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Transferable Tax Credits: 3 Taxpayer Lessons From Oregon's Debacle

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In this viewpoint, Burton and Page say there are three things taxpayers can take from the recent controversy over Oregon's transferable renewable energy tax credits. They say the credits are not always easily transferable, that they should be sold in a competitive public bidding process (particularly when there are private inurement concerns because the seller is a governmental entity or a tax-exempt entity tasked with serving a public interest), and that a buyer of discounted transferable tax credits should report a gain on the difference between the purchase price and the value of the realized credits.

There are three taxpayer lessons to be learned from Oregon's transferable tax credit debacle.

Since 2007 Oregon has awarded nearly $1 billion of transferable renewable energy tax credits as part of its business energy tax credit (BETC) program.[1] The credits are transferable (that is, sellable to other taxpayers) because entities that earn them by developing renewable energy facilities often have little or no taxable income against which to apply them (for example, TriMet, Portland's public transportation agency). The credits are not "refundable," in that Oregon will not provide a cash payment to a taxpayer who has no income tax liability to offset with the credits.

The BETC program has been mired in controversy, most recently culminating in December 2015 with state lawmakers making public claims of noncompliance, noncompetitive bidding, and tax evasion regarding the buying and selling of the credits. At least one Republican lawmaker has even called for clawing back or reducing the value of some credits that have already been granted;[2] the U.S. Supreme Court has provided relatively broad leeway for lawmakers to retroactively amend tax provisions,[3] but it is not clear to us that those principles would apply to retroactive changes to the rules governing tax credits that were actually purchased. However, the Republican lawmaker in question has broadly asserted that retroactive changes to the BETC regime would be legal.[4] And one of his Democratic counterparts has said that he might support retroactive tax law changes "to claw the money back" from the BETC program.[5]

With that backdrop, here are three considerations for taxpayers involved with transferable tax credit regimes.

1. Transferable credits are not always easily transferable.

Taxpayers are often surprised to learn that transferable tax credit regimes can involve highly restrictive transfer rules, which may in some instances make transfer impossible. Those restrictions can even result in the credits effectively having no value, if the taxpayer has no taxable income against which to apply them before they expire.

In Oregon, for example, many taxpayers apparently did not realize that the state had developed strict rules limiting how deeply the transferable credits could be "discounted" when sold to other parties (setting a variable floor price via a formula). Meanwhile, potential purchasers of the credits often will not buy them unless they are sold at a deep discount.

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[1]Ted Sickinger, "Oregon's Business Energy Tax Credit Is Officially Dead, but Its Liability Lives On," *The Oregonian*, July 1, 2014 ("The Oregon Department of Energy [has] approved some 12,529 credits worth $857 million. As of the beginning of [2014], it had precertified another 122 credits for projects yet to be completed worth $86 million").

[2]Paul Jones, "Lawmakers Want Criminal Probe Into Renewable Energy Credits," *State Tax Notes*, Dec. 14, 2015, p. 816. ("The opinion of our legislative counsel . . . is yes, there likely is an ability to offer legislation to claw back or reduce the value of some of these credits.")

[3]*United States v. Carlton*, 512 U.S. 26 (1994).

[4]Jones, *supra* note 2.

[5]Jones, "Energy Tax Credit Sales Draw Scrutiny," *State Tax Notes*, Aug. 31, 2015, p. 753.

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A tax credit purchaser might require deep discounting because the purchaser wants to be compensated for each of the following:

- transaction costs (including capital gains taxes);
- assuming the risk that the credits will expire before being used or will otherwise not be usable;
- the time value of money regarding the duration between purchasing the credits and the moment of realizing their value; and
- its advantage as a buyer in a market in which supply typically exceeds demand.

BETC credits have reportedly been sold for as low as 60 cents on the dollar.[6]

As an example of that deep discounting, TriMet sold $1.8 million of BETCs to the local co-founder of an advertising agency for $1.35 million (that is, at a 25 percent discount), giving that purchaser a gain of $450,000 (ignoring CGT implications).[7] Further, TriMet hired a broker to find the purchaser, and the broker required a fee for its services, so TriMet ultimately realized only 70 cents of each dollar of BETCs it was awarded.[8]

Because Oregon restricts deep discounting, while many buyers require it, millions of dollars of awarded tax credits in the state are believed to be expiring unused, to the dismay of the financial modelers who projected the discounted cash flows that helped justify developing some massive renewable energy facilities.

Meanwhile, Oregon taxpayer advocates may have little sympathy for the renewable energy developers whose BETCs are expiring. A representative of the advocacy group Tax Fairness Oregon has been reported as saying that if the BETCs are "worthless, that's [the developers'] problem. I make bad investments and the state doesn't hold me harmless."[9]

The lesson here is that a taxpayer embarking on a project that is dependent on generating revenue from transferable tax credits should understand at the outset any regulatory risks to transferability.

