensuring that compliance monitoring processes will be in place when needed.

Data and Systems to Support Compliance Monitoring

NMTC compliance monitoring will focus on (1) events that could lead to recapture of NMTCs from investors and (2) CDEs' compliance with the terms of their allocation agreements. For both of these areas, the CDFI Fund and IRS will rely on some data that will be routinely collected.

The statute establishing the NMTC provide three events that trigger recapture of tax credits for an equity investment in a CDE:[29]

- the entity ceases to be a CDE,
- the proceeds of the equity investment cease to be used in a manner that satisfies the "substantially all" requirement, and
- the investment is redeemed by the CDE.

IRS is responsible for determining whether a recapture event has occurred. IRS officials said that they will focus primarily on the "substantially all" requirement and rely on the CDFI Fund to help monitor whether a CDE ceases to be qualified. Further, IRS will rely on data collected by the CDFI Fund to some extent in identifying whether any of the three events leading to recapture occur.

[29] 26 U.S.C. § 45D(g)(3).

To determine whether CDEs remain qualified for the NMTC program, data will be needed on whether CDEs continue to meet the primary mission and accountability tests. To meet the primary mission test, a CDE must show that it has a primary mission of serving or providing investment capital for low-income communities or low-income persons and that at least 60 percent of its activities are dedicated to serving low-income communities or persons. The accountability test is met by demonstrating that 20 percent of the members of either the governing board or advisory board(s) represent the low-income communities or persons in the CDE's service area.[30] Adherence to these two tests is required as long as an entity participates in the NMTC program as a CDE.[31]

To determine whether the entity has a primary mission of serving low-income communities or low-income persons during the initial application for CDE certification, the CDFI Fund reviews an organization's mission statements (as contained in its bylaws, articles of incorporation, board resolutions, etc.) during the initial application for CDE certification. The CDFI Fund requires applicants to certify that at least 60 percent of its products and services will be directed to low-income communities or low-income persons. To determine whether CDEs meet their accountability test, the CDFI Fund reviews the composition of the governing boards, advisory boards, or both at the time of the initial application. According to an official, the CDFI Fund requires all CDE allocatees, subsidiary allocatees, and CDE investees to certify annually that they continue to meet their certification requirements. CDFI Fund officials indicated that they might conduct audits or reviews to determine whether CDEs continue to meet these tests.

[30] Guidance for Certification of Community Development Entities, New Markets Tax Credit Program, 66 Fed. Reg. 65,806 (Dec. 20, 2001).

[31] IRS Notice 2003-64 (Sept. 29, 2003) and IRS Notice 2003-68 (Oct. 14, 2003) enable each CDE that receives an allocation to either make investments through multiple tiers of CDEs that are not allocatees or purchase loans through multiple CDEs that are not allocatees, respectively.

IRS officials said that to monitor whether CDEs continue to meet the "substantially all" test, they will review data that the CDEs are required to report, such as the type, amount, and timing of investments. IRS officials also said they will use data on various IRS forms to identify NMTC investors and investment-related data reported by taxpayers.[32] In addition, CDEs will report identifying data on investors and the amount of investments they made to the CDFI Fund, which IRS may use in its compliance monitoring activities.

In terms of whether CDEs redeem investments, the CDFI Fund plans to collect data annually on whether CDEs have redeemed any portion of the QEIs received in the previous year. A CDFI Fund official said the Fund was considering whether to request more data on possible redemptions. However, he thought it unlikely that a CDE would redeem any investments prior to the end of the 7-year investment period, since this would disqualify it from the NMTC and would trigger a recapture event.

While IRS will monitor compliance with events that could lead to a recapture of tax credits, the CDFI Fund will monitor CDEs for adherence to their allocation agreements.[33] To monitor allocation agreement compliance, CDFI Fund officials said that they would focus on data in section 3.2 of the allocation agreement. Section 3.2 is unique and will be tailored to each allocatee based on specific assertions a CDE made in its allocation application on its proposed use of the tax credits. For example, question 67 of the application for the first round of allocations asked if an applicant's investments or activities would be targeted principally to communities with higher levels of distress than the minimum poverty and income criteria required by the NMTC program. Section 3.2 is to include related information from those CDEs that checked "Yes" to question 67.

