VERNON BARNETT
Commissioner

State of Alabama
Department of Revenue
(www.revenue.alabama.gov)
50 North Ripley Street
Montgomery, Alabama 36132

CURTIS E. STEWART
Deputy Commissioner
MICHAEL D. GAMBLE
Deputy Commissioner
DONALD J. GRAHAM
Deputy Commissioner
DERRICK COLEMAN
Deputy Commissioner

ALABAMA DEPARTMENT OF REVENUE
REVENUE RULING 2019-001

TO: [REQUESTOR]

FROM: Vernon Barnett, Commissioner of Revenue
Alabama Department of Revenue

DATE: October 30, 2019

RE: Purchase and Special Allocation of tax credits arising from Rehabilitation of Historic Structures

In your letter dated July 24, 2019, you requested a Revenue Ruling regarding the proper interpretation of Alabama law relating to the purchase and special allocation of tax credits applicable under CODE OF ALA. (1975), § 40-9F-1, *et seq.*, providing credits to offset rehabilitation expenses of certain historic structures.

FACTS

The facts as represented by the Requestor are as follows:[1]

Requestor is the managing member of [LLC #1] (the "Investor"). The Investor is a limited liability company that was in existence during 2018. The Investor intends to purchase, through its wholly-owned subsidiary, [LLC #2] (the "Purchaser"), certain tax credits that were created pursuant to CODE OF ALA. (1975), § 40-9F-1 (the "Historic Credits"). The Historic Credits in question were themselves created in 2018. The original creator of the Historic Credits was a limited partnership (the "Seller") that owns a certified historic structure (the "Historic Site"), as that term is defined in § 40-9F-2(1). The Seller's application and rehabilitation plan to be issued the Historic Credits was completed and filed on or before May 15, 2016.[2]

Both the Investor and the Seller are taxable as partnerships for federal income tax purposes and are classified as partnerships for Alabama tax purposes also. The Purchaser is a disregarded entity, taxed as an unincorporated division of the Investor for both federal income tax and Alabama tax purposes.

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[1] This revenue ruling, like all revenue rulings, is the Alabama Department of Revenue's interpretation of the law or regulations as applied to the facts and assertions contained in the request for the ruling. If any facts or conclusions asserted by the Requestor were misstated or misleading, or if facts that are relevant or material to a proper legal determination of this Revenue Ruling are omitted by the Requestor, this Revenue Ruling may be void.

[2] This revenue ruling is dependent upon the Seller's application and rehabilitation plan for its certified historic structure having been completed and filed on or before May 15, 2016. Had the application and rehabilitation plan been filed after May 15, 2016, for it to have generated Historic Credits at all, it must have done so under CODE OF ALA. (1975), Title 40, Chapter 9F, Article 2 (§§ 40-9F-30 *et seq*.). The Department (A) expresses no opinion whether; and (B) gives no assurances that, its responses to the Requestor would or would not have been materially different had the stated facts been judged under Article 2 of Chapter 9F rather than Chapter 1.

The Historic Site was placed in service in 2018. Before the Historic Site was placed in service in 2018, the Purchaser entered into a purchase agreement with the Seller, by which the Seller agreed to transfer the Historic Credits to the Purchaser. The Seller became ready to transfer the Historic Credits to the Purchaser in July of 2019, as required by the purchase agreement. For both federal and Alabama income tax purposes, this transfer will be treated as a purchase of the Historic Credits by the Investor, because the Purchaser is a disregarded entity, wholly owned by the Investor.

Pursuant to a written agreement among Investor's members, upon the consummation of the Historic Credit purchase in 2019, the Investor intends to allocate all the Historic Credits among the said members, and the members will claim the credits on their 2019 tax returns. The members of the Investor in 2019 may or may not be the same persons who were members in 2018. The ultimate end user members of the Historic Credits will be set forth on the tax credit certificate application.

ISSUES

You have asked for rulings on the following issues:

1. Is the Investor's purchase of Historic Credits in 2019, but which credits were first generated in 2018, an acceptable method to transfer the Historic Credits to the Investor?

2. Is the Investor's special allocation of Historic Credits in 2019, but which credits were first generated in 2018, an acceptable method to transfer the Historic Credits to the Investor's members?

