NEW MARKETS TAX CREDIT AND ECONOMIC SUBSTANCE DOCTRINE

Mr. ROCKEFELLER. Mr. President, I would like to enter into a colloquy with my good friend, Senator Baucus, regarding the economic substance provision of the Jumpstart Our Business Strength, JOBS Act, S. 1637.

I ask my colleague to explain what, if any, impact the codification of economic substance doctrine would have on the new markets tax credit.

As my colleague knows, the new markets tax credit, NMTC, was signed into law in 2000 and is the largest Federal economic development initiative to be authorized in 15 years. The credit promises to spur some $15 billion in new private sector investment in economic development activity in poor communities throughout the country.

The idea behind the credit is that there are good viable business and economic development opportunities in poor communities that lack access to capital. The NMTC is designed to address this capital gap by providing the incentive of a Federal tax credit to individuals or corporations that invest in Community Development Entities, CDEs, working in these communities.

While many of the businesses that receive financing through the credit will present good business opportunities, it is possible that some projects, because of their market, will present only limited economic return on top of the credit. In many cases, the investor's chief incentive will be the tax benefit available through the new markets tax credit.

There is some concern among investors and potential NMTC investors that legislation crafted to codify the economic substance doctrine and curtail transactions that are simply motivated by tax incentives would apply to and have negative impact on the NMTC.

With $2.5 billion in new markets tax credits having been allocated to CDEs around the country and another $3.5 billion expected to be awarded within the next several months, it is critical that the investor markets get some clarification on this issue.

The NMTC holds great promise for communities throughout West Virginia where economic revitalization and business development are sorely needed. It is my understanding that the economic substance doctrine contained in S. 1637 does not apply and I would appreciate my colleague's comments on this issue.

Mr. BAUCUS. I appreciate the comments of the Senator and share his commitment to the new markets tax credit.

The Senator is correct. The intent of the economic substance provision in the JOBS bill is clearly to uphold and protect congressionally mandated tax benefits while curtailing unintended abuses of the tax code. I assure the Senator that the new markets tax credit would not be adversely affected by this provision.

As the Senator knows, our intent in codifying the economic substance doctrine is to curtail the use of abusive tax shelters that have no economic substance or business purpose other than reducing the Federal tax liability of the taxpayer. This is clearly not the case of the new markets tax credit.

[Page: S5206] GPO's PDF

We attempted to clarify the intent of this provision in the Finance Committee report, 108-192, in a footnote that states:

If tax benefits are clearly contemplated and expected by the language and purpose of the relevant authority it is not intended that the tax benefit be disallowed if the only reason for the disallowance is that the transaction fails to meet the economic substance doctrine as defined in this provision.

The report also specifically identifies the low income housing tax credit and the historic rehabilitation credit as examples of tax benefits that would not be taken into account in measuring potential tax benefits. These credits were noted as examples of the types of tax benefits that would not be considered in applying the economic substance doctrine.

The new markets tax credit was authorized with the clear intent of using a tax subsidy to attract private investors to business and economic development opportunities in poor communities--investment opportunities that otherwise might not be able to secure such investment capital. It is our intent that the NMTC be treated like the LIHTC and the HRTC and protected as a congressionally mandated tax benefit."