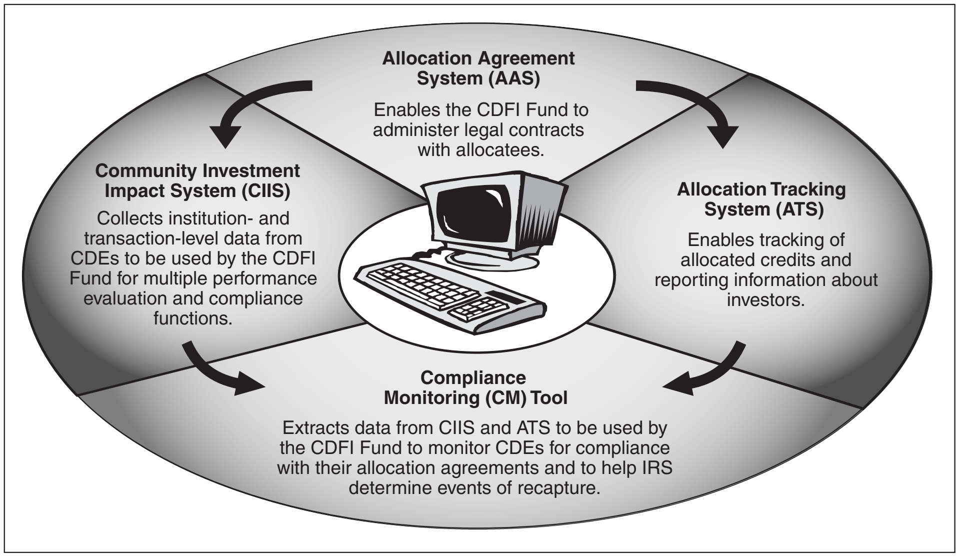
Web-based systems designed by the CDFI Fund are expected to be the primary sources of the data that the CDFI Fund and IRS plan to use to monitor compliance. CDFI Fund officials said that all the systems and processes for capturing and using the data from all CDE allocatees should

[32] According to IRS, forms 1120, 1065, 3800, and 8874 (the specific NMTC tax form) include sections where taxpayers can report NMTC-related information to IRS.

[33] Section 8.3 of the allocation agreement defines six actions that the CDFI Fund may take if an allocatee is found to be in default of section 8.1 of the allocation agreement. For example, one remedy is that the CDFI Fund may terminate or reallocate any unused portion of the NMTC allocation.

be ready by August 2004. Figure 3 shows the planned integration of the data systems.

Figure 3: The CDFI Fund's Primary Data Systems for Monitoring NMTC Compliance



Source: The CDFI Fund and GAO.

A fuller description of the purposes and time frames for these systems follows.

- Allocation Agreement System (AAS): AAS populates fields in the allocation agreements with certain allocatee information and sends an uneditable electronic copy of the allocation agreement to the CDE. CDFI Fund officials told us that AAS was functional in August 2003.
- Allocation Tracking System (ATS): ATS allows reporting by CDEs of specific data about the use of approved allocations, such as the type, amount, and timing of investments.[34] It will also track various self-reported data on investors in the CDEs. IRS may use the data to track compliance with timing requirements in the IRS regulations. ATS was on-line in November 2003, according to CDFI Fund officials.

[34] The CDFI Fund allows up to 60 days for investments to be reported to ATS, but encourages CDEs to report them as soon as possible.

- Community Investment Impact System (CIIS): CIIS is an annual reporting system that collects various data about the CDEs as institutions and about their transactions. These data are to be used to analyze what is happening with CDEs and investment projects as well as to monitor compliance. The CDFI Fund plans to test and implement CIIS by February 2004, receive data from CDEs in June 2004, and verify the data by August 2004.

- Compliance Monitoring (CM) Tool: The CM Tool extracts data from other databases to monitor for compliance with allocation agreements and helps IRS monitor for recapture events. The CDFI Fund plans for the CM Tool to include "red flags" where appropriate and feasible. The Fund plans to complete the CM Tool by July 2004.

CDFI Fund and IRS Have Incomplete Plans for Monitoring Compliance

CDFI Fund and IRS officials have many details to finish on how they will use the data that are routinely collected for actually monitoring NMTC program compliance. While officials from both agencies have listed possible monitoring processes (e.g., audits, compliance checks, or site visits) and have said that they will develop "red flags" to monitor compliance, neither agency could provide specific details about its proposed compliance monitoring processes. Officials believe they will have sufficient time to develop their compliance monitoring plans more fully.

A number of details remain to be settled in determining how the actual monitoring of compliance will occur and how the CDFI Fund and IRS will share data. For example, the CM Tool is to include various "red flags" on noncompliance by CDEs related to their adherence to IRS regulations and CDFI Fund compliance concerns. Presumably, the flags would trigger follow-up to determine whether CDEs actually have been noncompliant. According to officials at both agencies, neither the CDFI Fund nor IRS has yet developed its "red flags." Furthermore, whether, when, and how follow-up would occur has not been determined by either agency. The CDFI Fund also expects that audits will be used to help determine CDEs' compliance with recapture events and allocation agreements. What remains to be defined is how many audits will be conducted, who will perform them, and how extensive those audits will be. Similarly, processes beyond audits for following up on potential noncompliance have not been defined.

IRS expects to monitor CDEs' adherence to the "substantially all" test in part by accessing the CDFI Fund's data. IRS also expects that audits will be a tool for determining CDEs' compliance and is considering options for selecting CDEs for audit. IRS has told us that it may conduct 5 to 10 random audits of CDEs to help gather baseline data on CDEs. Other audit selection options include use of the CDFI Fund's data to trigger an audit or as an adjunct to other IRS audit work that may relate to an investor or CDE.

