

River Edge Historic Preservation Credit may be Allocated to Partners Pursuant to Agreement of Partners. (This is a GIL.)

April 6, 2020

Re: Illinois Historic Preservation Credit

Dear Xxxx:

This is in response to your letter dated October 17, 2019 in which you request a private letter ruling on behalf of the above-named taxpayer. The nature of your request and the information provided requires that we respond with a General Information Letter (GIL). A GIL is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code § 1200.120(b) and (c), which may be accessed from the Department's web site at www.Iltax.com.

Your letter states as follows:

The Illinois legislature, through the Statute, created the Illinois River Edge Historic Preservation Tax Credit (the "**Credits**"). The Statute originally became effective on July 28, 2011, and has been subsequently amended multiple times, including most recently under P.A. 101-81 (effective July 12, 2019). The Statute currently authorizes Credits to be allocated by the Illinois Department of Natural Resources ("**DNR**") for tax years beginning on or after January 1, 2012 and ending prior to January 1, 2022, with varying conditions imposed on the Credits depending on which year they are allocated. The circumstances (described below) explain Applicant's need for immediate guidance from the DOR in regard to Applicant's proposed plans to invest in "**Qualified Historic Structures**" (indirectly through investment in "**Qualified Taxpayers**" that own the Qualified Historic Structures), each as defined hereafter and by the Statute, that are located in River Edge Redevelopment Zones.

Statement of Facts: Business Reason for the Proposed Transactions

Applicant is a national banking association authorized to do business in the State of Illinois ("**Illinois**"). Applicant, through the activities of its wholly-owned subsidiary, COMPANY ("**COMPANY**"), is one of the nation's most active federal and state tax credit investors. Applicant invests primarily in four main types of federal, and, where applicable, state tax credit projects: low-income housing, new markets, historic rehabilitation, and renewable energy. Applicant frequently seeks to invest in federal tax credit projects located in states that, as with the Program, have state tax credit programs designed to complement their federal counterparts. Applicant also invests directly in various other state tax credit programs (not linked to federal credit programs) such as brownfields revitalization and film production projects. In addition to syndicating federal tax credits, Applicant is also able to make certain, transferable state tax credits available to other investors through COMPANY. In 1998, the Office of the Comptroller of the Currency licensed COMPANY as the first broker of state tax credits. Since that time, COMPANY has become a significant investor and has participated as syndicator in numerous states' tax credit programs. For instance, Applicant has invested in

Illinois' Film Production Services Tax Credit Program and Illinois' Live Theater Production Tax Credit Program (collectively, the "**Film and Theater Credits**"), and also in Illinois Affordable Housing Credits ("**IAH Credits**") and Illinois Hospital Credits ("**IH Credits**"). Accordingly, Applicant would also like to become an investor in the Credits.

Applicant has been approached by several Illinois real estate developers with proposals for Applicant and its affiliates to invest in the federal rehabilitation credits (the "**Federal Rehabilitation Credit**") under § 47 of the Internal Revenue Code (as amended through the date hereof, the "**Code**") and/or to become the Credits investor in certain limited partnerships and/or limited liability companies, each referred to herein as an "**IL Partnership**". Each IL Partnership intends to restore, preserve, and own an Illinois historic structure located in a River Edge Redevelopment Zone that qualifies as a "**Qualified Historic Structure**," pursuant to a "**Qualified Rehabilitation Plan**," each as defined hereafter and by the Statute. Applicant is respectfully requesting rulings and guidance from the DOR for a proposed acquisition structure that is intended to increase Applicant's ability to:

- invest in multiple Qualified Historic Structures (indirectly through investment in Qualified Taxpayers that own the Qualified Historic Structures) on behalf of itself and other investors,
- make larger capital contributions to Qualified Historic Structures (indirectly through investment in Qualified Taxpayers that own the Qualified Historic Structures), and
- increase the number of Illinois corporate, individual, and trust and estate taxpayers who can invest in Qualified Historic Structures (indirectly through investment in Qualified Taxpayers that own the Qualified Historic Structures) and who are qualified as "**Qualified Taxpayers**" under the Statute for purposes of acquiring and utilizing Credits.

The proposed acquisition and allocation structure will increase the income tax revenues that Illinois will receive from Illinois' investments in Credits.

Unlike the Film and Theater Credits, the IAH Credits, and the IH Credits, the Credits are not transferable. Before Applicant and Illinois developers can enter into letters of intent, and eventually enter into certain binding agreements pursuant to which Applicant will invest in Federal Rehabilitation Credits and/or Credits, Applicant seeks additional guidance from and approval of Applicant's proposed structure (and the Illinois income tax treatment of the proposed structure) prior to making investment commitments with respect to numerous proposed Credit transactions (the "**Transactions**").

