Obama Administration Announces New Measures to Support Job Creation and Small Businesses in Hard-Hit Communities through the New Markets Tax Credit

As part of the Administration's strategy to restore prosperity and create an economy that works for small businesses and for all Americans, Treasury Secretary Geithner today announced new steps to extend and expand the New Markets Tax Credit (NMTC) to support investment in hard-hit communities. The NMTC spurs growth in distressed communities by catalyzing private sector investments that create jobs and enhance access to capital for small businesses and community development. The NMTC has played a central role in the Obama Administration's commitment to foster an economic recovery that supports job creation and small business growth in America's hardest-hit communities, creating hundreds of thousands of jobs since its inception– including full-time jobs at operating businesses, construction jobs at real estate projects, and full-time jobs at tenant businesses or community facilities operating out of NMTC-financed real estate projects.

Secretary Geithner is announcing three steps today that will expand support for the credit, ensure that every dollar of tax cut that has been authorized gets claimed by American taxpayers, and help to focus its support on small businesses. These proposals include:

Funding authority to catalyze high levels of private investment in distressed communities. The Administration has proposed to authorize NMTCs at $5 billion in 2010 and 2011. Data show that every $1 of foregone tax revenues under the NMTC leverages about $12 of private investment in distressed communities on a cost basis. NMTC dollars are critical in spurring private sector investment in communities facing economic challenges. For example, investment in an airplane parts manufacturer allowed it to open a new plant in rural Oklahoma, that will create 500 new jobs in a low-income community.

Improving overall competitiveness, attractiveness and effectiveness of the New Markets Tax Credit. The Administration has proposed a number of changes to the NMTC to better support utilization of the credit:

- ***Allowing Alternative Minimum Tax (AMT) Taxpayers to Claim New Market Tax Credits.*** To support a healthy level of investment in low-income communities, the Administration has proposed allowing the NMTC to offset AMT liability. Since current law does not allow NMTC credits to offset AMT liability, the investor base for the credit has been limited. The economic downturn has strained the investor base even further. Making the credit available to AMT taxpayers will put the credit on equal footing with other tax credits that can offset the AMT. It will also bolster investment in the NMTC, particularly among investors that currently pay the AMT.

- ***Reviewing passive activity rules.*** Currently, investors are not certain as to whether the "passive activity rules"—which limit the use of losses and credits from businesses in which a taxpayer does not materially participate—might limit their ability to use the NMTC to reduce tax liability. Investors generally do not play an active role in the investments made by CDEs and consequently may wonder whether they can immediately benefit from the credit. Treasury and the IRS are working on a revenue ruling that would clarify how the passive activity rules apply to investors that claim the NMTC.

- ***Qualification of certain types of investments for the credit.*** Investors are also not certain about the ability to invest funds taken in from “recourse” loans. A 2003 revenue ruling clarified that funds borrowed on a non-recourse basis may constitute a qualified investment when invested in a qualifying CDE, but the treatment of recourse loans has not been directly addressed. Treasury and the IRS are working on guidance that would clarify whether recourse borrowings can be used to make qualifying investments.

Improvement of NMTC rules to spur additional investment in small businesses. Treasury and the IRS are actively pursuing guidance to clarify the application of certain tax rules to the credit. We anticipate that this guidance will provide the flexibility to spur additional investment in small businesses in low-income communities:

- ***Re-examining “substantially all” requirements .*** The seven-year term of the NMTC matches poorly with the length of typical small business loans, which are usually much shorter in duration. Because current rules generally require that CDEs have “substantially all” of their NMTC investments be deployed at all times, they are hesitant to make investments that must be paid “early.” As a result, reexamining this “substantially all” requirement could yield additional flexibility for CDEs to provide working capital and other shorter term loans.

- ***Supporting greater investment in institutions that invest in small businesses*** through new rules that could also promote greater investment of NMTC dollars in Community Development Financial Institutions (CDFIs).

Background on the New Markets Tax Credit

The New Markets Tax Credit (NMTC) spurs investment of private sector capital in distressed communities by providing a tax credit for taxpayers who make qualified equity investments (QEIs) in designated Community Development Entities (CDEs).

The credit provided to the investor totals 39 percent of the investment in a CDE and is claimed over a seven-year credit allowance period. In each of the first three years, the investor receives a credit equal to five percent of the total amount paid for the stock or capital interest at the time of purchase. For the final four years, the value of the credit is six percent annually. Investors may not redeem their investments in CDEs prior to the conclusion of the seven-year period.

Community Development Entity (CDE) Certification

To qualify as a Community Development Entity (CDE), an entity must be a domestic corporation or partnership that: 1) has a mission of serving, or providing investment capital for, low-income communities or low-income persons; 2) maintains accountability to residents of low-income communities through their representation on a governing board of or advisory board to the entity; and 3) has been certified as a CDE by Treasury’s Community Development Financial Institutions (CDFI) Fund. Applicants may submit CDE certification applications to the CDFI Fund throughout the year.

Allocation of New Markets Tax Credits

The CDFI Fund allocates NMTCs to CDEs through an annual competitive application process. Since the creation of the credit, the CDFI Fund has been authorized to allocate to CDEs tax credit authority to support, in the aggregate, $26 billion of investments into CDEs. This includes $3 billion that was authorized through the Recovery Act and $1 billion that was authorized under the Gulf Opportunity (GO) Zone Act of 2005 that provided allocation authority for CDEs that have a significant mission of recovery and redevelopment in the Katrina GO Zone.

Use of Qualified Equity Investments (QEI) Proceeds

A CDE that is awarded an allocation of NMTCs by the CDFI Fund has five years from the date of notification of its allocation to close qualified equity investments (QEIs) with its investors. The CDE has 12 months to place "substantially all" of the proceeds from the QEIs into Qualified Low Income Community Investments (QLICIs), which generally are: 1) loans to, or investments in, qualifying businesses (including certain real estate projects); 2) loans to, or investments in, other CDEs; 3) the purchase of qualifying loans originated by other CDEs; and 4) counseling to low-income community businesses.

Highlights of New Markets Tax Credit Investments Across America

NMTC proceeds have financed a variety of activities in distressed urban and rural communities throughout the United States, including alternative energy companies, charter schools, health care facilities, timberlands, child care providers, supermarkets, manufacturers, processors, distributors, and business incubators. A sample of some NMTC transactions financed to date include:

- Investment in an airplane parts manufacturer that allowed it to open a new plant in rural Oklahoma, which will create 500 new jobs in a low-income community.
- The development of a high-tech business incubator in Detroit that will provide opportunities for minority, women and other small business owners.
- A 161,000 square-foot manufacturing facility in rural Iowa that manufactures parts for wind turbines.
- The development of a charter school, serving 650 middle school and high school students, in the Crenshaw neighborhood of south Los Angeles.
- An emergency worker training facility in Lafayette, LA, developed in the aftermath of Hurricane Katrina, which will train more than 240 students per year and provide more than 60 permanent jobs.
- A mixed use development of housing and retail, anchored by a national chain grocery store, located on a vacant military site in a severely distressed community in Washington, D.C.
- A loan to a Native American business woman, who operates a pharmacy in western Montana, that will enable her to own her business facility for the first time, and create jobs in a high poverty rural community.
- Investment in a community health center in San Diego, CA that enabled it to create a new maternal and child health care center.