2. Transferable credits should be sold in a competitive public bidding process.

The deep discounting being offered to purchasers of Oregon's BETCs has contributed to the outrage some lawmakers and taxpayers have had over the program. The logic of that outrage for a given transaction is as follows: $X million of tax credits was awarded to a renewable energy developer, but now an unrelated party is capturing a significant percentage of their value. Further, the unrelated party is a relatively unsympathetic wealthy person or company with no connection to the renewable energy project from which the credits stemmed.

Adding to that outrage is an allegation that "at least one buyer of tax credits was given the opportunity to purchase credits without a bidding process."[10] (The buyer and seller have not yet been publicly identified.)

To minimize public consternation over those deep discounts — and to ensure no laws are violated — credit holders should vigorously pursue the highest prices available for them in competitive, public bidding auctions. Because of private inurement concerns, that advice is especially relevant for developers that are governmental agencies or not-for-profit entities granted tax-exempt status in return for serving a public interest.

The public, however, should not expect these credits to be sold for an immaterial discount; for example, expecting developers to realize "more than 99 cents on the dollar."[11] Significant discounting is often necessary to attract a buyer, for the reasons noted earlier. The Online Incentives Exchange, which touts itself as the only "transparent" and "liquid" market for tax credits,[12] reportedly typically sees tax credits sold on its platform for a discount of 5 to 40 percent, or 95 to 60 cents on the dollar,[13] and sellers must also pay a fee to the platform.[14]

3. A buyer of discounted transferable tax credits should report a gain on the difference between the purchase price and the value of the realized credits.

Many Oregon taxpayers that bought BETCs seem not to have appreciated the CGT implications. Out of 43 reported tax audits involving BETC purchasers, 20 of the purchasers were found to have underpaid CGTs regarding the credits — a startling 53 percent failure rate.[15]

BETC-targeted audits are likely to follow given the recent negative publicity about the BETC program. As of late 2015, no such large-scale BETC-focused audit was believed

[6] *Id.*

[7] Nigel Jaquiss, "TriMet and a Portland Broker Work Around the Legislature's Rules on Selling Tax Credits to Wealthy Investors," *Willamette Week*, July 7, 2015.

[8] *Id.*

[9] Sickinger, "Energy Tax Credit Fix Could Cost Oregon Taxpayers, in Court or Out," *The Oregonian*, Dec. 6, 2015.

[10] Jones, *supra* note 2.

[11] Jaquiss, *supra* note 7 (implying that at least one public policy expert — Chuck Sheketoff, founder and executive director of the Oregon Center for Public Policy — sees that as a common possibility regarding transferable tax credits).

[12] *Available at* www.theoix.com.

[13] Emily Chasan, "Companies Cash In on Tax-Credit Arms Race," *The Wall Street Journal*, June 16, 2014.

[14] John Tozzi, "How to Sell Your Tax Credit," *Bloomberg Businessweek*, Apr. 11, 2013 (noting a commission on this platform of 2 to 5 percent depending on the size of a deal).

[15] Jones, *supra* note 5.

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to have been conducted by the Department of Revenue.[16] Presumably, audit-worthy taxpayers would be easy to identify by reviewing which taxpayers are claiming significant BETCs in any given tax year.[17]

Transferable tax credit purchasers must remember to treat transferable tax credits as they would any other asset regarding both federal[18] and state CGT laws.[19] Furthermore, although the DOR has reportedly focused on the CGT implications for BETC purchasers,[20] taxpayers should be aware that (1) for purchasers, tax authorities may assert that any gain realized is actually ordinary gain and not capital gain; and (2) for sellers, a sale of credits is taxable.[21] ✰

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[16] *Id.*

[17] Incidentally, if the DOR strictly enforced Oregon's CGT regime regarding the BETC program, it would actually benefit from deeply discounted sales of BETCs because some of the value of the credits could then be recouped via CGTs.

[18] IRC sections 1221-1223 (providing general federal rules on determining capital gains and losses).

[19] *See, e.g.*, Or. Rev. Stat. section 314.635 (explaining when some capital gains and losses are taxable by the state of Oregon).

[20] Jones, *supra* note 5.

[21] In Chief Counsel Advice 201147024, which relied in part on *Tempel v. Commissioner* (136 T.C. No. 15 (2011)), the IRS acknowledged that a taxpayer that earned transferable tax credits and sold them could treat the gain as a capital gain (with basis being zero); however, no guidance was offered with respect to whether the subsequent owner of the credits could treat any gain it realized as capital gain versus ordinary gain.

Crossword Puzzle Solution

1 W	R	2 I	G	3 H	4 T		5 I	6 N	T	7 E	R	8 N	E	9 T
A		R		10 A	M	P		O		L		E		R
11 G	R	A	12 F	T			13 G	I	L	L	E	T	T	E
E			14 I	C	O	N		S		I				N
15 S	I	16 X	T	H			17 R	E	18 A	S	19 O	N	20 E	D
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23 A	S	S	24 E	T		25 A	B	26 A	T	27 E	M	28 E	N	T
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39 C	H	40 A	F	F	E	41 T	Z		42 C	A	R	S	43 O	N
A		N		T		A		44 O	U	R		45 S	A	G
46 B	O	N	U	S	E	S		47 F	E	D			R	

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