CDFI Fund and IRS officials have been developing a memorandum of understanding that would define the relationship between the agencies and their respective roles in monitoring aspects of CDEs' compliance. For example, both agencies have an interest in monitoring whether an investment has been redeemed. The memorandum is expected to, for example, define how IRS would access the CDFI Fund's data and how and when the CDFI Fund should alert IRS to CDEs that no longer qualify due to violations of the primary mission and accountability tests. As of January 15, 2004, the memorandum had not been finalized.

CDFI Fund and IRS officials believe that they have time to finalize their processes for ensuring NMTC compliance. According to a CDFI Fund official, due to the timing of the allocation agreements, very few CDE allocatees are likely to receive QEIs and make QLICIs in 2003. Thus the first significant data available to be used for aspects of compliance regarding QLICIs will not be available until CDEs file CIIS reports at the conclusion of their fiscal year 2004; some data will not be available to IRS until 2005, after CDEs and investors file tax returns for tax year 2004. Additionally, CDFI Fund and IRS officials note that the potential for recapture of tax credits also provides an incentive to investors to help ensure that CDEs comply with the NMTC program. Finally, allocatees will be required to supply the CDFI Fund with copies of their audited financial statements, with which the CDFI Fund plans to verify some data reported by allocatees.

Although the CDFI Fund and IRS have some time to complete their processes for monitoring compliance, officials do not have schedules or documented plans for ensuring that compliance monitoring processes will be in place when needed. To date, some CDFI Fund self-imposed deadlines for making allocations and finalizing allocation agreements have been missed. CDFI Fund officials also face a continuing workload apart from finalizing and implementing these monitoring plans. Officials are currently managing the second round of allocations and, as discussed below, considering how to evaluate the outcomes of the NMTC program. Further, although much of the activity that will need to be monitored may not occur until well into 2004, some parts of the compliance monitoring may need to be developed before others. The "red flags" that are intended to surface potential noncompliance could be needed during 2004 to alert the CDFI Fund and IRS to possible recapture events. Finally, completion of the compliance monitoring plans would help CDFI Fund and IRS officials judge what type and mix of resources they will need to adequately monitor compliance so they can make a more informed budget request for fiscal year 2006.

The CDFI Fund Plans to Contract for an NMTC Evaluation

CDFI Fund officials intend to issue a contract for an evaluation of the NMTC program. They expect that the contractor will use some of the data that CDEs will report to the CDFI Fund or maintain in their records pursuant to their allocation agreements.

Even though the law authorizing NMTC does not charge the CDFI Fund with responsibility for evaluating the success of the NMTC program, CDFI Fund officials began considering how to evaluate the NMTC program shortly after it was authorized. For example, officials sought the advice of experts in March 2002 on the types of data that would be useful for evaluating the program. However, there was no consensus on the specific data required to evaluate the NMTC program. CDFI Fund officials also drafted a document in May 2002 outlining a broad preliminary framework for evaluating the NMTC program. The preliminary evaluation proposal outlines topics to consider in measuring NMTC program impacts. The topics proposed for assessment are the (1) flow of private capital to CDEs, (2) CDE performance, and (3) outcomes at the community level.

However, evaluating the success of economic development programs like the NMTC program is challenging. Our 2002 report[35] detailed some of those challenges, all of which apply in the case of the NMTC program. For example, program impact is usually difficult to determine because it is hard to know what participants and others who invest in low-income communities would have done absent the program. If a program did not exist, what would investors have done with their capital? Would the low-income communities have had more or less economic development due to business growth? Further, program effectiveness is difficult to measure when the program is small relative to total economic activity within the geographic area of interest. These challenges will be particularly problematic for the NMTC program because 36 percent of the U.S.

[35] GAO-03-223R.

population and 39 percent of the census tracts are eligible. Many of the eligible communities would already have significant business activities that could mask the NMTC impacts.

In part due to these challenges and the amount of expertise needed to deal with them, CDFI Fund officials have decided to contract for evaluation services. CDFI Fund officials expect to have a contractor design and implement an NMTC program evaluation. Officials plan to issue a request for proposals in summer 2004 and hire a contractor in early fiscal year 2005. CDFI Fund officials have not yet developed the statement of work for the contract and do not have an expected completion date for the evaluation design or the study itself. CDFI Fund officials note that since initial investments under the program will not likely begin until 2004 (as described above), program results will not be available for evaluation until enough time elapses for the investments to generate an effect.

To assist the contractor, the CDFI Fund is collecting significant amounts of data that officials believe may be useful for the evaluation. Additionally, the CDFI Fund requires CDEs to maintain additional records. According to CDFI Fund officials, data on whether an investment recipient (a QALICB) is minority- or woman-owned are to be captured by the CDFI Fund data systems for all CDE allocatees specifically for evaluation purposes. In addition, CDFI Fund officials said that some of the other data collected from CDE allocatees through these data systems could be useful to future evaluators, for example, the location and type of investments made, the type of business receiving the investment, and the gross revenues of the business. Also, officials noted that section 6.4 of the allocation agreement provides that CDEs "shall retain all financial records, supporting documents, and any other records pertinent to the NMTC Allocation." Officials expect that the data maintained under section 6.4 may also be used for the evaluation. Finally, officials recognize that the contractor may identify other necessary data and, if appropriate, will consider collecting the data.

