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MONETIZING STATE TAX CREDITS

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CREDITS ONLY AS GOOD AS TAX LIABILITY

- ▶ Credits allow “dollar-for-dollar” tax reduction
- ▶ But many credit earners already have a low tax burden
- ▶ Contrary to popular belief, taxpayers cannot typically sell tax credits directly
- ▶ Cottage industry of advisors, tax consultants, brokers has developed to monetize and facilitate sales of credits



MONETIZING THE CREDITS

1. Refundable Tax Credits
2. Transfers Authorized by Statute
3. Use of Limited Liability Companies

REFUNDABLE TAX CREDITS

- ▶ **The job development credit** (§ 12-10-80) and the **job retraining credit** (§ 12-10-95) (both of which are credits against withholding tax) are refundable to the extent of withholding actually paid.
- ▶ **Milk producer credit** for residents (§12-6-3590) allows a refundable income tax credit of (1) \$10,000 based on the production and sale of the first 500,000 pounds of milk sold below production price and (2) an additional \$5,000 for each additional 500,000 pounds sold below production price.
- ▶ No other business refundable credits



TRANSFERS AUTHORIZED BY STATUTE

- ▶ **Conservation Easement Credit** - Income tax credit equal to 25% of the amount of a charitable deduction resulting from the donation of a conservation easement, subject to caps of \$250 per acre and \$52,500 per year – can transfer any unused credits
- ▶ **Abandoned Building Income Tax Credit** – allows transfers to lessee/subsequent purchaser
- ▶ **Textile Mill Income Tax Credit** – allows transfers to lessee/subsequent purchaser
- ▶ **Retail Facility Income Tax Credit** – allows transfers to tenants/NO transfer to new owner



USE OF LIMITED LIABILITY COMPANIES

- ▶ State and federal tax credits can be monetized through the use of LLCs
- ▶ Typically the real estate developer allocates the state and federal credits to members with state and federal tax liabilities (“investors”)
- ▶ The investors in turn make capital/membership contributions in return for the credits



PASS THROUGH OF STATE TAX CREDITS

- ▶ Unlike Sub-S corporations, the allocation of the credits can be done disproportionately in an LLC
- ▶ E.g., the heart surgeon can own 5% membership interest and receive 85% of the credits



PASS THROUGH OF STATE TAX CREDITS

- ▶ Issues
 - ▶ The Heart Surgeon, for liability reasons, does not want to be a member of the LLC; and if required, she wants to tender/sell her LLC membership interest as quickly as possible
 - ▶ The developer does not want the Heart Surgeon to have any control over the real estate development



PASS THROUGH OF STATE TAX CREDITS

- ▶ Issues (cont'd)
 - ▶ The LLC structure works – but the LLC must comply with state and federal partnership rules (subchapter K)
 - ▶ Also must comply with the rules required by the particular state or federal credit
 - ▶ Also consider IRS disguised sale rules



PASS THROUGH OF STATE TAX CREDITS

- ▶ Tax Credit Brokers have established Master LLCs which provide quicker returns
- ▶ Typically the Brokers have identified investors who are willing to participate in qualifying deals



