

**Office of Chief Counsel
Internal Revenue Service
Memorandum**

Number: **200445046**

Release Date: 11/5/04
CC:ITA:1&3
POSTS-123179-04

Third Party Communication: State
Government
Date of Communication: September 21, 2004
Date of Communication: October 21, 2004

UILC: 164.00-00

date: October 29, 2004

to: Associate Area Counsel
(Small Business/Self-Employed)
CC:SB:1:BOS

from: Acting Chief, Branch 1
Office of Associate Chief Counsel
(Income Tax and Accounting)
CC:ITA:1

subject: Massachusetts Transferable Tax Credits

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUE

Whether the purchasers of Massachusetts historic rehabilitation tax credits and low-income housing tax credits have made a "payment," for purposes of § 164(a) of the Internal Revenue Code, when they file their state tax returns and use the purchased credits to reduce their state tax liability.

CONCLUSION

Such purchasers have made a payment for purposes of § 164(a) when they file their state tax returns and use the purchased credits to reduce their state tax liability.

FACTS

The following descriptions of the credits are based on our review of the relevant state statutes and regulations. Also, we contacted the Rulings and Regulations Bureau of the Massachusetts Department of Revenue to confirm our understanding of certain provisions.

Massachusetts Historic Rehabilitation Tax Credit

Chapters 62 and 63 of the Massachusetts General Laws provide, respectively, for an income tax and a corporate excise tax imposed on corporate net income. Section 6J of M.G.L. chapter 62 and § 38R of M.G.L. chapter 63 provide for a historic rehabilitation tax credit.¹ Section 6J applies to a person, firm, partnership, trust, estate, limited liability company, or other entity that is subject to the income tax imposed by chapter 62. Section 6J(a) (definition of "taxpayer"). Section 38R applies to a corporation or other entity that is subject to an excise tax imposed by chapter 63. Section 38R(a) (definition of "taxpayer"). See also § 63.38R.1(2).²

Pursuant to these provisions, the Commissioner of the Massachusetts Department of Revenue (MDOR), in consultation with the Massachusetts Historical Commission (MHC), will authorize annually, for the five year period beginning January 1, 2005, and ending December 31, 2009, an amount of credit not to exceed \$10,000,000 per year. The MHC will determine the criteria for eligibility for the credit, which will be set forth in regulations. Sections 6J(b)(1)(i) and 38R(b)(1)(i). See also § 63.38R.1(3)(b).

The credit will be equal to a percentage, not to exceed 20 percent, of the qualified rehabilitation expenditures made by a taxpayer with respect to a qualified historic structure that has received final certification and has been placed in service. The MHC will administer, determine eligibility for, and allocate the credit. Sections 6J(b)(1)(ii) and 38R(b)(1)(ii). The credit will be allowed for the tax year in which the substantially rehabilitated property is placed in service. Any amount that exceeds the year's tax may be carried forward for up to five years. Sections 6J(b)(2) and 38R(b)(2). See also §§ 63.38R.1(9) and 63.38R.1(10). Credits allowed to a partnership, a limited liability company taxed as a partnership, or multiple owners of property will be passed through to the partners, members, or owners, respectively, either pro rata or pursuant to an executed agreement documenting an alternative distribution method. See §§ 6J(b)(2)(i) and 38R(b)(2)(i). See also § 63.38R.1(8).

If, before the end of the five year period beginning on the date on which the qualified historic structure received final certification and was placed in service, the taxpayer

¹ References to "section 6J" and "section 38R" in this memorandum are to the sections in M.G.L. chapters 62 and 63, respectively.

² On the date this memorandum was issued, 830 CMR § 63.38R.1 was an emergency regulation scheduled to expire on December 29, 2004. References to "§ 63.38R.1" in this memorandum are to this regulation.

disposes of its interest in the structure, the tax for the year in which the disposition occurs will be increased by a recapture amount and any carry forward will be adjusted. Sections 6J(g)(1) and 38R(g)(1). The state income tax return and corporate excise tax return forms contain a line to report recapture of credits. Transferees are not subject to recapture. Section 63.38R.1(12).

