The Transferability and Monetization of Tax Credits

Article By
State & Local Tax Practice Group
Horwood Marcus & Berk Chartered
State & Local Tax (SALT)

- Tax
- All Federal

Monday, January 26, 2015

State tax credits have been in existence since the 1980s and can be found in 46 states. The credits offer a "dollar-for-dollar reduction" of a taxpayer's tax liability. However, the problem encountered early on in the promotion of these credits was what to do if the credit could not be fully utilized by the taxpayer. Transferability allows tax credits to remain attractive to businesses with a low tax burden because they are able to use part of the credit and sell the remainder to a business facing a larger tax liability.

The credits available to taxpayers of each state vary greatly. Currently, the most common activities incentivized by transferable state tax credits include: film production, historic rehabilitation, brownfield remediation, renewable energy and breweries. Generally, these credits are monetized in three different ways:

1. A state can refund the amount of a credit at a discounted rate;

2. Limited partnerships or a syndication structure can be used to transfer the credit; or

3. The state taxing authority can issue a tax credit certificate which can be sold to a third party.
Because an increasing number of states allow for the sale of these credits, a new market has emerged for tax credit brokers. These broker companies assist in matching sellers with potential buyers all the while collecting a fee in the process. Typically in these transactions, sellers receive 85-90 cents on the dollar for their credit. Even more recently, the Online Incentive Exchange (OIX) was formed to remove tax credit brokers from the process and therefore allowing the sellers to receive more value in each transaction.

While the transferability and monetization of these credits is a relatively new concept, it is not without some controversy. Some critics argue that states spend too much money incentivizing businesses through the use of credits, and that the money could be better spent towards education and healthcare improvements. Others suggest that states should completely eliminate all tax incentives and simply lower tax rates for everyone. On the other hand, supporters of these programs emphasize that state tax incentives are not simply a tool for generating revenue, but also used to encourage certain activities or investment in the state. Therefore to the extent that states continue to offer these tax credit incentives, transferability is quite necessary to the success of the state tax incentive programs.

© Horwood Marcus & Berk Chartered 2019. All Rights Reserved.

Source URL: https://www.natlawreview.com/article/transferability-and-monetization-tax-credits