Statement of Facts: Interested Parties, Description of Proposed Transactions, and Analysis

1. **The Parties.** The following parties are involved in or related to the proposed Transactions.
 - a. **IL Fund:** COMPANY1, a Missouri limited liability company taxed as a partnership (to be formed), and the Credits investor in existing or to be formed IL Partnerships that restore, preserve and own Qualified Historic Structures located in River Edge Redevelopment Zones.

- b. **Applicant:** APPLICANT, a national banking association taxed as a corporation, and the only Class A Member of the IL Fund.
 - c. **COMPANY:** COMPANY, a Minnesota corporation and a one hundred percent (100%) owned subsidiary and affiliate of Applicant, to become the organizing Member and partner of the IL Fund (for federal income tax purposes) and to be designated as the Fund Manager under the (to be formed) IL Fund operating agreement.
 - d. **Purchaser(s):** Unrelated third-party corporations, individuals, and trusts and estates who have Illinois tax liabilities and who will be admitted to the IL Fund as Class B Members of the IL Fund (to be identified).
 - e. **IL Partnership(s):** Certain limited partnerships or limited liability companies that restore, preserve and own Qualified Historic Structures located in River Edge Redevelopment Zones (to be identified).
2. Applicant and COMPANY propose to form the IL Fund that would be classified, structured, and treated as a partnership for federal and Illinois income tax purposes. **For purposes of these rulings, please assume that the IL Fund will qualify as a partnership for federal income tax purposes.**
- a. COMPANY will first form the IL Fund as a single member limited liability company under Missouri law.
 - b. Soon thereafter, Applicant would be admitted to the IL Fund as the “**Class A Member**” in exchange for a nominal capital contribution of one hundred dollars (\$100.00). At this point, the IL Fund will become a partnership between COMPANY (“**Fund Manager**”) and Applicant (the Class A Member) for federal and state income tax purposes. **For purposes of these rulings, please assume that the Member interests owned by both Fund Manager and the Class A Member qualify as partnership interests for federal income tax purposes.**
 - i. Applicant would have basis in its “**Class A Member Interest**” equal to its capital contribution, and the IL Fund would not recognize gain on receipt of the contribution of capital.
 - ii. The Class A Member’s rights in the IL Fund would consist of:
 1. a proportional percentage of all of the tax attributes of the IL Fund, except for the Credits and
 2. the right to negotiate for an annual allocation of Credits with Fund Manager.
 - c. The IL Fund would be admitted to own an interest in each IL Partnership (an “**IL Partnership Interest**”), from time to time, in exchange for an arms-length negotiated contribution of capital. **Please assume that each IL Partnership Interest will qualify as a partnership interest in each IL Partnership for federal income tax purposes.**

- i. The IL Fund would have basis in each IL Partnership Interest equal to its capital contribution, and such IL Partnership would not recognize income on the admission of the IL Fund as a partner.
 - ii. The IL Partnership Interest would be entitled to a proportional share of all of the tax attributes of the IL Partnership, except for the Credits.
 - iii. The IL Partnership Interest would be entitled to an allocation of one hundred percent (100%) of the Credits generated by the restoration and preservation of each IL Partnership's Qualified Historic Structure per the written agreement.
 - iv. The intended federal and Illinois income tax consequences of this transaction include the following:
 1. The IL Partnership would not recognize gain or loss on the IL Fund's contribution of capital to the IL Partnership.
 2. The IL Fund would receive basis in its IL Partnership Interest equal to the contribution of capital to the IL Partnership.
 3. The IL Fund will not be entitled to a capital loss for its capital contribution in each IL Partnership until it exits each IL Partnership.
3. The IL Fund would admit Purchasers, each as a Class B Member to the IL Fund. Each Purchaser would make a nominal capital contribution to the IL Fund in exchange for its "**Class B Membership Interest**".
 - a. A Purchaser's Class B Membership Interest could be structured as either an interest that would qualify the Purchaser as a partner in the IL Fund for federal income tax purposes, or an interest that would merely qualify as a recognized ownership interest in the IL Fund for Illinois corporate law and the Statute's purposes only. Applicant would prefer to structure the Class B Member's interest as merely qualifying as a recognized ownership interest in the IL Fund for Illinois corporate law and the Statute's purposes only.
 - b. The Class B Membership Interest would entitle the Purchaser to negotiate with Fund Manager for the current year's share of Credits that are allocated from the IL Fund on an annual basis.
4. Allocations of Credits would be affected in the following manner:
 - a. The IL Fund would be admitted to one or more IL Partnerships, entitling the IL Fund to an allocation provided in a written agreement of one hundred percent (100%) of each IL Partnership's Credit allocations under the Statute.
 - b. Under the terms of IL Fund's operating agreement, COMPANY would be entitled to receive an allocation of one hundred percent (100%) of the IL Fund's Credits from all IL Partnerships. COMPANY can choose to receive an allocation from the IL Fund of all or part of the IL Fund's Credits for COMPANY's own use, or COMPANY, as Fund

Manager, can direct the IL Fund to allocate all or part of the IL Fund's Credits to Class A or Class B Members; provided that, any Credits allocated to COMPANY for its own use may not be further allocated to other members.