LAW AND ANALYSIS

Claiming Historic Credits in a Year Later than their Creation

Certain tenets are fundamental to the interpretation and application of Alabama tax laws in general. Among these are that "the fundamental rule of statutory construction is that this Court is to ascertain and effectuate the legislative intent as expressed in the statute." League of Women Voters v. Renfro, 290 So. 2d 167 (Ala. 1974). "In this ascertainment, we must look to the entire Act instead of isolated phrases or clauses." Opinion of the Justices, 85 So. 2d 391 (Ala. 1956). "To discern the legislative intent, the Court must first look to the language of the statute. If, giving the statutory language its plain and ordinary meaning, we conclude that the language is unambiguous, there is no room for judicial construction." Ex parte Waddail, 827 So. 2d 789, 794 (Ala. 2001). If a literal construction would produce an absurd and unjust result that is clearly inconsistent with the purpose and policy of the statute, such a construction is to be avoided. Ex parte Meeks, 682 So. 2d 423 (Ala. 1996)" City of Bessemer v. McClain, 957 So. 2d 1061, 1074-75 (Ala. 2006). "'Furthermore, this Court has stated that its role is not to displace the legislature by amending statutes to make them express what we think the legislature should have done. Nor is it this Court's role to assume the legislative prerogative to correct defective legislation or amend statutes.' Siegelman v. Chase Manhattan Bank (USA), N.A., 575 So. 2d 1041, 1051 (Ala. 1991)." Hill v. Galliher, 65 So. 3d 362, 370 (Ala. 2010).

The first question has to do with the fact that, in the case the Requestor presents, the Historic Credits were produced and first eligible for use in 2018; however, the Investor proposes to purchase those credits in 2019. The Requestor's attorney represents that the Seller itself did not utilize the credits in 2018, because it was already under contract to transfer those credits to the Purchaser.

Section 40-9F-4(b) states "[t]he entire tax credit may be claimed by the taxpayer in the taxable year in which the certified rehabilitation is placed in service. Where the taxes owed by the taxpayer are less than the tax credit, the taxpayer shall not be entitled to claim a refund for the difference, but any unused portion of the credit may be carried forward for up to 10 additional tax years."

The Department's opinion is that the use of the word "may" in the above-cited statute indicates a permissive license instead of a mandatory command. "Ordinarily, the use of the word 'may' indicates a discretionary or permissive act, rather than a mandatory act. American Bankers Life Assurance Co. v. Rice Acceptance Co., 739 So.2d 1082, 1084 (Ala. 1999). *See also* Bowdoin Square, L.L.C. v. Winn-Dixie Montgomery, Inc., 873 So.2d 1091, 1098-99 (Ala. 2003) (stating that our supreme court has long recognized that the word 'may' denotes a permissive alternative rather than a mandatory restriction)." Ex parte Mobile City Board of School Commissioners, 61 So. 3d 292, 294 (Ala. 2010).

There are occasions when Alabama courts have held the word "may" to denote a mandatory command. Language stating parties "may" submit a matter to arbitration is generally deemed to require that disputes be arbitrated or else dropped entirely, not that arbitration is optional. *See* Hanover Ins. Co. v. Kiva Lodge Condominium Owners Assoc., Inc., 221 So. 3d 446, 449 (Ala. 2016). Statutes providing that a public official "may" undertake a certain act have been held to be mandatory where "the public interest and rights are concerned and where the public or third persons have a claim de jure." Alabama State Bd. of Health ex rel. Baxley v. Chambers County, 335 So. 2d 653, 654 (Ala. 1976). However, the Department does not believe that such situations occur in the present case. If the entire tax credit "may" be claimed in the taxable year in which the certified rehabilitation is placed in service, it follows that it "may" not.

Further, keeping in mind the purpose and scope of the entire statutory scheme relating to the Historic Credits, and reading the rest of the provisions *in pari materia*, it is apparent that a rule requiring that Historic Credits be used immediately upon creation or lost forever would frustrate the intent of creating the credit program in the first instance. The statute clearly expects and intends that the Historic Credits will be a thing of value that developers can sell. If their ability to sell such credits rests entirely upon finding a willing buyer and concluding the sale before years' end (even where construction schedules may be adversely affected by weather, availability of supplies and labor, and a myriad of other factors beyond the control of either seller or buyer), the availability and marketability of such credits would be adversely affected in a material way.

Therefore, the Department's conclusion is that the Historic Credits are not adversely affected by the fact that their first use will be by the Investor in 2019 instead of 2018 when the project was first placed in service.[3]

[3] The Department notes that the scheme applying to such credits created in 2017 and after is quite different, requiring that credits "must be claimed by the taxpayer for the taxable year in which the certified rehabilitation is placed in service." § 40-9F-33(c) (emphasis added). However, this is ameliorated by the fact that these credits for later projects are refundable, whereas credits under Article 1 are

Special Allocation of Credits

The allocation of items of income, deduction, gain, loss, and credit for Alabama income tax purposes is governed by § 40-18-24(a), which in turn incorporates by reference §§ 701-761 of the Internal Revenue Code (the "IRC") (i.e., Subchapter K). Section 704 of the IRC provides as follows concerning the allocation of such items among partners or members of a Subchapter K entity, such as the Investor:

> (a) Effect of partnership agreement
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> A partner's distributive share of income, gain, loss, deduction, or credit shall, except as otherwise provided in this chapter, be determined by the partnership agreement.
>
> (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.