Conclusions

The NMTC program provides billions of dollars over multiple years as an incentive to stimulate additional billions of dollars in investments in low-income communities. Given the significant sums involved, ensuring that funds are properly used to accomplish the economic development envisioned by Congress in creating the program is vital. CDFI Fund and IRS officials have taken a number of steps to implement the program and begin collecting information needed to monitor compliance with the tax laws and the allocation agreements between the CDFI Fund and CDEs.

However, the CDFI Fund and IRS have not defined how they will share data, use the data in monitoring compliance, and develop other processes required for an effective monitoring program. Although the agencies do have some time to develop the processes they will use to monitor compliance, they do not have schedules and other documented plans for developing the processes. Having such schedules and plans would help ensure that compliance monitoring processes and resources will be in place when needed, particularly given the other tasks that need to be done and other deadlines that have been missed.

Recommendations for Executive Action

To ensure that compliance monitoring processes will be in place when needed, we recommend that the Secretary of the Treasury instruct the Director of the CDFI Fund and the Commissioner of Internal Revenue to develop plans, including milestones, for designing and implementing compliance monitoring processes for the NMTC program.

Agency Comments and Our Evaluation

We received written comments on a draft of this report from the CDFI Fund Director and IRS Commissioner (see app. IV and V). Both agencies cited the importance of compliance monitoring in the NMTC program and agreed with our recommendation to develop plans and milestones for designing and implementing compliance monitoring processes for the NMTC program. Staffs at both agencies have been directed to work together to implement a comprehensive compliance program and appropriate information sharing arrangements. In addition, officials from both agencies provided technical comments that we have incorporated into the report where appropriate.

The CDFI Fund also attached three other written comments for our consideration (see app. IV). A summary of these comments and our evaluation of them follows.

First, the CDFI Fund said that it provided us with a schedule and dates for the major compliance and monitoring tools, such as AAS and ATS. This is true. We made no changes to the report because we had already described these schedules and dates. In making our recommendation, we recognized that progress had been made in ensuring that data would be available for monitoring compliance. However, we had not received schedules or documented plans for ensuring that the processes for monitoring compliance using data from these and other systems would be in place when needed.

Second, the CDFI Fund also said that it and IRS took steps to expedite investments in CDEs and build investor confidence, such as IRS incorporating a "look back provision" in its regulations so that investors could claim tax credits for certain investments made before the CDE entered into an allocation agreement, and the CDFI Fund releasing draft versions of the allocation agreement template so that potential investors in CDEs could understand the terms and conditions before an allocation agreement was finalized. Although we did not have evidence that investor confidence was built, we agree that both agencies took steps to offset the delays in finalizing allocation agreements. Although the look back provision may have helped offset delays, we did not change our report because we had already mentioned the release of the draft templates as well as other steps.

Third, the CDFI Fund said that although data about any investments being made in CDEs are already being collected through ATS, data on the use of those investments in actual projects are not yet being collected. Such project-related data will be collected annually at the end of each CDE's fiscal year. This was one of the technical comments that we discussed with CDFI Fund officials and incorporated into the final report.

We are sending copies of this report to the interested congressional committees; the Commissioner of Internal Revenue, the Director of the Community Development Financial Institutions Fund, and other interested parties. We will make copies available to others on request. In addition, the report will be available at no charge on the GAO Web site at http://www.gao.gov.

If you or your staff have any questions on matters discussed in this report or would like additional information, please contact me or Tom Short at (202) 512-9110 or at brostekm@gao.gov or shortt@gao.gov. Major contributors to this report are acknowledged in appendix VI.

Michael Brostek
Director, Tax Issues

List of Congressional Committees

The Honorable Charles E. Grassley
Chairman
The Honorable Max Baucus
Ranking Minority Member
Committee on Finance
United States Senate

The Honorable Olympia J. Snowe
Chair
The Honorable John F. Kerry
Ranking Minority Member
Committee on Small Business and Entrepreneurship
United States Senate

The Honorable Richard C. Shelby
Chairman
The Honorable Paul S. Sarbanes
Ranking Minority Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable William M. Thomas
Chairman
The Honorable Charles B. Rangel
Ranking Minority Member
Committee on Ways and Means
House of Representatives

The Honorable Donald A. Manzullo
Chairman
The Honorable Nydia M. Velázquez
Ranking Minority Member
Committee on Small Business
House of Representatives

The Honorable Michael G. Oxley
Chairman
The Honorable Barney Frank
Ranking Minority Member
Committee on Financial Services
House of Representatives

The Honorable Richard H. Baker
Chairman
The Honorable Paul E. Kanjorski
Ranking Minority Member
Subcommittee on Capital Markets, Insurance and
Government Sponsored Enterprises
Committee on Financial Services
House of Representatives

