Internal Revenue Service

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Legend

state A	=
Taxpayer	=
N partnership	=
Q corporation	=
R corporation	=
U fund	=
V corporation	=
state board W	=
F taxes	=

a	=
b	=
c	=
d	=
e	=

Dear :

This ruling responds to a letter dated May 12, 2009, submitted by your authorized representative, requesting a ruling regarding the tax basis of venture capital tax credit certificates issued by state board W and purchased by Taxpayer, and the deductibility of state income taxes paid with the purchased credits, pursuant to § 164 of the Internal Revenue Code.

FACTS

For federal income tax purposes, Taxpayer is a corporation that uses the calendar taxable year and whose overall method of accounting is an accrual method. Taxpayer is a regulated public utility under the laws of state A and is engaged principally in the generation and distribution of electric energy and the distribution and transportation of natural gas.

N partnership is a private, for-profit limited partnership authorized to make investments in private venture capital funds. The purpose of N partnership is to make investments in private seed and venture capital partnerships or entities in a manner that will enhance venture capital investment within state A. In order to receive an investment from N partnership, a venture fund must commit to consider equity investments in businesses in state A, and to maintain physical presence in state A.

N partnership was organized by Q corporation pursuant to the provisions of state A Code § *a*. Q corporation was authorized under the provisions of state A Code § *a*, and has been organized as a private, not-for-profit corporation under state A Code § *b*. Q corporation was granted tax-exempt status under § 501(c)(3) of the Internal Revenue Code.

N partnership currently has four partners. Q corporation, the general partner; R corporation, a preferred limited partner; U fund, a special limited partner; and V corporation, a limited partner and the manager of N partnership.

N partnership is financed through an arrangement in which Q corporation and V corporation have organized a special purpose entity, R corporation, to serve as a limited partner and investor in N partnership. R corporation receives contingent tax credit certificates when it makes a capital commitment to the N partnership. The tax credit certificates are issued to R corporation by state board W, an agency of state A. R corporation uses the certificates as collateral to secure loans, the proceeds of which are used to invest in N partnership and to pay expenses. N partnership in turn invests in individual venture funds. As capital is returned by the venture funds from their investment programs, that capital is used to repay the loans.

The state A venture capital tax credits are allowed for investments in U fund that do not meet a specified rate of return. The credit certificates, which are transferable, are issued in contingent form when the investment is made. At a specified future maturity date or dates, the credits are verified by state board W and allowed to the investor, or a transferee, to the extent that the actual return on the U fund investment did not meet the rate of return guaranteed to the investor. A credit cannot be claimed for a tax year that begins before the maturity date or dates. The credits are allowable against certain personal net income taxes, corporate taxes, taxes on financial institutions and insurance companies, and the monies and credit tax. Any excess credit may be carried forward for up to *c* years.

Taxpayer has entered into a Tax Credit Purchase Agreement with R corporation to purchase state A venture capital tax credits that have been earned by R corporation and verified by state board W. Under the agreement, Taxpayer will purchase verified credits in the amounts and at the times specified by R corporation, limited in any calendar year to *d* percent of Taxpayer's total tax liabilities or $*e*, whichever is less. Taxpayer is not required to purchase credits on any date other than a "tax due date," as specified in the agreement.

Taxpayer has entered into a Tax Credit Purchase Agreement with R corporation to purchase certain tax credit certificates issued by state board W. A condition precedent to Taxpayer's obligation to purchase the tax credits is to affirm that the tax credit certificates used by it to reduce or extinguish a state tax will result in a deduction on its federal income tax return for state taxes paid in the year applied. As such, Taxpayer requests this ruling.

LAW AND ANALYSIS

Section 164(a) of the Internal Revenue Code generally allows as a deduction certain types of taxes, listed in § 164(a)(1)-(5), that are paid or accrued within the tax year. Specifically, § 164(a)(3) provides for the deduction of state and local income taxes paid or accrued within the tax year. Additionally, § 164(a) provides for the deduction of state and local taxes not described in § 164(a)(1)-(5) that are paid or accrued within the tax year in carrying on a trade or business or an activity described in § 212. See also Rev. Rul. 70-561, 1970-2 C.B. 40 (Pennsylvania excise tax imposed on corporate net income is deductible under § 164(a)).

Section 1012(a) provides that generally, the basis of property is the cost of such property.

Generally, a state tax credit, to the extent that it can only be applied against the original recipient's current or future state tax liability, is treated for federal income tax purposes as a reduction or potential reduction in the taxpayer's state tax liability, not as a payment of cash or property to the taxpayer that is includible in gross income under § 61. See Rev. Rul. 79-315, 1979-2 C.B. 27. Consequently, the federal tax effect of such a state credit is normally to reduce any deduction for payment of state tax the taxpayer may otherwise have had under § 164. By itself, the fact that a state tax credit is transferable does not cause it to lose its character as a reduction or potential reduction in liability in the hands of the taxpayer who originally qualified for the credit. However, if and when a transferable credit is in fact transferred to another taxpayer for value, the transaction is a sale and purchase of property for purposes of §1001 and §1012.

With respect to the transferee of the credit, a payment for the purchase of a transferable

tax credit is not a payment of tax or a payment in lieu of tax for purposes of § 164(a). See Rev. Rul. 61-152, 1961-2 C.B. 42; Rev. Rul. 71-49, 1971-1 C.B. 103; Rev. Rul. 81-192, 1981-2 C.B. 50. Rather, the transferee has purchased a valuable right, the basis of which is the cost incurred. The use of the credit to satisfy the transferee's state tax liability is a transfer of property to the state in satisfaction of the liability. Generally, therefore, when the transferee uses the credit to satisfy a state tax liability, the transferee will have gain or loss under § 1001 on the use of the credit and will be treated as having made a payment of state tax, for purposes of § 164(a). See Rev. Rul. 86-117, 1986-2 C.B. 157.

RULING

Taxpayer's basis in the purchased state tax credit will be the cost of the credit. In the year or years Taxpayer applies the credit to satisfy the Taxpayer's state tax liability, Taxpayer will realize gain or loss equal to the difference, if any, between the basis of the credit and the amount of liability satisfied by the application of the credit. Taxpayer will have made a payment, for purposes of § 164(a), when it uses the purchased credit to satisfy its state tax liability, in the amount of the liability that was satisfied.

CAVEATS

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

The rulings contained in this letter are based upon information and representations submitted by the Taxpayer and accompanied by a penalty of perjury statement

executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Andrew Irving
Senior Counsel, Branch 1
(Income Tax & Accounting)

cc: