Supplemental Report
By the
Tax Law Committee of the Missouri
Tax Credit Review Commission
December 2012

Committee Members

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Missouri Tax Credit Review Commission

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On October 28, 2010, the Tax Law Committee issued its initial report to the Missouri Tax Credit Review Commission, with a supplemental report filed on November 15, 2010. Subsequent to Governor Nixon's reconvening of the Missouri Tax Credit Review Commission in the fall of 2012, a hearing notice was posted on the TCRC website (http://tcrc.mo.gov) and the Tax Law Committee convened by teleconference. Minutes of the meeting were recorded.

COMMITTEE HEARING
The Tax Law Committee of the Tax Credit Review Commission held a meeting on December 5, 2012, by conference call to discuss the recommendations contained in the 2010 report and discuss the update to the report. A quorum of the Committee was established and the Committee members unanimously adopted this supplemental report.

CONSIDERATIONS
The focus of this Committee was then, and is now, the interplay between the federal tax law and the effects on all state tax credit programs. Basically, there is a "cost" at the taxpayer maximum marginal tax rate embedded in all state tax credit programs either (i) on credits that reduce a Missouri taxpayer's liability (i.e. Social Credits, PTCs, or LIHTCs) thereby decreasing the federal deduction for state taxes 'paid', which then increases the federal tax payment by that marginal tax bracket percentage, or (ii) on transferrable credits (i.e. HTCs or Brownfields) subject to taxation, although in 2010, there were some questions inside the Tax Bar as to the character and timing of the tax.

Since our 2010 report, the IRS has issued one ruling and won two significant court cases on the tax treatment of state tax credits and the federal historic preservation tax credit:

1. In the IRS Chief Counsel Advisory Memorandum, issued September 15, 2011, #201147024, the IRS ruled explicitly that its position on transferable state tax credits would be that [a] the sale of a state tax credit was a taxable event, [b] the original recipient had no tax basis in that tax credit, and [c] a tax credit certificate was property treated generally as a capital asset. This CCA memorandum also addressed the IRS ' position for incidences of taxation for the purchaser of a transferable tax credit.

2. In the case entitled -- Virginia Historic Tax Credit Fund 2001, LP v. Commissioner, 634 F.3rd 129 (4th Cir.) (2011) -- the IRS sustained its position that the receipt of cash by the development partnership was a taxable sale. [The IRS's position on 'disguised sales' was also sustained].

3. In the case entitled -- Historic Boardwalk Hall, LLC v. Commissioner, (no-11-1832), (3rd Cir.) (2012) -- the IRS sustained its position that the corporate limited partner claiming the federal historic tax credits was 'not a partner' for tax purposes, thereby blocking the use by that investor of these federal credits.

Suffice it to say, the 2010 reports of the Tax Law Committee's 2010 with its various recommendations for all of (i) a federal legislative focus, (ii) a corollary state law modification, and / or (iii) a private letter request to the IRS on various possible alternatives, must be suspended. There just needs to be more clarity on these unknown facts before any updated meaningful recommendations can be made.

[The Chair of the Tax Law Committee acknowledges the receipt of an email as of December 4, 2012 from Mr. Greg Young on his alternate plan to improve the mathematics of the MO Low Income Housing Tax Credits, given these federal tax law and other impacts under the MO LIHTC. But, for the same logic, that proposal also should be suspended].

Independently, there will likely be federal tax law changes coming in 2013, which may include:

[1] Repealing or limiting 'tax expenditures' which include the myriad of federal tax credits. If the federal LIHTC or HTC programs are changed, it would have an immediate and dramatic effect on these two state programs;

[2] Adjusting either or both the marginal maximum tax brackets for individuals or corporations, as well as the alternative minimum tax rates, and which of these continued federal tax credits would apply on the AMT liability as well as the regular tax liability;

[3] Modifying the amount of these tax credits, or their stacking attributes, or

[4] Adding, as a catch all, the unknowns to come in a major tax overhaul yet to be defined is critically important, but admittedly beyond the scope of the TCR.

COMMITTEE RECOMMENDATIONS
The Recommendation of this Tax Law Committee is to Wait and See What Happens in 2013 in both Congress and from the IRS in rulings or cases on the federal income taxation of state tax credits.

SUPPLEMENTAL COMMITTEE RECOMMENDATION ON AN EMERGING TAX ISSUE
One last and critically important note to the Legislature and Executive Branch, admittedly beyond the scope of the TCRC, is there needs to be a Standing Committee formed to focus on the effect of this unknown but forthcoming federal tax law change on Missouri's General Revenue. The Missouri individual income taxes account for 66.9% and corporate income taxes tally 3.8% of the General Revenue. Both the Missouri individual and corporate income tax laws are integrated with the federal income tax law. So every item of income and every deduction on the federal law flows through to the Missouri tax calculus. Hence, changes in the federal law will per se cause a change in the General Revenue. It is not possible here to predict whether that will be an increase or decrease to Missouri, but care and focus needs to be jointly exercised here by the Legislature and Executive Branch.

Respectfully submitted on behalf of the members of the Tax Law Committee,
Steven Stogel, Chair