Distribution of New Markets Tax Credit Eligibility by State

State	Total population	Population in NMTC-eligible tracts	Percentage of population in NMTC-eligible tracts	Total number of census tracts	Number of census tracts eligible for NMTC	Percentage of census tracts eligible for NMTC
Alabama	4,447,100	1,513,897	34.0	1,081	447	41.4
Alaska	626,932	166,284	26.5	158	49	31.0
Arizona	5,130,632	2,170,799	42.3	1,107	458	41.4
Arkansas	2,673,400	837,645	31.3	624	227	36.4
California	33,871,648	14,228,860	42.0	7,049	2,909	41.3
Colorado	4,301,261	1,626,666	37.8	1,062	425	40.0
Connecticut	3,405,565	1,018,248	29.9	819	267	32.6
Delaware	783,600	253,756	32.4	197	68	34.5
District of Columbia	572,059	392,784	68.7	188	128	68.1
Florida	15,982,378	5,383,460	33.7	3,154	1,104	35.0
Georgia	8,186,453	3,373,431	41.2	1,618	816	50.4
Hawaii	1,211,537	389,822	32.2	286	100	35.0
Idaho	1,293,953	289,973	22.4	280	71	25.4
Illinois	12,419,293	4,451,452	35.8	2,966	1,259	42.4
Indiana	6,080,485	1,580,385	26.0	1,414	456	32.2
Iowa	2,926,324	554,614	19.0	793	174	21.9
Kansas	2,688,418	847,596	31.5	727	266	36.6
Kentucky	4,041,769	1,666,229	41.2	994	465	46.8
Louisiana	4,468,976	2,006,649	44.9	1,106	568	51.4
Maine	1,274,923	281,916	22.1	348	92	26.4
Maryland	5,296,486	1,768,525	33.4	1,218	471	38.7
Massachusetts	6,349,097	1,874,138	29.5	1,367	465	34.0
Michigan	9,938,444	3,291,727	33.1	2,757	1,005	36.5
Minnesota	4,919,479	1,640,749	33.4	1,303	510	39.1
Mississippi	2,844,658	1,288,823	45.3	605	309	51.1
Missouri	5,595,211	2,110,929	37.7	1,320	596	45.2
Montana	902,195	238,126	26.4	270	96	35.6
Nebraska	1,711,263	487,124	28.5	503	167	33.2
Nevada	1,998,257	615,332	30.8	487	131	26.9
New Hampshire	1,235,786	335,288	27.1	273	82	30.0
New Jersey	8,414,350	2,807,584	33.4	1,950	715	36.7
New Mexico	1,819,046	852,741	46.9	456	213	46.7
New York	18,976,457	7,346,694	38.7	4,907	1,956	39.9

(Continued From Previous Page)

State	Total population	Population in NMTC-eligible tracts	Percentage of population in NMTC-eligible tracts	Total number of census tracts	Number of census tracts eligible for NMTC	Percentage of census tracts eligible for NMTC
North Carolina	8,049,313	2,550,363	31.7	1,563	579	37.0
North Dakota	642,200	148,687	23.2	227	65	28.6
Ohio	11,353,140	3,444,005	30.3	2,941	1,092	37.1
Oklahoma	3,450,654	1,255,471	36.4	990	394	39.8
Oregon	3,421,399	1,052,608	30.8	755	254	33.6
Pennsylvania	12,281,054	3,892,107	31.7	3,135	1,121	35.8
Puerto Rico	3,808,610	3,603,560	94.6	861	773	89.8
Rhode Island	1,048,319	304,225	29.0	234	72	30.8
South Carolina	4,012,012	1,329,983	33.2	867	346	39.9
South Dakota	754,844	186,224	24.7	235	82	34.9
Tennessee	5,689,283	1,813,322	31.9	1,261	485	38.5
Texas	20,851,820	8,948,614	42.9	4,388	2,020	46.0
Utah	2,233,169	665,977	29.8	496	154	31.0
Vermont	608,827	115,063	18.9	179	35	19.6
Virginia	7,078,515	2,830,159	40.0	1,541	675	43.8
Washington	5,894,121	1,986,457	33.7	1,318	464	35.2
West Virginia	1,808,344	782,252	43.3	466	214	45.9
Wisconsin	5,363,675	1,386,144	25.8	1,333	423	31.7
Wyoming	493,782	89,243	18.1	127	24	18.9
Total	**285,230,516**	**104,076,710**	**36.5**	**66,304**	**26,337**	**39.7**
Total without Puerto Rico	281,421,906	100,473,150	35.7	65,443	25,564	39.1

Source: GAO analysis of U.S. Census Bureau data.

Congressional Staff Interviews

To provide a profile of community development entities (CDE) that received New Markets Tax Credit (NMTC) allocations, we reviewed the congressional contact file from a recent GAO report.[1] For that report, we conducted 14 interviews with congressional staff of majority and minority members serving on the following committees.

- United States Senate
  - Committee on Finance
  - Committee on Small Business and Entrepreneurship
  - Committee on Banking, Housing, and Urban Affairs
- House of Representatives
  - Committee on Ways and Means and its Subcommittee on Oversight
  - Committee on Small Business
  - Committee on Financial Services and its Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises

[1] U.S. General Accounting Office, *New Markets Tax Credit: Status of Implementation and Issues Related to GAO's Mandated Reports*, GAO-03-223R (Washington, D.C.: Dec. 6, 2002).