Taxpayers eligible for the credit may, with prior notice to the MDOR, transfer the credits, in whole or in part, to an individual or entity, and "the transferee will be entitled to apply the credits against tax with the same effect as if the transferee had incurred the qualified rehabilitation expenditures itself." The transferee must use the credit in the year it is transferred; any excess may be carried forward for up to five years after the close of the tax year during which the qualified historic structure received final certification and was placed in service. Sections 6J(b)(2)(ii) and 38R(b)(2)(ii). See also § 63.38R.1(10)(b).

Section 63.38R.1(7)(a) of 830 CMR, tracking the statutory provisions, states:

Any taxpayer allowed to take the historic rehabilitation credit may transfer the credit, in whole or in part, to any individual or entity, without the requirement of transferring any ownership interest in the project or any interest in the entity which owns the project. Transferees are entitled to apply the credits against the tax or excise with the same effect as if the transferee had incurred the qualified rehabilitation expenditures. ... The credit can be transferred only after the date a chosen project becomes a completed project.

The regulations require that the transferor enter into a transfer contract with the transferee of the credit. The transfer contract must include certain specified information. Section 63.38R.1(7)(c). The transferor must file a transfer statement form and a copy of the proposed transfer contract with the MDOR prior to the transfer, and file the executed transfer contract within 30 days after the transfer. Section 63.38R.1(7)(b). Any taxpayer who is a transferee of the credit may, provided all transfer and other requirements or limitations are met, apply the credit to either the income tax imposed under chapter 62 or the excise tax imposed under chapter 63. Section 63.38R.1(7)(d).

Although the statute and regulations are not explicit on these points, it appears that the credit is nonrefundable, and that transferees may choose either to use the credits or transfer them to other taxpayers.

Massachusetts Low-Income Housing Tax Credit

Section 6I of chapter 62 and § 31H of chapter 63 of the Massachusetts General Laws³ provide for a low-income housing tax credit that supplements the credit provided for in

³ References in this memorandum to "section 6I" and "section 31H" are to the sections in M.G.L. chapters 62 and 63, respectively.

§ 42 of the Internal Revenue Code. Section 6I applies to a person, firm, partnership, or other entity that is subject to the income tax imposed by chapter 62. Section 6I(a) (definition of “taxpayer”). Section 31H applies to corporations that are subject to an excise tax imposed by chapter 63. Section 31H(a) (definition of “taxpayer”). See also 760 CMR §§ 54.02 and 54.05.

The Massachusetts Department of Housing and Community Development (MDHCD), or its successor agency, may authorize annually, for the five year period beginning January 1, 2001, and ending December 31, 2005, the total sum of:

- (1) the lesser of 50 percent of the federal per capita tax credits awarded to the commonwealth pursuant to § 42 of the Internal Revenue Code or \$4,000,000;
- (2) unused Massachusetts low-income housing tax credits, if any, for the preceding calendar years; and
- (3) any Massachusetts low-income housing tax credits returned to the MDHCD by a qualified Massachusetts project.

Sections 6I(b)(1) and 31H(b)(1). See also 760 CMR § 54.03. Generally, the MDHCD authorizes, administers, determines eligibility for, and allocates the Massachusetts low-income housing tax credit in accordance with the standards and requirements set forth in I.R.C. § 42. The combined federal and Massachusetts low-income housing tax credit is the least amount necessary to ensure financial feasibility. Sections 6I(b)(2) and 31H(b)(2). The MDHCD, in consultation with the MDOR, monitors and oversees compliance with the Massachusetts program. Sections 6I(g) and 31H(g).

The Massachusetts low-income housing tax credit is claimed equally for five years and is not refundable. Sections 6I(c)(3) and 31H(c)(3). See also 760 CMR § 54.03(2). Any amount of the credit that exceeds the tax due for a year may be carried forward to any of the five subsequent years. Sections 6I(c)(3) and 31H(c)(3). See also 760 CMR § 54.10. See 760 CMR §§ 54.08 and 54.09 for rules concerning the time for claiming the credit. See 760 CMR § 54.06 for rules concerning the allotment of credits to partners/members of flow-through entities and multiple owners of property.

