What is the New Markets Tax Credit and how does it work?

The credit provides an incentive for investment in low-income communities. The US Treasury competitively allocates tax credit authority to intermediaries that select investment projects. Investors receive a tax credit against their federal income tax.

BACKGROUND

The New Markets Tax Credit (NMTC) was established in 2000. Congress annually authorizes the amount of credit authority, which is then allocated to qualified applications by the Treasury Department. Since 2003, the program has parceled out credits worth nearly $17 billion. The NMTC has supported over 4,500 projects in all 50 states, the District of Columbia, and Puerto Rico. Some 41 percent of US census tracts qualify for NMTC investments. The credit expired at the end of 2014, but bills to extend it are pending in Congress.

WHO INITIATES NMTC PROJECTS?

Community development entities (CDEs) are intermediaries that make loans or investments. They apply to the Treasury Department's Community Development Financial Institutions (CDFI) Fund to receive tax credit authority. CDEs sell these tax credits to investors and use the funds to make debt or equity investments in entities located in qualified low-income communities. CDEs are encouraged to make deals and offer preferential rates and terms in areas that are more highly distressed. CDEs frequently use other public subsidies and private sector funds to invest in projects.

Many enterprises, including banks, developers, and local governments can qualify to become CDEs. The Urban Institute found in its 2013 evaluation of the first years of the New Markets program that for-profit non-financial institutions (such as developers and other private corporations) were awarded the highest share of NMTCs, followed by CDFIs and other mission-driven lending institutions. The third highest share went to for-profit financial institutions. Nonprofit nonfinancial institutions and government and quasi-government CDEs were awarded fewer and smaller NMTC allocations.

WHO INVESTS IN NMTC PROJECTS?

NMTC investors provide capital to CDEs, and are awarded credits against their federal tax obligations in exchange. Investors can claim their allotted tax credits in as little as seven years—5 percent of the investment for each of the first three years and 6 per-

cent of the project for the remaining four years—for a total of 39 percent of the NMTC project. A CDE can be its own investor or find an outside investor. Investors are primarily corporate entities—often large international banks or other regulated financial institutions—but any entity or person is eligible to claim NMTCs.

WHO RECEIVES NMTC INVESTMENTS?

"Qualified active low-income businesses" (QALICBs) are the recipients of NMTC investments. While called "businesses," QALICBs can be for-profit or nonprofit enterprises. The Urban Institute found in its 2013 evaluation that about 60 percent of projects in the first years of the NMTC program went to for-profit QALICBs, and most of the rest went to nonprofits. (The remaining 2 percent of projects were linked to tribal or other government organizations.)

The study found that QALICBs ranged in size—as measured by annual gross revenues or operating budgets at the start of their NMTC projects—from zero for start-ups to $7 billion for a large for-profit parent entity in the natural resources business, with a median of $740,000.

WHAT TYPES OF PROJECTS DOES THE PROGRAM FUND?

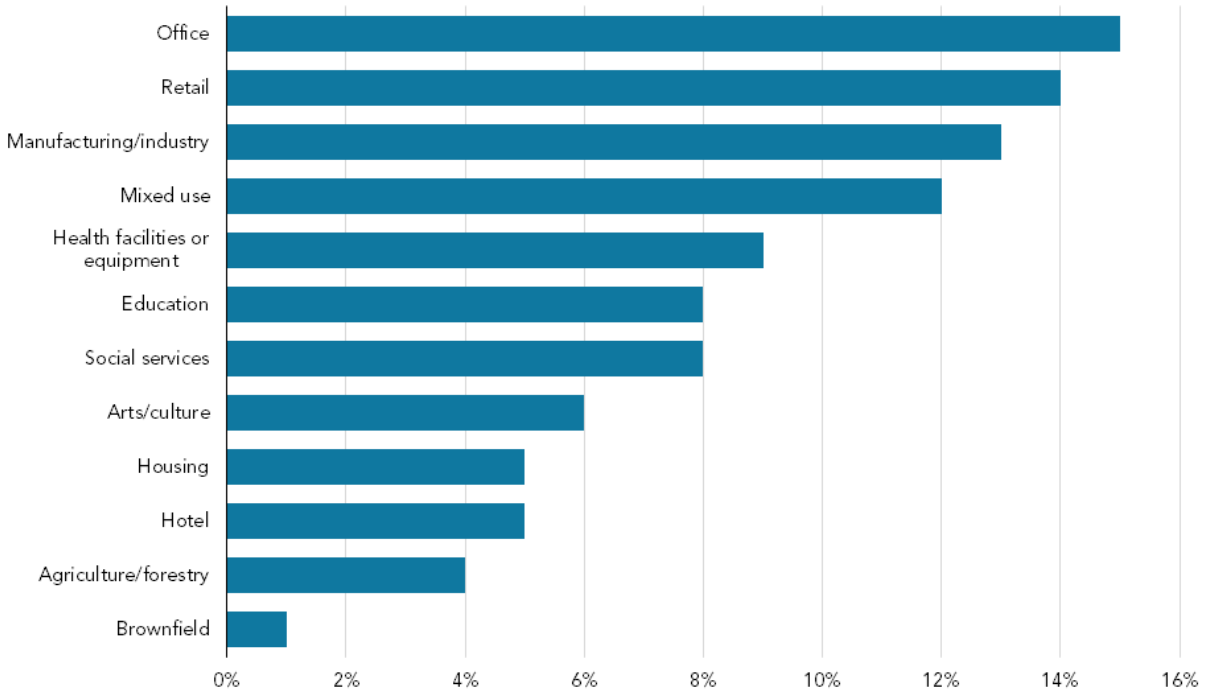
The NMTC program is flexible with regard to project type and purpose. QALICBs can be used to finance equipment, operations, or real estate. The real estate financing can be for the purchase or rehabilitation of retail, manufacturing, agriculture, community facilities (e.g., health services, museums, or charter schools), rental or for-sale housing, or combinations of these.

In its 2013 evaluation, the Urban Institute categorized project types (table 1 and figure 1). Although no project type dominated early-year projects, the most prevalent were office, retail, manufacturing/industrial, and mixed-use.

FIGURE 1

New Market Tax Credit Projects by Share

2003-2007



Source: Abravanel et al. 2013.

Further Reading

Abravanel, Martin D., Nancy M. Pindus, Brett Theodos, Kassie Dumlao Bertumen, Rachel Brash, and Zachary J. McDade. 2013. "New Markets Tax Credit Program Evaluation." Washington, DC: Urban Institute.