Profile of Participants

As of the August 2002 allocation application deadline for the first round of NMTC allocations, the Community Development Financial Institutions (CDFI) Fund had certified 1,033 CDEs. Of these 1,033 certified CDEs, 345 applied in the first round of NMTC allocation, requesting nearly $26 billion of equity related to NMTCs. From this applicant pool, 66 CDEs received NMTC allocations.

These 66 allocatees requested $5.1 billion in equity, but the allocation limitation for the first round was $2.5 billion. While the average and median amounts requested were $76.8 million and $40.0 million, respectively, the amounts allocated were $37.9 million and $18 million. Furthermore, while 11 of the 66 allocatees received the full amounts requested, the typical allocation was reduced by 58 percent to reach the 2002 allocation limitation.

Tables 5 and 6 profile CDEs according to their structure and profit status. Of the 1,033 CDEs certified by the CDFI Fund, nearly 60 percent were structured as single entities and 16 percent were parents with at least one subsidiary[1] CDE. Also, 57 percent of CDEs were certified as for-profit entities and 39 percent as nonprofit entities.

[1] Subsidiary means a legal entity that is owned or controlled directly or indirectly by a CDE.

Table 5: Number of CDEs Certified, Applying for, and Receiving NMTCs by CDE Structure and Profit Status

	Certified/ registered CDEs	Allocation applicants		Allocatees		
	Number	Number	Requested equity that is eligible for NMTCs (dollars in millions)	Number	Requested equity that is eligible for NMTCs (dollars in millions)	Allocated equity that is eligible for NMTCs (dollars in millions)
Structures of CDEs						
CDFI	317	88	$4,593	22	$1,214	$625
Specialized Small Business Investment Companies	9	5	102	-	-	-
Not specified	707	252	21,217	44	3,855	1,876
Total	**1,033**	**345**	**$25,912**	**66**	**$5,069**	**$2,500**
Single entities	615	215	$15,110	27	$1,008	$574
Parents with subsidiaries	166	120	10,506	36	3,961	1,883
Subsidiaries	252	10	296	3	100	43
Total	**1,033**	**345**	**$25,912**	**66**	**$5,069**	**$2,500**
Profit status						
Profit	593	224	$18,966	36	$2,563	$1,301
Nonprofit	400	102	5,061	17	1,135	555
Other	13	3	196	1	16	15
Not specified	27	16	1,689	12	1,355	630
Total	**1,033**	**345**	**$25,912**	**66**	**$5,069**	**$2,500**

Source: GAO analysis of CDFI Fund data.

Note: Results are based on self-reported data from applicants.

Columns may not sum to totals due to rounding.

Table 6: Percentage of CDEs Certified, Applying for, and Receiving NMTCs by CDE Structure and Profit Status

	Certified/ registered CDEs	Allocation applicants		Allocatees		
	Percentage of CDEs	Percentage of applicants	Percentage of request	Percentage of allocatees	Percentage of request	Percentage of allocation
Structures of CDEs						
CDFI	31.0%	26.0%	18.0%	33.0%	24.0%	25.0%
Specialized Small Business Investment Companies	1.0%	1.0%	0.0%	-	-	-
Not Specified	68.0%	73.0%	82.0%	67.0%	76.0%	75.0%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**
Single entities	60.0%	62.0%	58.0%	41.0%	20.0%	23.0%
Parents with subsidiaries	16.0%	35.0%	41.0%	55.0%	78.0%	75.0%
Subsidiaries	24.0%	3.0%	1.0%	5.0%	2.0%	2.0%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**
Profit status						
Profit	57.0%	65.0%	73.0%	55.0%	51.0%	52.0%
Nonprofit	39.0%	30.0%	20.0%	26.0%	22.0%	22.0%
Other	1.0%	1.0%	1.0%	2.0%	0.0%	1.0%
Not specified	3.0%	5.0%	7.0%	18.0%	27.0%	25.0%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Source: GAO analysis of CDFI Fund data.

Note: Results are based on self-reported data from applicants.

Columns may not sum to totals due to rounding.

The equity allocations for NMTCs ranged from $500,000 to $170 million in credits with

- 13 allocatees receiving $5 million or less,
- 20 allocatees receiving more than $5 million to $20 million,
- 16 allocatees receiving more than $20 million to $50 million,
- 10 allocatees receiving more than $50 million to $100 million, and
- 7 allocatees receiving over $100 million.

The goals of the NMTC program are not stated in the legislation that authorizes it. Interested congressional staff said they are interested in how the program will affect different community types and service areas. Tables 7 and 8 profile NMTC activity by community types and service areas in terms of the number and percentage of participants, respectively.[2] Over three-quarters of the CDEs applied for NMTC allocations primarily to serve urban areas, while less than 20 percent intended to focus primarily on rural areas. Additionally, a majority of applicant CDEs were planning to serve specific local areas, while 18 percent intended to serve specific states.

