

LEGISLATIVE SUMMARY

Community Renewal Tax Relief Act of 2000

New Markets Tax Credit

New Markets Venture Capital Program Act of 2000

and

Small Business Reauthorization Act of 2000

On December 26, 2000, President Clinton signed into law one of his major public policy initiatives: the *Community Renewal Tax Relief Act of 2000*. See below for the [legislative history](#).

The bill actually included several programs. They are discussed below:

I. New Markets Tax Credits:

1) Applicability:

- a) Tax Credits only apply to investments made **after** December 31, 2000
- b) Credits are not retroactive to tax years beginning before January 1, 2001
 - i) Therefore, only **new** investor dollars will qualify for credits

2) Amount:

- a) Aggregate credits equal 39% of taxpayer's investment
- b) Credit claimed on individual investor's tax return over seven years
- c) Taxpayer receives:
 - (a) Credits equal to 5% of the investment in years 1 to 3 ...*then* ...
 - (b) Credits equal to 6% of the investment in years 4 through 7
- d) Credits thus have a present value of approximately 30% of taxpayer's investment in Investment Fund.

3) Purpose:

- a) Credits intended to stimulate \$15 billion in equity investments for community-sponsored economic development
 - i) \$1 billion in 2001
 - ii) \$1.5 billion in 2002 and 2003
 - iii) \$2 billion in 2004 and 2005 and
 - iv) \$3.5 billion in 2006 and 2007.

4) Tiered Investment Structure:

- a) Taxpayer will typically make an investment in a Pooled Investment Fund with other investors
- b) PIF then makes Qualified Equity Investments in Qualified Community Development Entities

- c) In turn, CDE makes the actual Qualified Low Income Community Investments
 - d) Qualified Low Income Community Investments are made in Qualified Active Low Income Community Businesses
- 5) Investment Fund:
- a) Can be a for-profit, investor-controlled entity
 - b) No apparent restrictions on whether investor capital contributions are debt or equity
 - c) Makes Qualified Equity Investments in CDEs
- 6) "Qualified Equity Investments"
- a) Made by Investment Fund in CDE
 - b) Must be an equity investment only
 - c) Cannot be §351(g)(2) non-qualified preferred stock
 - d) Must be acquired at original issue
 - e) Must be acquired for cash
- 7) "Community Development Entities"
- a) Receives Qualified Equity Investments from investor-tier fund
 - b) CDEs will be certified by the Treasury Department
 - c) Must have a primary mission of serving or providing investment capital for low-income persons or communities
 - d) Must have community accountability through community representation on CDE board of directors or on an advisory board.
 - e) SSBICs and CDFIs automatically qualify as CDEs
 - f) 85% of CDE's gross assets should be invested in Qualified low-income community investments
 - g) CDE makes the actual Qualified Low Income Community Investments
- 8) "Qualified Low Income Community Investments"
- a) Made by CDE
 - b) Can be an equity or debt investment in Qualified Active Low Income Community Business ...or ...
 - c) Can also be for other proper purposes:
 - i) Financial counseling and similar services for a Qualified Active Low Income Community Business
 - ii) Purchasing qualified investment loans from other qualified CDEs
 - iii) Investing in another CDE.
- 9) Low Income Community
- i) Population Census Tract has at least 20% poverty ... or...
 - ii) Median family income below 80% of either the statewide or relevant metropolitan area median family income.
- 10) Qualified Active Low Income Community Business:
- a) At least 50 % of gross income from active conduct of a qualified business within any low-income community
 - b) a substantial portion of the use of the tangible property of business is within any low-income community

- c) a substantial portion of the services performed by employees are performed in any low-income community
- d) less than 5 percent of the average of the aggregate unadjusted bases of the property of such entity is attributable to collectibles other than collectibles that are held primarily for sale to customers in the ordinary course of such business, and
- e) less than 5 percent of the average of the aggregate unadjusted bases of the property of such entity is attributable to nonqualified financial property (as defined in section 1397C(e))
- f) Portions of business may be qualified active low-income community business

11) Basis:

- a) Credits reduce investors' basis in the Investment Fund.
 - i) Note: Thus, if after seven years of claiming the credit, the investor sells the investment for a loss greater than or equal to 39% of the original investment, the taxpayer will not be able to recognize any loss-on-sale for tax purposes. This is because the benefit of the investment has been taken in credits over the seven years. Generally, a taxpayer cannot deduct a loss in excess of the adjusted basis of an investment.
 - b) Credit is based on the taxpayer/investor's basis in equity investment, not on the CDEs basis in the qualified active low-income community business.

12) Transferability:

- a) The right to claim credit can be transferred along with the stock

13) AMT:

- a) Credit is subject to the general business credit rules.
- b) Credit cannot be used against the alternative minimum tax.