- c. One or more Purchasers would be admitted as Class B Members of the IL Fund.
- d. On or before each December 31st prior to an annual Credit vesting year, COMPANY, as Fund Manager, will negotiate the allocation of the IL Fund's Credits for such year with the IL Fund's Class A Member and each of the Class B Members. The IL Fund will allocate the Credits to the Class A and B Members. The Class A Member and the Class B Members will make an additional payment to COMPANY for the agreed upon "purchase price/additional contribution of capital" (a "**Payment**") for such Class A Member's and Class B Members' agreed to allocation of the IL Fund's available Credits on or before each delivery of Credits in the year following the relevant annual Credit vesting year.
- e. The IL Partnerships generate the first year's allocation of Credits and allocate them to IL Fund. Under the direction of COMPANY, the IL Fund allocates the agreed to shares of the Credits to the Class A Member and the Class B Members.
- f. For federal and Illinois income tax purposes, the parties intend for the "**Allocations**" described in Paragraphs 4(d) and 4(e) to be treated as "disguised sales" of the Credits from COMPANY to the Class A Member and each of the Class B Members who received them, and for Illinois state law and the Statute's purposes, the parties intend for such Allocations to be treated as allocations of the Credits from the IL Fund to the Class A Member and Class B Members. The proposed federal and Illinois tax and state law/Statute treatment of these transactions are as follows:
 - i. In the year following each Credit allocation year, for federal and Illinois income tax purposes, COMPANY will recognize one hundred percent (100%) of each Payment as taxable gain from the "deemed sale" of the Credit, and the Class A Member and each Class B Member will receive basis in the allocated Credit equal to its Payment.
 - ii. When the Class A Member or a Class B Member utilizes the Credits to offset its Illinois tax liabilities, the Class A Member or such Class B Member will recognize gain equal to the difference between the face value of the Credits utilized and the Payment it paid to COMPANY for the Credits.
 - iii. This process will be repeated for each annual allocation year in which IL Fund receives Credits from an IL Partnership.
 - iv. Applicant and COMPANY anticipate that IL Fund will be admitted to numerous IL Partnerships, and that more than one Purchaser will be admitted as Class B Members of the IL Fund.

5. Example:

- a. IL Fund is formed on September 20, 2019 and Applicant is admitted as the Class A Member on September 21, 2019.
- b. IL Fund is admitted to an IL Partnership (“**ILP1**”) on September 30, 2019. ILP1 is entitled to receive from the DNR (i) \$1,000 of Credits in 2019 and (ii) \$1,000 of Credits in 2020, pursuant to a “**Phased Rehabilitation**” (as defined in the Statute) project that results in Qualified Expenditures (as defined hereafter and in the Statute) being incurred for the restoration and preservation of a Qualified Historic Structure for which (A) a phase is completed and “**Placed in Service**” (as defined in the Statute) in 2019 and (B) a phase is completed and Placed in Service in 2020, respectively.
- c. Under the terms of ILP1’s partnership agreement, IL Fund is entitled to receive one hundred percent (100%) of the Credits (\$1,000 of Credits for 2019 and \$1,000 of Credits for 2020).
- d. IL Fund admits a Purchaser (“**P1**”) as a Class B Member on October 15, 2019.
- e. On December 1, 2019, under the terms of IL Fund’s operating agreement, COMPANY, as Fund Manager, negotiates the Allocation of \$500 of the 2019 Credits to P1 and \$500 of the 2019 Credits to Applicant (the Class A Member).
- f. P1 and Applicant both make a Payment to COMPANY equal to the fair market value of their respective shares of 2019 Credits on or before the delivery date for the 2019 Credits (in 2020).
- g. On May 15, 2020, ILP1 allocates the \$1,000 of Credits to IL Fund, and IL Fund allocates \$500 of the Credits to P1 and \$500 of the Credits to Applicant.
- h. Under Applicant’s proposed treatment, for book and state corporate law/Statute purposes, \$500 of the Credits are allocated to each of P1 and Applicant on its Form K-1 received from the IL Fund. For federal and Illinois tax purposes, P1 and Applicant will claim their shares of the Credits against their 2019 Illinois tax liabilities on their 2019 returns, filed in 2020. On their 2020 returns, P1 and Applicant will each report a gain equal to the difference between the face value of the 2019 Credits received and their Payments for the Credits in 2020. COMPANY will report the 2020 Payments received from P1 and Applicant as taxable gain on its 2020 federal and Illinois income tax returns.
- i. On January 15, 2020, IL Fund is admitted as the Credit investor in a second IL Partnership (“**ILP2**”). ILP2 is entitled to receive \$10,000 of Credits from the DNR for Qualified Expenditures incurred in 2019 and 2020 in connection with a Qualified Rehabilitation Plan that is completed in 2020. ILP2’s Qualified Historic Structure will be Placed in Service on April 1, 2020.
- j. On October 1, 2020, IL Fund admits another Purchaser (“**P2**”) as a Class B Member. On December 1, 2020, COMPANY negotiates the Allocation of \$11,000 of IL Fund’s Credits to P2, or 100% of IL Fund’s Credits to be received from both ILP1 and ILP2 for the 2020 tax year. P1 and Applicant remain members of the Fund but do not negotiate allocations of 2020 Credits.

