

Historic Preservation Tax Credit Historic Preservation Credit may be
Allocated to Partners Pursuant to Agreement of Partners. (This is a GIL.)
August 31, 2021

Re: COMPANY

Dear NAME:

This is in response to your letter received June 1, 2021, in which you requested a Private Letter Ruling on behalf of the above-named taxpayer. The nature of your request and the information provided requires that we respond with a General Information Letter (GIL). A GIL is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code § 1200.120(b) and (c), which may be accessed from the Department's web site at www.tax.illinois.gov.

The facts and analysis as you have presented them are as follows:

We are writing to you on behalf of our client, COMPANY, a STATE limited liability company ("Fund"), to resolve issues with the Illinois Historic Preservation Tax Credit ("SH TC") stated below. The Illinois Historic Preservation Tax Credit Act, 35 ILCS 31/1 et seq. ("Act") which authorizes the SHTCs, became effective on January 1, 2019, and permits a tax credit against certain taxable income in an aggregate amount equal to 25% of qualified expenditures incurred by a qualified taxpayer undertaking a qualified rehabilitation plan of a qualified historic structure. The issue regarding the SHTCs and the Act involves the method of allocation of the SHTCs among partners in or members of a partnership or limited liability company which has an indirect ownership interest in the qualified taxpayer; various Illinois statutes, namely 35 ILCS 5/228 and 35 ILCS 31/10(d), provide conflicting guidance on the extent to which such allocations can be made. We are seeking guidance in the form of a Private Letter Ruling under Title 2, Section 1200.110 of the Illinois Department of Revenue Regulations to resolve the conflicting guidance. More specifically, we are requesting that for the transaction at issue, the parties be permitted to allocate the SHTCs pursuant to an alternate distribution method that does not involve allocation of the SHTCs in accordance with partnership or membership interests.

The Fund's federal identification number is ##-####-. Its address is ADDRESS and its telephone number is ###-###-####. The Fund has been organized as a STATE limited liability company under ACT, and is currently operating subject to an Amended and Restated Operating Agreement dated as of February 1, 2020 ("Fund OA", attached hereto as Exhibit A). The issue, as it applies to Fund, is not currently under investigation or audit by the Illinois Department of Revenue ("DOR") nor subject to any pending litigation, nor is Fund pursuing any protest, litigation or negotiation on the issue with DOR. There is no

case law or regulations dispositive of the request at issue. To the best knowledge of the Fund and the Fund's representative, the DOR has not previously ruled on the same or similar issue for Fund or an affiliate or predecessor of Fund. Neither Fund nor any representative of Fund has previously submitted this issue or a similar issue to the DOR. Fund requests that all Operating Agreements (as defined below) be deleted from any publicly disseminated version of a Private Letter Ruling or other ruling as may be issued by the DOR, as the Operating Agreement contain proprietary and trade secrets that could financially harm the Fund in the event of their release. To the extent that the Project Owner (as defined below) and the General Partner (as defined below) would also be required to obtain a Private Letter Ruling to resolve the issues within the Transaction (as defined below), the Transaction is such that the Fund, Project Owner, and General Partner are all the members of a "unitary group" as defined in Title 2, Section 1200.110(a)(3)(A)(ii) of the Illinois Department of Revenue Regulations wherein Fund should be permitted to file a request for a Private Letter Ruling with applicability to all such parties without such request being considered a prohibited combined transaction, as all issues in the Transaction are common to all such parties.

Statement of the Issues

The issue at hand is whether the SHTCs can be allocated by the original recipient of the SHTCs to entities holding direct and indirect partnership and membership interests in the original recipient, including but not limited to Fund, and whether Fund can further allocate the SHTCs to its members pursuant to a series of executed agreements among the partners, members or owners documenting an alternate distribution method other than allocation to partners and members in accordance with the determination of income and distributive share of income under Sections 702 and 704 and Subchapter S of the Internal Revenue Code.

Statement of the Facts and Desired Position

Under 35 ILCS 31/20(a), the State Historic Preservation Office ("SHPO"), a division within the Illinois Department of Natural Resources, is permitted to annually award an aggregate of \$15,000,000 of total SHTCs pursuant to qualified rehabilitation plans for qualified historic structures, as such terms are defined in the Act. SHPO is not permitted to award more than \$3,000,000 in HTC's with regard to a single qualified rehabilitation plan.

