New Markets Tax Credits

What are New Markets Tax Credits?

The New Markets Tax Credit (NMTC) Program provides a tax incentive for private sector investment into economic development projects and businesses located in low-income communities. The program is overseen by the United States Department of the Treasury and is directly administered by the Community Development Financial Institutions (CDFI) Fund.

NMTCs are allocated by the CDFI Fund to community development entities (CDEs) under a competitive application process.

To qualify as a CDE, an entity must be a domestic corporation or partnership that:

- has a mission of serving, or providing investment capital for, low-income communities or low-income persons;
- maintains accountability to residents of low-income communities through their representation on a governing board of, or advisory board to, the CDE; and
- has been certified as a CDE by the CDFI Fund.

CDEs offer the NMTCs to investors in exchange for qualified equity investments (QEIs). The CDEs then invest those funds into qualified active low-income businesses (QALICBs).

NMTCs provide a subsidy to businesses and economic development projects in low-income communities that is equal to approximately 20% of the project financing. These projects, in turn, provide jobs, economic activity, and needed products and services in low-income communities.

What are the benefits to banks?

- The NMTC provides a subsidy that helps banks participate in projects in low-income communities that might not otherwise be eligible for financing.
- Bank investors receive a credit against federal income taxes for making qualified equity investments in CDEs. The credit totals 39 percent of the cost of the investment and is claimed over a seven-year period.
- NMTC participants can also earn interest income on their investments, depending upon how they are structured.
- Banks may receive positive CRA consideration for community development activities related to NMTC projects if the activities benefit the bank’s assessment area(s) (AA), or the broader statewide or regional area that includes the bank’s AA(s). Examiners will consider these activities if they have a purpose, mandate, or function that includes serving geographies or individuals located within the institution’s AA(s). Examiners will also consider these activities even if they will not benefit the institution’s AA(s), as long as the institution has been responsive to community development needs and opportunities in its AA(s).

How can banks participate in the NMTC Program?

Banks can participate in the NMTC program in several ways:

- *As a NMTC Allocatee*
  A bank can form a subsidiary CDE and apply to the CDFI Fund for an allocation of NMTCs.
  - The CDE can apply for certification with the CDFI Fund.
  - CDFI Fund-certified CDEs are eligible to apply for NMTC during the CDFI Fund's annual funding round. Please see the CDFI Fund's website for further information on the application process.

- *As an investor in NMTCs*
  A bank can invest in an existing NMTC allocatee, either one that is bank-owned or owned by a third-party
  - A list of CDEs that have received NMTC allocations is available on the CDFI Fund's website.

- *As a lender in NMTC transactions*

A bank can participate as a leverage lender in a NMTC transaction, or as a lender outside of the NMTC transaction.

What are the key risks and regulatory considerations with NMTC investments?

- NMTCs are subject to recapture for seven years after an equity investment is made in a CDE if:
  - A CDE ceases to be a certified CDE, or
  - "Substantially all" of the equity investment proceeds are no longer used for qualified Low-Income Community Businesses, or
  - The CDE redeems the equity investment.
- An investor bank should consider the CDE's management, experience, and compliance capabilities. A bank should also consider the credit and liquidity risks of any investment in NMTCs.
- Banks also need to consider reputational risk. The NMTC Program was created to meet the public goals of revitalizing low-income communities and assisting low-income individuals. Banks participating in NMTC transactions need to consider how these public goals are being met, how the community supports the project being financed, and how the benefits to low-income communities and individuals are documented.
- The National Bank Act, 12 USC 24 (Eleventh), and the OCC's Part 24 rules implementing that section of the Act enable national banks to make equity investments in certain CDEs as well as in NMTC investment funds.
- Federal savings associations may make public welfare investments under specific authorities that are described on the OCC's Public Welfare Investments Web Resource Directory.
- The leverage structure often requires non-traditional collateral, forbearance agreements, and non-amortizing debt for the seven year compliance period.

For more information

- OCC's February 2013 Community Developments *Insights* report entitled *"New Markets Tax Credits: Unlocking Investment Potential"*

- OCC's Summer 2004 *Community Developments Investments* entitled *" New Markets Tax Credits – Bridging Financing Gaps"*

- OCC's Web-site for information about the Part 24 community development investment authority.

- OCC's District Community Affairs Officers

- CDFI Fund's New Markets Tax Credit Program
- The New Markets Tax Credit Coalition

Disclaimer

Community Developments Fact Sheets are designed to share information about programs and initiatives of interest to bankers and community development practitioners. These fact sheets differ from OCC bulletins and regulations in that they do not reflect agency policy and should not be considered definitive regulatory or supervisory guidance. Some of the information used in the preparation of this fact sheet was obtained from publicly available sources. These sources are considered reliable, but the use of this information does not constitute an endorsement of its accuracy by the OCC.

The Tax Cuts and Jobs Act (Pub. L. No. 115-97), signed into law on December 22, 2017, made numerous changes to the Internal Revenue Code. This document has NOT been updated to reflect these changes. Banks or other entities considering a tax credit equity transaction should consult with a tax professional with knowledge of how the changes in the tax code may affect specific tax equity transactions.