For type of service area, allocatees proposing local projects received 63 percent of what was requested and multiple-local projects received 37 percent; state, national, and multistate projects received about half of what they requested. Regardless of the type of community (e.g., urban or rural) they proposed to serve, the 66 allocatees received about half of the requested allocations.

[2] Results are based on self-reported data from applicants. Also, the terms and conditions of the NMTC allocation only become final after the allocation agreement is signed; therefore, certain factors, such as the service area, might change at the initiative of the applicant or the CDFI Fund.

Table 7: Number of NMTC Allocation Applicants and Allocatees by Community Type and Service Area

	Applied for NMTC allocation		Received NMTC allocation		
	Number	Requested equity that is eligible for NMTCs (dollars in millions)	Number	Requested equity that is eligible for NMTCs (dollars in millions)	Allocated equity that is eligible for NMTCs (dollars in millions)
Community type[a]					
Urban	265	$22,100	46	$4,366	$2,137
Rural	59	2,808	15	606	310
Mixed	17	903	5	98	53
Suburban	4	101	-	-	-
Total	**345**	**$25,912**	**66**	**$5,069**	**$2,500**
Service area[b]					
Local	179	$8,332	22	$938	591
State	62	5,560	17	659	344
Regional[c]	32	2,069	-	-	-
Multiple-local[c]	-	-	5	471	176
Multistate	17	1,246	7	445	198
National	55	8,706	15	2,557	1,192
Total	**345**	**$25,912**	**66**	**$5,069**	**$2,500**

Source: GAO analysis of CDFI Fund data.

Note: Columns may not sum to totals due to rounding.

[a]CDEs were required to report the percentage of activity they intended to conduct in selected degrees of urbanization on the NMTC Allocation Application. We categorized CDEs according to their predominant response. In cases in which two or more predominant responses exist, we categorized the CDE as mixed.

[b]CDEs were required to report their intended type of service area on the NMTC Allocation Application. We used the categories as defined by the CDFI Fund.

[c]The measure of service area comes from certification and allocation applications. However, the CDFI Fund reclassified the service area for allocatees, eliminating the regional category and adding a multiple-local category.

Table 8: Percentage of NMTC Allocation Applicants and Allocatees by Community Type and Service Area

	Applied for NMTC allocation		Received NMTC allocation		
	Percentage of applicants	Percentage of requests	Percentage of allocatees	Percentage of requests	Percentage of allocations
Community type[a]					
Urban	76.8%	85.3%	69.7%	86.1%	85.5%
Rural	17.1%	10.8%	22.7%	12.0%	12.4%
Mixed	4.9%	3.5%	7.6%	1.9%	2.1%
Suburban	1.2%	0.4%	-	-	-
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**
Service area[b]					
Local	51.9%	32.2%	33.3%	18.5%	23.6%
State	18.0%	21.4%	25.8%	13.0%	13.8%
Regional[c]	9.3%	8.0%	-	-	-
Multiple-Local[c]	-	-	7.6%	9.3%	7.0%
MultiState	4.9%	4.8%	10.6%	8.8%	7.9%
National	15.9%	33.6%	22.7%	50.4%	47.7%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Source: GAO analysis of CDFI Fund data.

Note: Columns may not sum to 100 percent due to rounding.

[a]CDEs were required to report the percentage of activity they intended to conduct in selected degrees of urbanization on the NMTC Allocation Application. We categorized CDEs according to their predominant response. In cases in which two or more predominant responses exist, we categorized the CDE as mixed.

[b]CDEs were required to report the of the type service area that they intended to serve on the NMTC Allocation Application. We used the categories as defined by the CDFI Fund.

[c]The measure of service area comes from certification and allocation applications. However, the CDFI Fund reclassified the service area for allocatees, eliminating the regional category and adding a multiple-local category.

Comments from the Community Development Financial Institutions Fund

DEPARTMENT OF THE TREASURY
COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS FUND
601 THIRTEENTH STREET, NW, SUITE 200 SOUTH
WASHINGTON, DC 20005

DIRECTOR

Michael Brostek
Director, Tax Issues
United States General Accounting Office
Washington, DC 20548

Dear Mr. Brostek:

Thank you for providing the Treasury Department with the opportunity to comment on the draft GAO report, "New Markets Tax Credit Program: Progress Made in Implementation but Further Actions Needed to Monitor Compliance"(Report). We are very pleased with the implementation and administration of the New Markets Tax Credit (NMTC) Program, and appreciate that your first audit of the NMTC Program recognizes the significant accomplishments that we have achieved to date. The $15 billion NMTC Program will stimulate job creation and economic development in our nation's low-income communities by attracting capital from private sector investors. The successful implementation and quality management of this program is one of the Department's highest priorities.