k. On May 15, 2021, ILP1 allocates \$1,000 of Credits to IL Fund, ILP2 allocates \$10,000 of Credits to IL Fund, and IL Fund allocates \$11,000 of Credits to P2.

l. Under Applicant's proposed treatment, for book and state corporate law/Statute purposes, \$11,000 of Credits are allocated to P2 on its Form K-1 received from IL Fund for 2020. For federal and Illinois tax purposes, P2 will claim \$11,000 of Credits against its 2020 Illinois tax liabilities on its 2020 return filed in 2021. On its 2021 return, P2 will report a gain equal to the difference between the face value of the 2020 Credits received and its 2021 Payment for the Credits. COMPANY will report one hundred percent (100%) of the 2021 Payment received from P2 as taxable gain on its 2021 federal and Illinois income tax returns.

Statement of Statutory Authority

The Credits offset the taxes imposed by 35 ILCS 5/201(a)-(b), which includes an income tax imposed on individuals, corporations and trusts and estates (the "**Qualified Taxes**"). The Credit eligibility is administered by the DNR.

The Credits are based on the federal rules for costs and expenses that satisfy the definition of a "qualified rehabilitation expenditure" under § 47 of the Code ("**Qualified Expenditures**"), that are incurred in the restoration and preservation of certain Illinois historic structures located in River Edge Redevelopment Zones that satisfy the definition of a "certified historic structure" under § 47(c)(3) of the Code ("**Qualified Historic Structure**"), by the owner of the Qualified Historic Structure or any other person who qualifies for the Federal Rehabilitation Credits with respect to that Qualified Historic Structure ("**Qualified Taxpayer**"), pursuant to a project that is approved by the DNR and the National Park Service as being consistent with the United States Secretary of the Interior's Standards for Rehabilitation ("**Qualified Rehabilitation Plan**").

With respect to taxable years that begin on or after January 1, 2018 and end prior to January 1, 2022, the total amount of Qualified Expenditures incurred by a Qualified Taxpayer in the restoration and preservation of a Qualified Historic Structure located in a River Edge Redevelopment Zone pursuant to a Qualified Rehabilitation Plan must (i) equal \$5,000 or more and (ii) exceed the adjusted basis of the Qualified Historic Structure on the first day the Qualified Rehabilitation Plan begins (the "**Qualified Expenditure Requirements**"). For any such rehabilitation project, regardless of duration or number of phases, the project's compliance with the Qualified Expenditure Requirements shall be determined based on the aggregate amount of Qualified Expenditures for the entire project. If the Qualified Rehabilitation Plan spans multiple years, the aggregate Credit for the entire project shall be allowed in the last taxable year, except for Phased Rehabilitation projects, which may receive Credits upon completion of each phase. Before obtaining the first phased Credit: (A) the total amount of such Qualified Expenditures must meet the Qualified Expenditure Requirements; (B) the rehabilitated portion of the Qualified Historic Structure must be Placed in Service; and (C) the requirements set forth in 35 ILCS 5/221(b), relating to applying for the Credit with the DNR, must be met.

Under the terms of the Statute (and related guidance), the Credits are **neither** freely transferable nor refundable, but any Credit granted to a Qualified Taxpayer that is a pass-through entity will flow through to its partners or shareholders, and if a partner in a partnership that earns the Credit is itself a partnership or a Subchapter S corporation, that partner's share

of the Credit is allocated among its partners or shareholders. In a structure with multiple tiers of partnerships or Subchapter S corporations, the Credit flows through each tier. Additionally, the Statute (and related guidance) permits Credits granted to a partnership, a limited liability company taxed as a partnership, or other multiple owners of property (excluding Subchapter S corporations) to be disproportionately allocated under such pass-through entity's partnership agreement or operating agreement, so long as the partner, member or other owner becomes a partner, member or owner prior to the last day of the partnership's, limited liability company's, or other pass-through entity's taxable year.

