



# Legal Minute

April 2002

## Understanding the New Markets Tax Credit *What Does it Mean to a Community Development Corporation?*

*(This article is the first in a series of articles providing nonprofits with up-to-date legal information on topics of importance to community-based organizations. The format is designed for easy filing and quick reference.)*

### Which of these activities could benefit from the New Markets Tax Credit Program?

- A. The ABC Community Development Financial Institution (CDFI) wants to issue a small-business loan to a home-based tamale business in a community where 25% of the population falls below the poverty rate.
- B. The Eastside Job Training Program trains employees for living wage jobs with benefits. EJTP partners with a nearby business in a low-income neighborhood that wants to expand its operations.
- C. ABC CDC needs a loan to purchase a new building to use as an office.

**Answer:** All of the above.

### What is the New Markets Tax Credit Program?

Congress passed the Community Renewal Tax Relief Act of 2000 to encourage private loans and investments in qualified activities located in low-income communities. Under the program, \$2.5 billion in tax credits authorized for 2002 will be awarded by the CDFI Fund of the United States Treasury to Community Development Entities (CDEs). Taxpayers who make an investment in a qualified CDE can receive a credit for a portion of their investment that will reduce their tax liability.

*Note: The New Markets Tax Credit Program specifically excludes residential real estate and the operation of rental housing as a qualified investment.*

### What Can a Nonprofit Gain From the New Markets Program?

The New Markets Program will make more money available for investment in low-income communities. A CDE that is awarded a tax credit allocation, an "Award Winning Entity" ("AWE"), will need partners who work with businesses in low-income communities. An AWE can provide loans to a nonprofit or purchase loans a nonprofit makes to a small business. An AWE can also make loans directly to qualified businesses in a low-income community. A nonprofit that anticipates developing commercial real estate or taking out a loan in the next ten years should consider obtaining certification as a CDE. All CDFIs should become CDEs.

### Should all Nonprofits Apply for Tax Credit Allocation?

No. First, only a for-profit CDE can receive an allocation of tax credits. Therefore, a nonprofit must form a new legal entity such as a for-profit corporation. Second, managing the tax credit allocation requires a level of capacity that many nonprofits do not have. For example, an entity must have extra resources to recruit investors, track investments, conduct compliance reviews, respond to investors, prepare tax returns and K-1 forms, and maintain accountability to the low-income community. A nonprofit certified as a CDE may instead accomplish its goals simply by obtaining funding from an AWE that already has the capacity to manage the tax credit allocation.

## How Does A Nonprofit Become a CDE?

The eligibility test to become a CDE is simple:

- be a legal entity (corporation or partnership), either for-profit or nonprofit;
- have a primary mission of serving low-income communities;
- be accountable to residents of its low-income communities; and
- submit an application for CDE certification to CDFI Fund.

*Note: CDFIs and SSBICs are deemed CDEs but must still request certification.*

## What Types of Investments Qualify for Tax Credits?

- any loan to or investment in a low-income community business (see below);
- the purchase of a loan from another CDE that is a qualified investment;
- financial counseling and other services in low-income communities; and
- any loan or investment in another CDE.

### **Exclusions:**

- *businesses that develop or hold intangibles for sale or license or collectibles;*
- *massage parlors, hot tub facilities, suntan facilities, gambling facilities, liquor stores;*
- *housing;*
- *farms (except those with assets less than \$500,000);*
- *organizations that make loans of longer than 18 months in duration.*

## What Businesses Qualify for Investment?

In order to qualify for investment, businesses must satisfy a locational test. Each of the following must be located in a low-income community:

- a substantial portion of the business's property;
- 40% of the business's tangible assets;
- 40% of the business's employees; and
- 50% of the business's income results from conducting business in the community.

## What is a Low-Income Community?

Any community which meets any of the following criteria is considered to be a low-income community and is therefore eligible for investments through the New Markets Tax Credit Program:

- any population census tract in which at least 20% of the population falls below the poverty rate;
- any population census tract in which the median family income does not exceed 80% of statewide median family income;
- if the tract is within a metropolitan area, the median family income does not exceed 80% of the greater of the statewide median family income or the metropolitan area median family income;
- empowerment zones.

## Need Further Assistance?

Your nonprofit may be eligible for free legal assistance to apply for CDE certification and to receive other legal assistance with the New Markets Tax Credit. For more information, contact Texas C-BAR at (512)447-7707, ext 370, or [txcbar@lact.org](mailto:txcbar@lact.org).

## Useful Links:

[www.communitycapital.org](http://www.communitycapital.org)  
[www.tacdc.org](http://www.tacdc.org)  
[www.shorebankadvisory.com](http://www.shorebankadvisory.com)  
[www.ncced.org](http://www.ncced.org)

[www.ncif.org](http://www.ncif.org)  
[www.liscnet.org](http://www.liscnet.org)  
[www.cdfifund.gov](http://www.cdfifund.gov)