

Introduction to the New Markets Tax Credit ("NMTC")

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Created as part of the Community Renewal Tax Relief Act of 2000, the NMTC is the result of a bipartisan initiative intended to spur the investment of \$15 billion in new private capital into a diverse range of privately managed investment vehicles that in turn will make loans to and equity investments in businesses located in rural and urban low-income communities. The NMTC Program is set forth in Section 45D of the Internal Revenue Code of 1986, as amended (the "Code"), and is administered through the U.S. Treasury Department's Community Development Financial Institutions ("CDFI") Fund. Under the NMTC Program, investors receive a credit against federal income taxes for making qualified equity investments in designated Community Development Entities ("CDEs").

To qualify for the NMTC, investors must purchase an equity interest in a for-profit CDE that invests roughly 85 percent of its capital in qualifying loans, commercial real estate development, and businesses located in low-income communities. Non-profit organizations can also form for-profit subsidiaries or affiliates in order to qualify. CDEs are typically structured as a limited liability company (LLC) or as a partnership in which an investor purchases an ownership stake.

To qualify as a 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 the CDFI Fund. Note that existing Community Development Financial Institutions automatically qualify as CDEs.

Once an entity has been certified as a CDE, the entity must then apply to the CDFI Fund for an allocation of NMTCs. The application and selection process is very competitive and is based on factors such as the expertise and experience of the CDE management team in working with disadvantaged businesses and communities.

Once a CDE is allocated NMTCs, the CDE is authorized to market such NMTCs to private equity investors, who have generally responded quite favorably to making investments subsidized by the NMTC. Specifically, the NMTC equals 39 percent of the investor's equity investment in the CDE and is claimed by the investor over a seven-year period. In each of the first three years, the investor receives a credit equal to five percent of the taxpayer's total equity investment in the CDE and, for the final four years, the annual value of the credit is equal to six percent of the taxpayer's equity investment. In addition to the NMTC, investors may receive a cash return based on the profitability of the CDE. For example, a cash return may take the form of a distribution of available cash after the

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payment of the CDE's expenses (including a management fee to the CDE sponsor), or may be structured as a fixed quarterly or annual interest or dividend disbursement. Note that the NMTC is required to be recaptured if at any time during the seven-year credit period: (i) the entity ceases to be a CDE, (ii) substantially all the proceeds of the investment cease to be used for the required purposes, or (iii) the investor's equity interest in the CDE is redeemed.

Please contact the Wiggin and Dana Affordable Housing, Community Development and Tax Credits Practice Group to discuss in detail the technical aspects of the NMTC and how the NMTC can benefit you or your business.

This advisory is designed to inform clients about recent developments in the fields of real estate law. Nothing in this advisory constitutes legal advice, which can only be obtained as the result of personal consultation with an attorney. The information published here is believed accurate at the time of publication but is subject to change and does not purport to be a complete statement of all relevant issues.

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