The Credit does not apply against the personal property tax replacement income tax ("**Replacement Tax**") imposed under 35 ILCS 201(c) and (d), and therefore, the Credit is not available to reduce the Replacement Tax liability of a partnership or Subchapter S corporation.

The Credits may not reduce the taxpayer's liability for the Qualified Taxes to less than zero. If the amount of the Credit exceeds the liability for Qualified Taxes for the year, the Credits have a five (5) year carryforward period but no carryback period.

Upon completion of the project and approval of a complete application, the DNR will issue a single certificate in the amount of the eligible Credits (excepting any Credits awarded prior to January 1, 2019 and any phased Credits issued prior to January 1, 2018), and a taxpayer must attach the certificate to the tax return on which the Credits are claimed.

The Statute provides for no further review of the Credit after it is awarded, and it does not contain a recapture provision. Nonetheless, if a taxpayer attempts to claim a Credit in an amount greater than the amount of the eligible Credits, or if a partner or shareholder attempts to claim an amount of Credit greater than the amount properly passed through, the DOR may issue a notice of deficiency.

Authority to the Contrary

Except for the Statute (35 ILCS 5/221), DOR Letter No. IT 18-0001-PLR (January 29, 2018), and DOR Letter No. IT 15-0001-PLR (July 13, 2015), there appears to be no other guidance published by either the DNR or the DOR with respect to the operation of these rules.

As also stated previously, DOR Letter No. IT 18-001-PLR (January 29, 2018) states that "...the [C]redit cannot be allocated to any person that was not a member in the year in which the expenses were incurred." However, the Statute was amended by Public Act 100-629 (effective January 1, 2019) to provide that "[i]f the [Q]ualified [R]ehabilitation [P]lan spans multiple years, the aggregate [C]redit for the entire project shall be allowed in the last taxable year, except for [P]hased [R]ehabilitation projects, which may receive [C]redits upon completion of each phase." Based on the amendment to the Statute, a partnership, limited liability company or other pass-through entity (excluding a Subchapter S corporation) should be permitted to disproportionately allocate the Credit under such partnership's, limited liability company's or other pass-through entity's partnership agreement or operating agreement, so long as the partner, member or other owner becomes a partner, member or owner prior to the last day of such pass-through entity's taxable year in which the Credit is allowed (which would be (i) the year in which a phase is completed and Placed in Service if the Credit is issued in connection

with a Phased Rehabilitation project and (ii) the last taxable year if the Qualified Rehabilitation Plan spans multiple years).

To the best of Applicant's and Applicant's Authorized Representatives' knowledge, there are no other contrary authorities; however, analogous support for the rulings requested does exist. Applicant received positive rulings from the Wisconsin Department of Revenue and Georgia Department of Revenue for similar structures under the state low-income housing tax credit programs in those states, which include similar attributes to the Program. The Wisconsin and Georgia rulings are available upon request.

Requested Rulings and Analysis

1. **If the IL Fund is respected as a partnership for federal income tax purposes, it will be respected as a partnership for Illinois income tax purposes.** In general, Illinois' income tax law conforms to the Code. Accordingly, we believe that if the IL Fund is treated as a partnership for federal income tax purposes, it will be respected as a partnership for Illinois income tax purposes.
2. **If the Fund Manager's interest and the Class A Member's interest in the IL Fund are respected as partner interests for federal income tax purposes, they will be respected as partner interests for Illinois income tax purposes.** In general, Illinois' income tax law conforms to the Code. Accordingly, we believe that if each of the Fund Manager's and Class A Member's interest in the IL Fund is treated as a partner interest for federal income tax purposes, it will be respected as a partner interest for Illinois income tax purposes.
3. **If the IL Fund's interest in an IL Partnership is respected as a partner interest in an IL Partnership for federal income tax purposes, it will be respected as a partner interest for Illinois income tax purposes.** In general, Illinois' income tax law conforms to the Code. Accordingly, we believe that if the IL Fund's IL Partnership Interest is treated as a partner interest for federal income tax purposes, it will be respected as a partner interest for Illinois income tax purposes.
4. **A Class B Member's interest in the IL Fund need only be structured so that it qualifies as a recognized ownership interest in the IL Fund for purposes of being able to receive allocations of Credits from the IL Fund in accordance with the IL Fund's operating agreement.** Under the Statute, a "Qualified Taxpayer" includes "the owner of the [Q]ualified [H]istoric [S]tructure or any other person who qualifies for the [F]ederal [R]ehabilitation [C]redit...with respect to that [Q]ualified [H]istoric [S]tructure. Partners, shareholders of subchapter S corporations, and owners of limited liability companies (if the limited liability company is treated as a partnership for purposes of federal and State income taxation) are entitled to a [C]redit...to be determined in accordance with the determination of income and distributive share of income under Sections 702 and 703 and subchapter S of the...Code, provided that [C]redits granted to a partnership, a limited liability company taxed as a partnership, or other multiple owners of property shall be passed through to the partners, members, or owners respectively on a pro rata basis or pursuant to an executed agreement among the partners, members, or owners documenting any alternate distribution method." There is no definition of what constitutes an "owner" of a Qualified Historic Structure in the Statute. Under the facts presented, the IL Partnership will own, restore, and preserve a