14) NMTC Less Attractive than Low Income Housing Tax Credits

- i) LIHTC generally has a present value of 70% (vs. 39% for NMTC)
- ii) LIHTC does not reduce the basis of the investment (NMTC reduces basis)
- iii) LIHTC based on the entire cost of the underlying real property asset. Not based just on investor's equity investment in a top-tier investment vehicle. (NMTC basis cannot include leverage on investment)

15) Recapture

- a) CDE cannot redeem its Qualified Equity Investments in Active Businesses for at least seven years.
 - i) If CDE does redeem investment, or the entity ceases to be a CDE during the seven-year period, any credits claimed by taxpayer are recaptured (with interest), and no further credits are allowed.
 - ii) After 7 year holding period, taxpayer no longer faces recapture even if:
 - (1) Investment is sold
 - (2) CDE ceases to be a CDE
 - (3) CDE redeems the stock.

II. Renewal Communities and Empowerment Zones

- 1) New "Renewal Communities" are similar to old "Empowerment Zones"
 - i) Preference for first 20 RCs for current EZs and Enterprise Communities.
- 2) Nine new EZs designated by January 2002.
- 3) EZ assets can be rolled-over for new assets in an EZ with no capital gain liability:
 - i) Asset must have been acquired after December 2000

- ii) Asset must be held for at least a year
 - iii) New asset in the EZ must be bought within 60 days of sale of old asset
 - iv) Many additional complex rules
- 4) Taxpayers can exclude 60% of gain-on-sale of stock in small EZ corporations
- i) Stock must have been held for at least five years
 - ii) Normally only 50% of long-term capital gain is excluded
- 5) RC tax incentives include:
- i) No capital gains tax on assets held at least five years
 - ii) Commercial Revitalization Deduction
 - (1) Up to \$12 million annually in commercial development costs
 - (2) Maximum of \$10 million per property.
 - (a) In lieu of depreciation, taxpayers deduct either:
 - (i) 50% of eligible costs in year one; or
 - (ii) 100% of costs over 10 years.
- 6) Tax Credits available for wages paid to employees who both live and work in Zones
- (1) In RCs: 15% Credit on first \$10,000 paid to each employee
 - (2) In EZs: 20% Credit on first \$15,000 paid to each employee
 - (3) Most of employee's work must be performed within the zone or community.
- 7) Expands Work Opportunity Tax Credit eligibility for high-risk youths and summer youths living in RCs.
- 8) Rehabbers of commercial buildings in RCs can either
- i) Deduct half of rehabilitation costs ... or ...
 - ii) Amortize rehabilitation costs over 10 years
- 9) Businesses in RCs and EZs can expense additional \$35,000 in business investments (IRC §179)
- 10) Businesses in EZs are eligible for special tax-exempt financing

III. New Markets Venture Capital Companies

- NMVCs will operate in a manner similar to SBIC program
- Combine equity venture capital financing and technical assistance
- NMVC companies provide financing of roughly \$50,000 to \$300,000
- Provide technical assistance to small businesses in low-income areas
- Must raise at least \$5 million in investment and commitments for \$1.5 million for technical assistance
- In return will receive \$5 million in federal loan guarantees, plus a grant of \$1.5 million for technical assistance.
- The NMVC companies can use New Markets Tax Credits to help raise the equity capital.

- The Small Business Administration is expected to select 10 to 20 NMVC companies.
- SBA will guarantee up to \$150 million in debentures to match \$100 million in private equity
- SBA is authorized to spend \$30 million in NMVC technical assistance

IV. SBA Reauthorization

7(a) Program –

- Establishes an 85% guarantee for loans up to \$150,000
- Simplifies fees for guarantees
- Sets prepayment fees
- Increases the maximum guarantee to \$1 million
- Increases maximum loan size to \$2 million
- Authorizes sale of export loans in the secondary market

504 Program

- Makes the pilot loan liquidation and the Preferred Certified Lender programs permanent

Microloan Program

➤ SBA makes loans of up to \$750,000 to intermediaries who in turn make very small loans to entrepreneurs.

- Maximum amount of microloans increased to \$35,000

SBIC Program

- Revises fee language
- Explicitly authorizes Federal Savings Associations investment

Surety Bond Program

- Increases the maximum size of surety bonds to \$2 million
- Changes the dollar restrictions on preferred sureties to 50% of authorized amount for the full program

Entrepreneurial Development

- Clarifies the SBDC funding formula
- Clarifies co-sponsorship authority

Legislative History:

On December 26, 2000, President Clinton signed into Law HR 4577. This became Public Law 106-554. HR 4577 incorporated, among other measures HR 5662 (the *Community Renewal Tax Relief Act of 2000*), HR 5663 (the *New Markets Venture Capital Program Act of 2000*) and HR 5667 (the *Small Business Reauthorization Act*). HR 4577 also incorporated Conference Report 106-1033 (H12100-12439).

PLEASE NOTE:

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