We concur with the Report's comments regarding the importance of the compliance monitoring process to ensure the integrity of the NMTC Program, and the recommendation that the Treasury Secretary "instruct the Director of the Community Development Financial Institutions (CDFI) Fund and the Commissioner of Internal Revenue to develop plans, including milestones, for designing and implementing compliance monitoring processes for the NMTC Program." The Report correctly states that CDFI Fund and Internal Revenue Service (IRS) officials have been working cooperatively to develop data sharing and other processes so that both agencies can monitor allocatees' compliance with specific provisions of the program. The Report also acknowledges that we have achieved key compliance milestones, such as the implementation of the CDFI Fund's automated Allocation Agreement System (AAS) and Allocation Tracking System (ATS).

Notwithstanding these significant accomplishments, ongoing coordination between the CDFI Fund and the IRS will be critical to ensuring the success of the NMTC Program. Secretary Snow has directed the IRS to work together with the CDFI Fund to complete implementation of a comprehensive NMTC compliance program and to formalize appropriate information sharing arrangements. Treasury plans to establish measurable program goals by the end of fiscal year 2004 that will be results oriented.

Thank you again for the opportunity to review and comment on your draft report. Attached please find some additional comments that we hope you will consider in the final report. Please be assured that Treasury will take all appropriate measures to complete the implementation of a monitoring and compliance system to ensure the integrity and continued success of the NMTC Program.

Sincerely,

Tony T. Brown

Tony T. Brown

cc: Pamela F. Olson, Assistant Secretary for Tax Policy, U.S. Department of the Treasury

OTHER OBSERVATIONS AND COMMENTS TO DRAFT REPORT
(GAO-04-326)

While Treasury Department concurs with the sole Recommendation for Executive Action contained in the draft Report, there are certain other observations in the Report that the Department would like to take this opportunity to address:

1. *The Report states "the agencies have not established schedules or documented plans for ensuring that monitoring processes will be in place when needed."*

   Please note that CDFI Fund officials did provide the GAO with a schedule for the major compliance and monitoring tools, and dates from this schedule are referenced throughout the Report. The Report correctly notes that the CDFI Fund implemented the Allocation Agreement System (AAS) and the Allocation Tracking System (ATS) in advance of the first investments being made into Community Development Entities (CDEs), demonstrating that the agencies are committed to introducing monitoring processes as they become needed.

2. *The Report indicates that it is unlikely that many NMTC-related projects had started by the end of 2003, and further states that this may in part be because the Fund did not enter into allocation agreements with CDE allocatees until late in calendar year 2003.*

   We believe it should also be noted that both the Fund and the IRS took important measures to expedite investments in CDEs and build investor confidence around the program. For instance, the IRS incorporated a "lookback provision" in its regulations so that, in certain circumstances, investors could claim tax credits for investments made prior to the CDE entering into an allocation agreement with the Fund. Additionally, the Fund released multiple, draft versions of the allocation agreement template, in part so that investors wishing to make investments into CDEs in advance of the allocation agreement being finalized would better understand the terms and conditions of those agreements.

3. *The Report states "The CDFI Fund hopes to have initial data on the status of actual investments and related projects by February-March of 2004, at the earliest. This is when the initial round of reporting by all 66 allocatees is slated to be finished."*

   The above statement isn't entirely accurate. It is true that the Fund is already collecting "initial data on the status of actual investments." This is done through the ATS, a real-time, web-based system where allocatees report information about the status and timing of their Qualified Equity Investments (QEIs). Allocatees are required to report this information in ATS within 60 days of receiving the proceeds of a QEI.

   However, there will be an interval between when the Fund collects data on QEIs and when the Fund will have information regarding the status of "related projects." By statute, an allocatee has up to one year from the date it issues a QEI to demonstrate that substantially all of those proceeds were used to fund Qualified Low Income Community Investments (QLICIs). The Fund will be collecting such project-level data on an annual basis following the conclusion of each allocatee's fiscal year.

Comments from the Internal Revenue Service

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

COMMISSIONER

Mr. Michael Brostek
Director, Tax Issues
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Brostek:

I reviewed your draft report entitled, "New Markets Tax Credit Program: Progress Made in Implementation but Further Actions Needed to Monitor Compliance" (GAO Job Code 450223). We appreciate your comments regarding the importance of the compliance monitoring process in ensuring the integrity of the New Markets Tax Credit Program (NMTC). We agree with your recommendation that the IRS, in coordination with the Community Development Financial Institutions Fund (CDFI), will need to develop a compliance program during Fiscal Year 2004 for the NMTC Program. We anticipate that these credits will first appear on 2004 income tax returns and that the compliance program will be available when needed. Your report also points out that CDFI Fund and IRS officials have been cooperating on data sharing and other processes that will help both agencies monitor compliance with provisions of the program.

I have directed the Commissioners of Small Business/Self-Employed and Large and Mid-Size Business to work together with the CDFI Fund to develop a comprehensive compliance program and to formalize our information sharing arrangements. We will establish measurable program goals by the end of Fiscal Year 2004 which will be process and results oriented. When appropriate, other operating units such as Tax Exempt and Government Entities, Wage and Investment, and the Office of Chief Counsel may participate.

If you have any questions, please contact me or Kelly Cables, Director of Performance and Quality and Audit Assistance within the LMSB Division at (202) 283-8334.

Sincerely,

Mark W. Everson

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