Qualified Historic Structure located in a River Edge Redevelopment Zone. The IL Fund will own an interest in the IL Partnership that will entitle the IL Fund to receive an allocation of one hundred percent of the Credits generated by the IL Partnership. In turn, COMPANY as founding Member of IL Fund, Applicant (after admission as the Class A Member of IL Fund) and one or more Purchasers (after admission as one or more Class B Members of the IL Fund), will each own, indirectly through the IL Fund, an ownership interest in each IL Partnership to which the IL Fund is admitted, which in turn, owns directly the Qualified Historic Structure, the restoration and preservation of which will generate the Credits. Accordingly, each of the IL Fund, COMPANY, the Class A Member and the Class B Members will own an indirect ownership interest in each Qualifying Historic Structure in which each IL Partnership invests. It does not appear that there is anything in the Statute that would require the Class B Members to qualify as partners for federal and Illinois income tax purposes, so long as the Class B Members qualify as “state law members” of the IL Fund under Illinois corporate law and the Statute. The parties intend to structure a Class B Member interest so that it qualifies as a member of a limited liability company under Missouri and Illinois corporate law.

- 5. If the federal income tax treatment of the proposed Allocations is respected, it will be respected for Illinois income tax purposes.** Applicant believes it is likely that the Internal Revenue Service (“IRS”) will treat the Allocations, as described above, as “disguised sales” for federal income tax purposes, based on the holding of *Virginia Historic Tax Credit Fund 2001 LLC, et. al., v. Commissioner of Internal Revenue*. Under the authority of this case, Applicant believes that the IRS would hold that IL Fund’s allocations of Credits to its Members would be collapsed as taxable sales of the Credits by COMPANY to the other IL Fund Members for federal income taxes. Accordingly, because Applicant desires certainty in its treatment of the Allocations for federal and Illinois income tax purposes, Applicant intends to treat the Allocations as taxable sales of Credits for federal and Illinois income tax purposes, and as allocations of Credits, for Illinois corporate law purposes and for purposes of the Statute.
- 6. Under the Statute (and related guidance), the Credit is not subject to recapture, and only the taxpayers (in this case, the Class A Member and the Class B Members) would be issued a notice of deficiency.** The Statute provides for no further review of the Credit after it is awarded, and it does not contain a recapture provision. Nonetheless, if a taxpayer attempts to claim a Credit in an amount greater than the amount of the eligible Credits, or if a partner or shareholder attempts to claim an amount of Credit greater than the amount properly passed through, the DOR may issue a notice of deficiency. Accordingly, under the transactions presented above, only the Class A Member and the Class B Members of the IL Fund would be issued a notice of deficiency, if applicable.
- 7. There are no limitations on the number of Purchasers who may participate in the IL Fund’s Credits as Class B Members, so long as each Purchaser is admitted to IL Fund prior to the end of IL Fund’s year in which each year’s Credits vest.** The Statute (and related guidance) permits allocations of Credits relating to the restoration and preservation of a Qualified Historic Structure that is owned by a partnership, limited liability company taxed as a partnership, or other multiple owners of property (excluding Subchapter S corporations) to be disproportionately allocated under such pass-through entity’s partnership agreement or operating agreement, so long as the partner, member, or other Qualified Taxpayer claiming the Credit has been joined as a partner, member or other permitted owner of the pass-through entity prior to the last day of the pass-through entity’s taxable year in which the Credit is

allowed (which would be (i) the year in which a phase is completed and Placed in Service if the Credit is issued in connection with a Phased Rehabilitation project and (ii) the last taxable year if the Qualified Rehabilitation Plan spans multiple years). The Statute does not appear to provide any provisions that would limit participation in a particular pass-through entity to only those Qualified Taxpayers who owned an interest in the pass-through entity prior to the date that the only or last building of the restored and preserved Qualified Historic Structure is Placed in Service or the date that a phase is Placed in Service in the case of a Phased Rehabilitation project. Accordingly, under the Allocations as presented, to the extent that a Purchaser is admitted as a Class B Member to the IL Fund prior to the next annual Credit vesting date (i.e., December 31st of the Credit allocation year, which shall also be the last day of the IL Fund's tax year) for various existing Qualified Historic Structures (in which the IL Fund participates through the IL Partnerships), such Purchaser can negotiate with COMPANY for an Allocation of Credits from such next vested year's Credits.

