

Rulings of the Tax Commissioner

Document Number: 13-225
Tax Type: Land Preservation Tax Credit
Brief Description: Land Preservation Tax Credits
Topics: Land Preservation Tax Credit
Date Issued: 12/17/2013

December 17, 2013

Re: Ruling Request: Sales of Land Preservation Tax Credits and Virginia Taxable Income

Dear *****:

This is in response to your letter, dated May 31, 2012, requesting that Virginia disregard the federal treatment of income from deemed sales of Land Preservation Tax Credits by partnerships.

FACTS

***** and ***** ("Partnerships") are partnerships in which ***** ("Taxpayer") is a partner. In 2012, the IRS and the Taxpayer entered into a settlement agreement that recharacterized 2003-2005 capital contributions to the Partnerships as sales of Virginia Land Preservation Tax Credits by the Partnerships to the investors. Therefore, the investors' contributions were deemed to be purchases and generated income for the Partnerships. As a result of the Taxpayer's distributive share of the Partnerships' income, the Taxpayer's federal adjusted gross income and itemized deductions were adjusted for Taxable Years 2003 through 2009.

In addition to these adjustments, the settlement agreement changed the amount of the federal student loan interest and tuition and fees deductions that the taxpayer was entitled to claim for certain taxable years.

DETERMINATION

The Taxpayer contends that the Department should disregard the federal adjustments that resulted from the recharacterization of the Partnership's capital contributions. As support for this position, the Taxpayer cites Public Document (P.D.) 07-82, in which the Department conformed to the federal income tax treatment of gain resulting from a deemed sale of Historic Rehabilitation Tax

Credits, but did not allow the federal treatment to dictate whether the credits should be denied. The Taxpayer also relies on a statutory exception which allows federal income created by the allocation of Historic Rehabilitation Tax Credits to be subtracted from federal income when computing Virginia taxable income.

Federal Adjustments Related to Historic Rehabilitation Tax Credits

Under *Va. Code* § 58.1-322, the Virginia taxable income of an individual taxpayer for a taxable year begins with his federal adjusted gross income. This is subject to a number of modifications which may cause Virginia taxable income to differ from federal adjusted gross income.

Prior to 2012, no subtraction was allowed for gain related to Historic Rehabilitation Tax Credits. P.D. 07-82 addressed the treatment of federal deemed sales of Historic Rehabilitation Tax Credits for Virginia income tax purposes. In this ruling, advice was requested regarding an IRS General Counsel Advice Memorandum that addressed the transfer of state tax credits. The IRS determined that the allocation of certain state tax credits to investors by partnerships were sales and therefore taxable at the federal level. The recharacterization of those transactions produced gain for the partnerships and increased the partners' distributive share of the partnership's gain. In P.D. 07-82, the Department stated that, because Virginia conforms to federal gross income, including any income from deemed transactions, taxpayers were not allowed to subtract gain created as a result of deemed sales of Historic Rehabilitation Tax Credits. However, the Department determined that the federal treatment of state tax credits did not affect the ability of taxpayers to use Historic Rehabilitation Tax Credits. Accordingly, the Department allowed taxpayers to continue to claim Historic Rehabilitation Tax Credits in cases where a partnership's allocation of the credit was deemed to be sales for federal income tax purposes.

The current Virginia treatment of deemed sales of Historic Rehabilitation Tax Credits is different than it was in 2007 when P.D. 07-82 was published. *Va. Code* § 58.1-339.2(F) provides that gain or income under federal law from the allocation of Historic Rehabilitation Tax Credits shall not be taxable gain or income for purposes of the Virginia income tax. This provision was enacted in 2012 and stated to be declaratory of existing law. Therefore, such gain or income is subtracted from federal adjusted gross income when computing Virginia taxable income.

Federal Adjustments Related to Land Preservation Tax Credits

No statutory authority extends the subtraction of federal taxable income in *Va. Code* § 58.1-339.2(F) to the Land Preservation Tax Credit. However, *Va. Code* § 58.1-513(E) provides that the transfer of Land Preservation Tax Credits shall not create gain or loss for the transferor or the transferee of the credit. This allows for the

subtraction of federal income and the addition of federal losses created by the allocation of Land Preservation Tax Credits. Therefore, the Taxpayer shall disregard any federal gains or losses created by the Partnerships' deemed sales of Land Preservation Tax Credits when computing his Virginia taxable income.

Because *Va. Code* § 58.1-513(E) allows the subtraction of federal income and the addition of federal losses created by the Partnerships' deemed sales of Land Preservation Tax Credits, the Taxpayer may subtract such income from his federal adjusted gross income when computing his Virginia taxable income.

If the Taxpayer wants to claim Land Preservation Tax Credits, he must file a notice of allocation with the Department. Further, pursuant to *Va. Code* § 58.1-513(c)(2), transfers of Land Preservation Tax Credits taking place after 2007 are subject to a fee equal to the lesser of 2% of the value of the donated interest or \$10,000.

Amended Return

Under *Va. Code* § 58.1-311, if the amount of any individual taxpayer's federal taxable income reported on his federal income tax return for any taxable year is changed or corrected by the IRS or other competent authority, then the taxpayer must file an amended Virginia income tax return within one year after the final determination of such change or correction. If the Department has sufficient information from which to compute the proper additional tax and the taxpayer has paid the tax, then the taxpayer is not required to file an amended individual income tax return.

In this case, the Taxpayer contends that the resolution of the federal tax issue will not result in any change in the Taxpayer's Virginia income taxes. However, it is not clear from the documentation provided that this is true. For example, the settlement agreement references items such as the student loan interest deduction and the deduction for tuition and fees and there is no explanation of these changes. Thus, the Taxpayer must file amended Virginia income tax returns reflecting the changes in federal income and claiming any relevant additions and subtractions in the proper taxable years.

CONCLUSION

Based on the foregoing, the IRS's recharacterization of the Taxpayer's income related to the deemed sales of Land Preservation Tax Credits will not result in any change to the Taxpayer's Virginia taxable income for Taxable Years 2003 through 2009. Although the deemed sales of Land Preservation Tax Credits may not result in a change to the Taxpayer's Virginia taxable income, the Taxpayer is required to file amended Virginia income tax returns for these years pursuant to *Va. Code* § 58.1-311.

The *Code of Virginia* sections and public documents cited are available online at www.tax.virginia.gov in the Tax Policy Library section of the Department's website. If you have additional questions, please contact ***** in the Office of Tax Policy, Policy Development Division, at *****.

Sincerely,

Craig M. Burns
Tax Commissioner

PD/1-5161554855