If under I.R.C. § 42 a portion of any federal low-income housing tax credits taken on a low-income project must be recaptured, the Massachusetts low-income housing tax credit authorized with respect to such project is also recaptured; any credit not yet claimed is disallowed. See §§ 6I(d)(2) and 31H(d)(2); 760 CMR § 54.12(1). Transferees are subject to recapture. 760 CMR § 54.12(1). The amount of recapture shall be reported and subject to tax in the year during which the federal recapture occurs. 760 CMR § 54.12(4). The state income tax return and corporate excise tax return forms contain a line to report recapture of credits.

All or any portion of the credits may be transferred, sold, or assigned to taxpayers who have received an allocation of federal low-income housing tax credit. Sections 6I(f)(1)

and 31H(f)(1). An owner or transferee desiring to make a transfer, sale, or assignment must submit to the MDOR a statement that describes the amount of credit eligible for transfer, as well as appropriate information so that the credit can be properly allocated. Sections 6I(f)(2) and 31H(f)(2).

Section 54.07(1) of 760 CMR provides the following rules:

Any taxpayer with an ownership interest in a qualified Massachusetts project with respect to which there has been allocated Massachusetts low-income housing tax credit and any taxpayer to whom the right to claim Massachusetts low-income housing tax credit has been allotted or transferred may transfer the right to claim unclaimed Massachusetts low-income housing tax credit to any other Massachusetts taxpayer eligible to claim a federal low-income housing tax credit with respect to the original or a different qualified Massachusetts project without the necessity of transferring any ownership interest in the original project or any interest in the entity which owns the original project. The transferor must transfer all credit attributable to periods after the transfer date agreed upon by the parties.

The regulations require that the transferor enter into a transfer contract with the transferee of the credit. The transfer contract must include certain specified information. 760 CMR § 54.07(2). The transferee may then claim the credit “notwithstanding the fact that the credit may initially have been allocated to a taxpayer paying a different income tax (i.e., personal or corporate).” 760 CMR § 54.07(3). The transferor must file a transfer statement form with the MDOR within 30 days after the transfer. Each taxpayer claiming the credit must file with each Massachusetts tax return on which the credit is claimed copies of all transfer statements and transfer contracts necessary to enable the MDOR to trace the claimed credit to the credit that was initially allocated with respect to the project. 760 CMR § 54.13(4).

LAW AND ANALYSIS

Section 164(a) of the Internal Revenue Code generally allows as a deduction certain types of taxes, listed in § 164(a)(1)-(5), that are paid or accrued within the tax year. See also § 1.164-1(a) of the Income Tax Regulations. Specifically, § 164(a)(3) provides for the deduction of state and local income taxes paid or accrued within the tax year. Additionally, § 164(a) provides for the deduction of state and local taxes not described in § 164(a)(1)-(5) that are paid or accrued within the tax year in carrying on a trade or business or an activity described in § 212 (relating to expenses for production of income). See also Rev. Rul. 70-561, 1970-2 C.B. 40 (Pennsylvania excise tax imposed on corporate net income is deductible under § 164(a)).

A transferee’s payment to a transferor for the purchase of a transferable state tax credit is clearly not a payment of tax or a payment in lieu of tax for purposes of § 164(a). See

Rev. Ruls. 61-152, 1961-2 C.B. 42; 71-49, 1971-1 C.B. 103; 81-192, 1981-2 C.B. 49. In addition, generally the application of a credit against a tax liability is merely a reduction of the tax liability. See Rev. Rul. 79-315, 1979-2 C.B. 27. However, in this situation, a transferee has purchased a credit for value and the credit is “property” in the transferee’s hands rather than a factor in the calculation of tax due. The use of the credit to reduce the transferee’s state tax is analogous to the transfer of property to the state in satisfaction of the transferee’s tax liability. Thus, the transferee of a Massachusetts historic rehabilitation tax credit or low-income housing tax credit will have made a payment, for purposes of I.R.C. § 164(a), when it files its state tax return and uses the purchased credit to reduce its state tax liability.

Please call (202) 622-4950 if you have any further questions.