

NMTC Program Generates Equity and Interest Savings for Qualified Businesses

On February 23, 2012, the U.S. Treasury Department announced the award of \$3.623 billion in new markets tax credit (NMTC) allocation authority. The purpose of the NMTC program is to encourage investment of private capital in low-income communities (LIC). LICs are determined using federal census tract data.

Through fiscal year 2010, approximately \$21 billion has been invested in qualified businesses in LIC under the program. The businesses included, among others, the rental of commercial real estate, charter schools, health care facilities, timberlands, grocery stores, restaurants, hotels, child care providers, manufacturing facilities and pharmacies. The NMTC program provides significant benefits to qualified businesses:

- An equity infusion due to forgiveness of a portion of the NMTC financing. The amount of equity will equal the amount of debt forgiven. Assuming a 9% after-tax return for the NMTC investor, the amount of the equity infusion will be approximately 26% of the NMTC financing. For example, in a \$10 million NMTC financing, the amount of debt forgiven and the equity infusion would be approximately \$2.6 million. The qualified business will realize cancellation of indebtedness income at the time of the debt forgiveness.
- An interest rate on the NMTC financing 200-300 basis points below the conventional rate.
- No principal amortization for 7 years.

The NMTC program imposes certain limitations on the business:

- The business must covenant to remain qualified under the program for 7 years. This could interfere with a business' expansion plans.
- The business may not prepay the NMTC financing for 7 years.

A "qualified business" under the program includes generally any trade or business except for golf courses, country clubs, massage parlors, hot tub facilities, suntan facilities, race tracks or other gambling facilities or liquor stores. The rental of commercial real estate may be a qualified business. Mixed-use real estate projects (residential and commercial) may also qualify provided at least 20% of the gross rent is from the commercial space. The development and sale (as opposed to rental) of residential housing may also be a qualified business.

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A qualified business must be a corporation or partnership and must also meet certain gross income, tangible property and services tests to be eligible for investments under the program:

- At least 50% of its gross income must be derived from conducting its business within an LIC.
- At least 40% of the tangible property used in the business must be located within an LIC.
- At least 40% of the services performed by its employees must be performed within an LIC.
- For rental real estate businesses, the "gross income" and "services" tests are eliminated if at least 85% (instead of 40%) of its tangible property is within an LIC and the business has no employees.

In addition, the amount of certain nonqualified financial property and collectibles owned by the business must, in each case, be less than 5% of the average of the aggregate bases of the business' property.

If you have questions about this E-Alert, please contact your Reinhart attorney or any member of the tax credits team. We can help you determine whether your business qualifies under the program and also help you attract an NMTC allocation and investor for your business.

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