8. So long as the Class A Member and Class B Members own their respective Membership interests in the IL Fund by December 31 in the year in which Credits are allocated (which shall be the last day of the IL Fund's taxable year), those Members will be able to claim their Credits for the allocation year; the timing of making their capital contributions or "deemed payments" is irrelevant to when each Member may utilize its Credits. The Statute (and related guidance) permits allocations of Credits relating to the restoration and preservation of a Qualified Historic Structure that is owned by either a partnership, limited liability company taxed as a partnership, or other multiple owners of property (excluding a Subchapter S corporation) to be disproportionately allocated under such pass-through entity's partnership agreement or operating agreement, so long as the partner, member, or other Qualified Taxpayer claiming the Credit has been joined as a partner, member, or other permitted owner of the pass-through entity prior to the last day of the pass-through entity's taxable year in which the Credit is allowed (which would be (i) the year in which a phase is completed and Placed in Service if the Credit is issued in connection with a Phased Rehabilitation project and (ii) the last taxable year if the Qualified Rehabilitation Plan spans multiple years). The Statute does not appear to contain any requirements about when the partners, members, or other permitted owners of a pass-through entity must make their capital contributions or "deemed payments". Thus, when partners of partnerships, members of limited liability companies, and other permitted owners of pass-through entities make these payments is irrelevant to when the partners, members, and other owners may claim their Credits.

Request for Deletion

Applicant acknowledges that the DOR will delete the Applicant's identifying details from public disclosure, including Applicant's name and address, Applicant's Authorized Representatives, confidential return information, and specific trade secret information identified by the Applicant. A sample redaction of this Request is attached for your review and use.

No Other Declaratory Ruling Issued on the Same Issue

To the best of Applicant's and Applicant's Authorized Representatives' knowledge, the DOR has not previously issued a private letter ruling on the same or a similar issue for the Applicant

or any predecessor of the Applicant, and neither the Applicant or the Applicant's Authorized Representatives have previously submitted the same or a similar issue to the DOR and withdrew it before a private letter ruling was issued.

No Identical Issue in a Return Subject to Audit or Pending Litigation

An identical issue as described in this letter is not involved in the Applicant's return for an earlier period for which such issue is being examined as a part of a DOR audit or is pending in litigation in a case involving the taxpayer or a related taxpayer in which the DOR is named as a plaintiff or defendant.

Submission of Similar Requests

Applicant has submitted similar requests for rulings from the Georgia Department of Revenue and Wisconsin Department of Revenue relating to the state low-income housing tax credit programs in those states, which include similar attributes to the Program. Positive rulings were provided to the Applicant in both cases. Copies of the rulings from the Georgia Department of Revenue and Wisconsin Department of Revenue are available upon request.

Request for Conference

If the DOR requires additional information or, for any reason, does not believe that Applicant is entitled to the rulings it has requested, Applicant requests a conference to discuss this issue with the DOR and an opportunity to provide the additional information before the DOR issues to the Applicant a written reply and/or publishes a redacted private letter ruling.

RULING

Section 221 of the Illinois Income Tax Act ("IITA" ; 35 ILCS 5/221) allows for certain credits against the tax imposed under subsections (a) and (b) of Section 201 of the IITA related to the restoration and preservation of a qualified historic structure located in a River Edge Redevelopment Zone. To obtain a credit under Section 221, the taxpayer must apply with the Department of Natural Resources (DNR) as provided under Section 221(b). Under Section 221(b-1), upon completion of a project and approval of the complete application, DNR shall issue a tax credit certificate in the amount of the eligible credits. Section 221(c) requires the taxpayer to attach the tax credit certificate to the tax return on which credits are claimed. Section 221(c-2) states that DNR may adopt rules to implement Section 221. Section 221(d) provides, in part:

As used in this Section, the following terms have the following meanings.

...