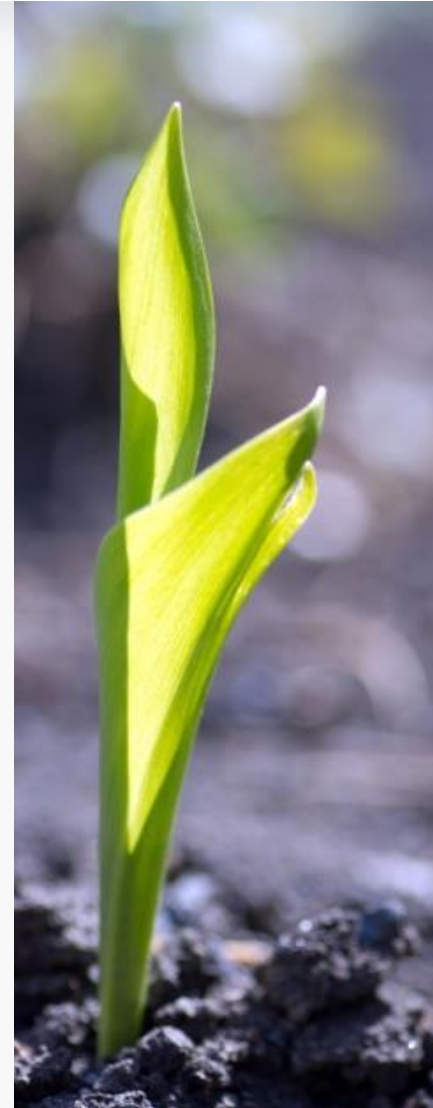
PASS THROUGH OF STATE TAX CREDITS

- ▶ Except as otherwise provided, credit must be used by taxpayer who earns it
- ▶ Exceptions
 - ▶ Pass through entities specifically qualifying for the credit
 - ▶ Unless specifically prohibited, S-Corporation, LLC taxed as partnership, or partnership that otherwise qualifies for a credit can pass through a portion of the credit earned to each shareholder/partner of the applicable entity
 - ▶ Amount of credit allowed is the percentage of the stock ownership/interest multiplied by the amount of the credit earned by the entity and available to pass through
 - ▶ LLC not specifically qualifying for the credit
 - ▶ LLCs not organized as a legal entity that expressly qualifies for a credit can earn and pass through any credits allowed only by Article 25 of Chapter 6 of Title 12



PASS THROUGH OF STATE TAX CREDITS

- ▶ SC PLR #11-6 – Pass Through of Biomass Credit (§ 12-6-3620)
 - ▶ Provides Practical application of state pass through rules



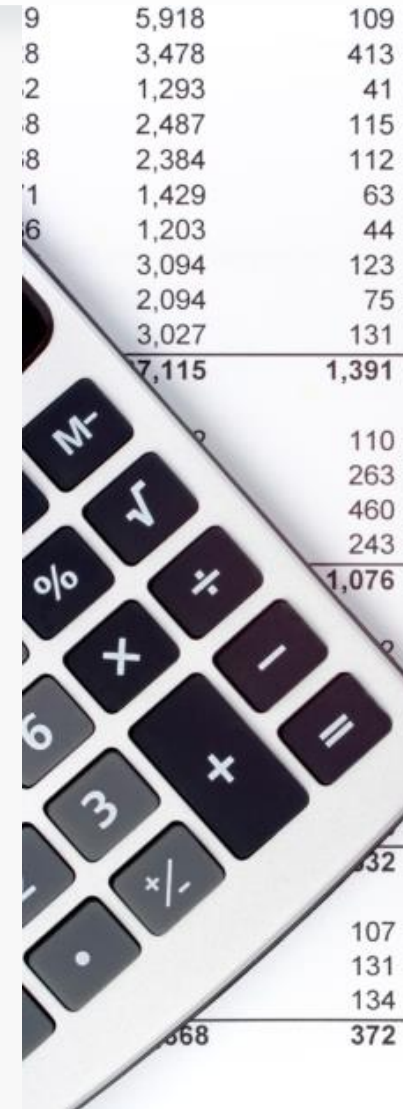
LIMITED LIABILITY COMPANIES – IRS SAFE HARBOR

- ▶ Rev. Proc. 2014-12 “establishes the requirements under which the IRS will not challenge partnership allocations of § 47 rehabilitation credits by a partnership to its partners”
- ▶ Factors (highlights only)
 - ▶ Principal (developer) must own at least 1% of partnership
 - ▶ Investors must have interest in income, gain, loss, deduction, AND credit equal to at least 5% of partnership
 - ▶ Investor’s interest must be a bona fide equity investment with a reasonably anticipated value commensurate with the investor’s overall percentage interest in the partnership
 - ▶ Investor must contribute at least 20% of its total expected capital contributions (i.e., the price of the credits) as of the date the building is placed in service (and maintain minimum contribution)
 - ▶ Minimum contribution cannot be protected with a guarantee/indemnification provision/loan
 - ▶ Developer cannot have call option, but Investor may have put option (for no more than FMV)
 - ▶ Investor cannot abandon interest after qualified rehabilitation



QUESTIONABLE APPLICATION TO OTHER CREDITS

- ▶ “This revenue procedure applies only with respect to allocations of § 47 rehabilitation credits from qualified rehabilitation expenditures...does not apply to federal credits other than the § 47 rehabilitation credit or to state credit transactions...does not indicate the circumstances under which the Service may challenge allocations of such other credits or the circumstances under which a transfer of state credits by a partnership may be treated as a disguised sale under § 707(a)(2)(B).”



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