Regarding the requirement of IRC § 704(b)(2) that allocations have "substantial economic effect," the general rule is that tax credits, because they do not affect a partner's capital accounts, are incapable of having substantial economic effect,[4] and therefore must be allocated according to the partners' interest in the partnership (that is, without regard to special allocations). This is so due to Treas. Reg. § 1.704-1(b)(4)(ii), stating:

> Allocations of tax credits … are not reflected by adjustments to the partners' capital accounts… . Thus, such allocations cannot have economic effect under paragraph (b)(2)(ii)(b)(1) of this section, and the tax credits … must be allocated in accordance with the partners' interests in the partnership as of the time the tax credit … arises.

Thus, the general rule is that credits may not be subject to special allocations because they are incapable of having substantial economic effect under IRC § 704(b). However, Alabama law contains a special provision that overrides the general rule with respect to the credits at issue here.

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not refundable but rather are carried over to future years. *Compare* § 40-9F-33(c) ("Where the taxes owed by the taxpayer are less than the tax credit, the taxpayer shall be entitled to claim a refund for the difference.") with § 40-9F-4(b) ("Where the taxes owed by the taxpayer are less than the tax credit, the taxpayer shall not be entitled to claim a refund for the difference, but any unused portion of the credit may be carried forward for up to 10 additional tax years.").

[4] *See* Treas. Reg. § 1.704-1(b)(2)(ii)(b)(1), requiring that, to have substantial economic effect, a partnership agreement must provide "[f]or the determination and maintenance of the partners' capital accounts in accordance with the rules of paragraph (b)(2)(iv) of this section."

The rule of § 40-9F-4(d), in pertinent part, is that "Tax credits granted to a partnership, a limited liability company or multiple owners of a property shall be passed through to the partners, members, or owners (including any not-for-profit entity that is a partner, member, or owner) respectively pro rata or pursuant to an executed agreement among the partners, members, or owners documenting an alternate distribution method without regard to their sharing of other tax or economic attributes of the entity." (emphasis added). Thus, the Department's view is that Subchapter K entities, such as the Investor, may specially allocate the Historic Credits in whatever manner they wish, so long as the allocation method is reflected in a written agreement among the members or partners, notwithstanding the general rule of IRC § 704(b).

The Historic Credits are transferable, but are transferable only once. Section 40-9F-4(e) requires that "once a credit is transferred, only the transferee may utilize such credit and the credit cannot be transferred again." The Requestor asks whether the allocation of the Historic Credits among the Investor's members is such a "transfer." Reading the entire statutory scheme of the credits *in pari materia*, it is clear that the legislative intent of the Historic Credits was to allow the benefit of the credits to be transferred for value, and, if applicable, transferred to Subchapter K entities. The law is similarly clear that Subchapter K entities coming into ownership of Historic Credits may allocate them in whatever manner desired and agreed to among the partners or members. Thus, a holding that the special allocation of Historic Credits among partners or members is itself a "transfer" under § 40-9F-4(e) would, in effect, prevent any such allocation as a second transfer. In essence, such an interpretation would prevent any Subchapter K entity from allocating transferred Historic Credits to its members or partners at all, despite the fact that the plain language of the statute anticipates that such allocations will occur and are permitted.

Such an interpretation would be "clearly inconsistent with the purpose and policy of the statute," as described in the case Ex parte Meeks, cited above. Therefore, that construction is to be avoided. The Department's view is thus that the special allocation of Historic Credits among the Investor's members is not a "transfer" for purposes of § 40-9F-4(e).

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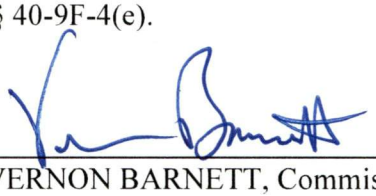
SUMMARY OF HOLDINGS

1. The use of the Historic Credits is not adversely affected by the fact that their first use will be in 2019 instead of 2018 when the project was first placed in service.

2. The Historic Credits may be allocated among the Investor's members in any way agreed to in writing by the members, and such allocation is not a "transfer" as that term is used in CODE OF ALA. (1975), § 40-9F-4(e).



VERNON BARNETT, Commissioner,
Alabama Department of Revenue