



# New Market Tax Credit Program Compliance

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## The Elements of Compliance

The New Market Tax Credit (NMTC) Allocation Application process is arduous and requires significant documentation. Once an allocation has been awarded, the documentation during the seven-year life of the program needs to be equally thorough. As a federal tax program, the NMTC Program is tightly regulated, with a long list of regulatory and programmatic rules and requirements that a community development entity (CDE) must follow, set by both the Treasury Department's Community Development Financial Institution (CDFI) Fund and the Internal Revenue Service (IRS). In practice, CDEs are responsible for three types of compliance to these two agencies:

- Compliance with the allocation agreement, governed by the CDFI Fund
- Compliance with Internal Revenue Code Section 45D, which governs NMTCs
- Submitting required documentation to the IRS and the CDFI Fund.

CDEs need to understand the compliance requirements from the start and build them into their back-office operating procedures. This is challenging because the NMTC program is in many ways still evolving, leading to frequent changes in its rules and regulations. Because of this, CDEs must exert considerable energy to make sure that they and their staff stay abreast of these changes or face serious consequences. Failure to comply with the Internal Revenue Code requirements can result in recapture of the tax credits claimed by the investor—a costly event for both the investors and the CDE. Noncompliance with the allocation agreement can result in the loss of any unused allocation as well as exclusion not only from future participation in the NMTC program but other federal programs.

### Compliance with the allocation agreement

The allocation agreement is the contract between the CDE and the CDFI Fund, outlining the program's goals and the rules, regulations and restrictions the CDE must follow as a condition of receiving its tax credit allocation. It is important to note that the allocation agreement focuses on *programmatic* issues rather than tax matters. In the allocation application, the CDE described its proposed program and the needs it would fill; compliance with the agreement is centered on ensuring that the CDE follows through on what it proposed. Schedule 1 of the agreement sets forth the specifics regarding the program's service area and targeted distressed areas, the types of products to be offered and permitted use of Qualified Equity Investments (QEIs) the CDE receives.

These requirements must be tracked on a cumulative basis for each allocation received by the CDE. It is important to document that these requirements have been met as of the three-year benchmark date and/or once the allocation is fully deployed. This documentation must also show that exceptions to the service area and types of products outlined in the agreement do not exceed the allowable 15 percent "carve-out" threshold.

For more detail regarding allocation agreement compliance, see "The Allocation Agreement."

### IRS Section 45D compliance

Section 45D sets forth the IRS's requirements for NMTC programs. It is particularly important that the CDE maintain its qualified status by fulfilling its mission to serve low-income communities (LICs) and by being accountable to those communities. This is demonstrated by establishing a governing or advisory

board in which at least 20 percent of its members are representatives of the low-income community, holding regular board meetings and being responsive to the input from those representatives.

It is also important that program investment is being made to Qualified Active Low Income Community Businesses (QALICBs). These businesses must meet several criteria to demonstrate that their services and resources are directed toward serving low-income communities. Documentation that these criteria are satisfied is a responsibility of the CDE.

Investment criteria for each QEI must be calculated and documented at the one-year anniversary of that investment, and semi-annually thereafter to show that “substantially all”—interpreted as at least 85 percent—of the CDE’s investment capital is invested in qualified low-income community investments. Operating income and distributions must also be documented to ensure that the CDE does not trigger a return of capital and fail the redemption test.

### **Submitting required documentation**

In addition to complying with the requirements of the CDFI Fund and the IRS, the CDE must also ensure that it is submitting the required documentation on a timely basis.

When a CDE receives a QEI, it must register that investment with the Fund’s Allocation Tracking System (ATS), which can be accessed on the Fund’s Web site. It must also complete Form 8874A, submit it to the IRS and send a copy to the investor. This form allows the investor to claim the tax credit on its return. These two requirements must be fulfilled within 60 days of receiving the QEI.

In addition, the CDE must file with the Fund an annual Community Impact Information Survey (CIIS). This is due within 180 days of the CDE’s year end. The CIIS contains three parts:

- The Transaction Level Report (TLR), consisting of approximately 200 data fields that are specific to each transaction that the CDE has financed during the year
- The Institutional Level Report (ILR), an overview of the CDE’s financial status, human resources capability and plans for the future year
- The audited financial statements of the CDE. The CDE and any subsidiary CDE must be audited annually.

## **How Reznick Group Can Help**

Reznick Group has been active in the New Markets Tax Credit Program since its inception in 2001. As a result, we have unparalleled experience in providing assurance, tax, compliance, transactional and consulting services for CDEs. We can help with compliance in a number of ways, including:

- Perform full turn-key compliance services on behalf of the CDE
- Design compliance policies, procedures and programs tailored to the needs and resources of individual CDEs
- Provide in-house compliance training

- Review in-house compliance programs and provide a written assessment and recommendations for improvement
- Represent CDEs under a regulatory IRS compliance audit or CDFI Fund site review
- Perform all CDFI Fund and IRS filings.

For more information, please contact Gary Perlow, New Markets Tax Credit Practice Leader, at [gary.perlow@reznickgroup.com](mailto:gary.perlow@reznickgroup.com) .

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