

Alabama: New Markets Development Act Designed to Spur Investment in Low-Income Communities

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A partner with the authors' law firm was involved with the legislative efforts in this matter.

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The Alabama legislature has enacted the New Markets Development Act (H.B. 257, 5/16/12; Act No. 2012-483), which provides state income, financial institution excise, and insurance premium tax credits to investors in community development entities that provide funding to businesses that locate in qualified low-income or impoverished communities in Alabama. The Act parallels the provisions of the federal New Markets Tax Credit ("NMTC"), IRC Section 45D, in many ways. The availability of the state credits is to be initially determined by the Alabama Department of Commerce (the "Department"), which is the state's industrial recruiting arm, formerly known as the Alabama Development Office (or simply "ADO").

Tax credit for investment. Under the new Act, investors in "qualified community development entities" (QCDEs) receive a nonrefundable tax credit of 8.33% of their "qualified equity investment" in each of the six years following the year in which the investment is made, thus allowing for a credit of up to 50% of the investor's overall qualified investments. The total tax credits the Department can grant to all applicants for any one tax year is capped at \$20 million, and the maximum investment that can qualify for a credit for a particular project is \$10 million.

The tax credit claimed in any tax year may not exceed the taxpayer's state tax liability for that year. In addition, the basis of any qualified equity investment is reduced by the amount of any credit determined with respect to that investment.

While the credit is nonrefundable, excess credits may be carried forward to subsequent tax years until used up. The original version of H.B. 257 allowed the credit to be transferred to a third party; however, the ability to transfer the credit on the open market was deleted by the Senate and that amendment was approved by the House before final passage. Any tax credits earned by a pass-through entity, such as a partnership, limited liability company (LLC), or S corporation, may be allocated in accordance with the provisions of any agreement among the owners of the entity, rather than allocated according to other income tax attributes.

Possible credit recapture. Tax credits claimed under the Act are subject to recapture if: (1) at any time during the seven-year period beginning on the date of the original issue of the qualified equity investment in a QCDE, any part of the federal NMTC available with respect to a qualified equity investment that is eligible also for the Alabama tax credit is recaptured under IRC Section 45D; or (2) the issuer fails to invest at least 85% of the purchase price of the qualified equity investment in qualified low-income community investments in Alabama within 12 months of the issuance of the qualified equity investment or fails to maintain that level of investment until the last credit allowance date for the qualified equity investment.

State Act follows federal NMTC. While Alabama's New Markets Development Act has a tax credit rate different from the federal NMTC, it does, as noted above, parallel much of the federal law and, with some minor adjustments, adopts most of the key federal definitions, including the definitions of "low-income community," "qualified active low-income community business," and "qualified community development entity." For instance, under the Alabama Act a "qualified equity investment" in a QCDE can take the form of a long-term debt security issued by the QCDE (i.e., a debt instrument with an original maturity date of at least seven years from the date of its issuance, with no acceleration of repayment, amortization, or prepayment features prior to its original maturity date). For the federal NMTC, only equity investments qualify.

The Act helps Alabama compete with neighbors. The New Markets Development Act's sponsor, Rep. Jamie Ison (R-Mobile), predicts that this new tax credit will aid Alabama's cities in finding uses for abandoned buildings or other vacated properties. Specifically, by encouraging investment in low-income communities, Ms. Ison said that the legislation will create jobs, including construction jobs, and convert currently vacant or empty properties into revenue-generating assets. Supporters of the Act also pointed out that several neighboring states, including Florida, Louisiana, and Mississippi, have passed similar legislation.

Paul Compton, a partner with the authors' law firm and General Counsel to the Alabama Council on Affordable and Rural Housing, frequently represents investors, community development entities, and NMTC borrowers across the country and sees first-hand the attraction of a state NMTC program. Compton pointed out that "Alabama has had a dearth of investment supported by NMTC compared to similar states. For instance, Mississippi, which has had a state NMTC program for a number of years, has been a much more frequent beneficiary of NMTC supported financing; you can see it from downtown Jackson towers to healthcare facilities on the Gulf Coast to lumber mills in between. A state tax credit in Alabama will be a great 'hook' to draw attention to opportunities across Alabama, and the design of the proposed statute smartly facilitates multiple investors in a project." The authors' research indicates that 13 states have adopted state-specific new markets tax credit programs and legislative bodies in five other states are considering similar programs.

For a look at another state's New Markets Capital Investment Program, see Beard and Eimicke, "Maine: Ranked Number One for Low Tax Burden on New Investment and Job Creation," 21 J. Multistate Tax'n 30 (Nov/Dec 2011). For The Journal's most-recent discussion of the federal NMTC program, see Propst, "New Markets Tax Credits—Creative Financing for Economic Development," 21 J. Multistate Tax'n 26 (June 2011). []

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