“Qualified taxpayer” means the owner of the qualified historic structure or any other person who qualifies for the federal rehabilitation credit allowed by Section 47 of the federal Internal Revenue Code with respect to that qualified historic structure. Partners, shareholders of subchapter S corporations, and owners of limited liability companies (if the limited liability company is treated as a partnership for purposes of federal and State income taxation) are entitled to a credit under this Section to be determined in accordance with the determination of income and distributive share of income under Sections 702 and 703 and subchapter S of the Internal Revenue Code, provided that credits granted to a partnership, a limited liability company taxed as a partnership, or other multiple owners of property shall be passed through to the partners, members, or owners respectively on a pro rata basis or pursuant to an executed agreement among the partners, members, or owners documenting any alternate distribution method.

Section 702 of the Internal Revenue Code (IRC) requires a partner to take into account separately his distributive share of partnership credits. Section 704(b) of the IRC provides:

(b) Determination of distributive share. A partner’s distributive share of income, gain, loss, deduction, or credit (or item thereof) shall be determined in accordance with the partner’s interest in the partnership (determined by taking into account all facts and circumstances), if—

- (1) the partnership agreement does not provide as to the partner’s distributive share of income, gain, loss, deduction, or credit (or item thereof), or
- (2) the allocation to a partner under the agreement of income, gain, loss, deduction, or credit (or item thereof) does not have substantial economic effect.

Treasury Regulations Section 1.704-1(b)(4)(ii) provides, regarding a partner’s distributive share of credits of the partnership:

Credits. Allocations of tax credits and tax credit recapture are not reflected by adjustments to the partners’ capital accounts (except to the extent that adjustments to the adjusted tax basis of partnership section 38 property in respect of tax credits and tax credit recapture give rise to capital account adjustments under paragraph (b)(2)(iv)(j) of this section). Thus, such allocations cannot have economic effect under paragraph (b)(2)(ii)(b)(1) of this section, and the tax credits and tax credit recapture must be allocated in accordance with the partners’ interests in the partnership as of the time the tax credit or credit recapture arises. With respect to the investment tax credit provided by section 38, allocations of cost or qualified investment made in accordance with paragraph (f) of § 1.46-3 and paragraph (a)(4)(iv) of § 1.48-8 shall be deemed to be made in accordance with the partners’ interests in the partnership. With respect to other tax credits, if a partnership expenditure (whether or not deductible) that gives rise to a tax credit in a partnership taxable year also gives rise to valid allocations of partnership loss or deduction (or other downward capital account adjustments) for such year, then the partners’ interests in the partnership with respect to such credit (or the cost giving rise thereto) shall be in the same proportion as such partners’ respective distributive shares of such loss or deduction (and adjustments). See example 11 of paragraph (b)(5) of this section. Identical principles shall apply in determining the partners’ interests in the partnership with respect to tax credits that arise from receipts of the partnership (whether or not taxable).

IITA Section 221(d) states that the River Edge historic preservation credit is allowed to partners in accordance with the distributive share rules of sections 704 of the IRC. Under IRC Section 704(b), credits must be allocated to partners in accordance with the partners’ interests in the partnership as of

the time the credit arises. However, Section 221(d) allows partners to divide the credit pursuant to an executed agreement documenting *any* alternative distribution method. Accordingly, a partnership may allocate the credit to partners pursuant to an executed agreement among the partners, regardless of whether the agreed upon allocation is in accordance with the partners' interests in the partnership. In the absence of either a provision in the partnership agreement or other executed agreement among partners documenting an alternative distribution method, a partnership may allocate credits to partners in accordance with the partners' interests in the partnership.

Your letter indicates that IL Fund will own partnership interests in IL Partnerships that own qualified historic structures and receive tax credits under Section 221 of the IITA. Pursuant to the partnership agreements, 100% of the awarded credits will be allocated to IL Fund. IL Fund is an LLC whose members include COMPANY, Class A members and Class B members. IL Fund elects to be taxed as a partnership. Prior to the end of the IL Fund's taxable year in which a credit is awarded, the partners, including COMPANY, Class A members and Class B members, will execute an agreement dividing the credit among the partners. The agreement requires that the Class B members and Class A members make a payment to COMPANY in consideration for the division of the credit. Under Section 221(d) of the IITA, COMPANY, the Class A members, and Class B members may claim the respective shares of the River Edge historic preservation credit as provided in their agreement. Each partner should attach to the partner's tax return claiming the credit a copy of their executed agreement documenting the partner's proportional share of the credit certificate. In no event may a partner claim an amount of credit exceeding the partner's agreed upon share, nor may the aggregate credits claimed by the partners exceed the amount of credit awarded.

As stated above, this is a GIL. A GIL does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you have questions regarding this GIL you may contact Legal Services at (217) 782-7055. If you have further questions related to Illinois income tax laws, visit our website at www.revenue.state.il.us or contact the Department's Taxpayer Information Division at (217) 782-3336.

Sincerely,

Brian L. Stocker
Associate Counsel (Income Tax)