In connection with allocation of SHTCs in the second round of 2019, SHPO awarded up to \$3,000,000 of SHTCs to the PROJECT, located at ADDRESS (award attached hereto as "Exhibit B"). This project, also known as DEVELOPMENT, involves the rehabilitation of BUILDINGS ("Project"), with the Project to be developed, owned, and operated by BUSINESS, a STATE limited partnership ("Project Owner"). In addition to qualifying for the SHTCs, the Project Owner also received an allocation of low income housing tax credits pursuant to Internal Revenue Code ("IRC") Section 42, and the Project Owner anticipated

qualifying for federal historic rehabilitation tax credits pursuant to IRC Section 47. BUSINESS, a STATE limited liability company ("General Partner") serves as the general partner of the Project Owner and is entitled to certain allocations of profits, losses, and cash flow from the Project Owner under the AGREEMENT, dated as of DATE ("Project Owner LPA", attached hereto as "Exhibit C"). In addition, Section 4.5.15 of the Project Owner LPA provides that the Project Owner shall allocate 100% of the SHTCs to the General Partner. Under the Project Owner's Certificate of Limited Partnership filed with the Illinois Secretary of State on DATE, the Project Owner is a limited partnership for state law purposes. Under Section 11.5.2 of the Project Owner LPA, the General Partner shall not make any election that would cause the Project Owner not to be treated as a partnership for federal income tax purposes - in other words, the Project Owner will be treated as a partnership for federal income tax purposes.

The General Partner was organized under STATE law as a limited liability company pursuant to Articles of Organization filed with the STATE Secretary of State on DATE. Following the award of the SHTCs by SHPO to Project Owner to redevelop the DEVELOPMENT, the General Partner was restructured to admit Fund as a member of General Partner, with the anticipation that Fund would be allocated the SHTCs. Under the Second Amended and Restated Operating Agreement of General Partner, made and entered into as of DATE ("General Partner OA", attached hereto as "Exhibit D", together with the Fund OA and the Project Owner LPA, the "Operating Agreements"), Fund was admitted as a member of General Partner and was given a one percent (1%) membership interest in the General Partner. The Fund remains obligated to make certain capital contributions to the General Partner, and Section 5.09(v) of the General Partner OA provides that the managing member of the General Partner shall "take all steps necessary to cause [the General Partner] to allocate one hundred percent (100%) of the [SHTCs allocated by Project Owner to General Partner] to [Fund]". The General Partner OA anticipates that the General Partner will be taxed as a partnership for federal income tax purposes. Finally, Sections 3.2(b) and 4.3 of the Fund OA permit the Manager of the Fund to admit, as members into the Fund, certain end users, who will further receive allocations of the SHTCs for the use of the end users against taxes imposed by subsections (a) and (b) of Section 201 of the Illinois Income Tax Act. The transactions as described in the above two paragraphs by and among the Project, Project Owner, General Partner and Fund shall be referred to hereafter as the "Transactions".

35 ILCS 31/10(d) states as follows:

[i]f a taxpayer is....(ii) a partnership, or (iii) a limited liability company, the credit provided under this Act may be claimed by...the partners of the partnership or the members of the limited liability company in the same manner as those... partners, or members account for their proportionate shares of the income or losses of the... partnership or limited liability company. Credits granted to a partnership, a limited liability company taxed as a partnership.... shall be passed through to the partners, members or

owners respectively on a pro rata basis or *pursuant to an executed agreement among the partners, members or owners documenting any alternate distribution method*. (emphasis added).

In structuring the Transaction, the parties relied upon the language in 35 ILCS 31/10(d) that permits the passing through of SHTCs to partners, members and owners pursuant to "any alternate distribution method". As such, the SHTCs were not anticipated to be allocated to the partners of the Project Owner, the members of the General Partner, or the members of the Fund in accordance with the determination of income and distributive share of income under Sections 702 and 704 of the Internal Revenue Code. Rather, in reliance on 35 ILCS 31/10(d), the SHTCs were to be passed through from Project Owner to General Partner, from General Partner to Fund, and from Fund to certain end users each in accordance with an alternate distribution method, and each in accordance with an agreement amongst such parties. General Partner is clearly a partner in the Project Owner partnership, and Fund holds a membership interest in General Partner, making the Fund a member of General Partner, a limited liability company. Finally, end users would be admitted as members of Fund prior to any allocation of SHTC, and thus would anticipate receipt of such SHTC allocations under 35 ILCS 31/10(d).

Analysis of the Law

As noted above, 35 ILCS 31/10(d) permits credits granted to a partnership or a limited liability company taxed as a partnership to be passed through to the partners, members or owners respectively on a pro rata basis *or pursuant to an executed agreement among the partners, members or owners documenting any alternate distribution method*. (emphasis added). The plain language of this statute clearly permits the SHTCs to be allocated according to either method. However, neither the term itself nor any of the individual words in the phrase "any alternate distribution method" are defined in the Act, and there are no regulations, caselaw, or further authority on the statute. As such, to further elucidate the meaning and the intent of the legislature, we turn to other sources. In determining the plain meaning of a statutory term, it is entirely appropriate to look to the dictionary for a definition. People v. Perry, 864 N.E.2d 196, 208 (Ill. 2007). Webster's New Collegiate Dictionary ("Webster's") defines "any" as "used to indicate one selected without restriction <any child would know that>". Webster's also defines the adjective "alternate" as "constituting an alternative <took the alternate road home>". Although the word "distribution" is a noun rather than an adjective, the closest fitting definition of "distribution" in Webster's as a noun applicable here would be the definition "a device by which something is distributed." Finally, the noun "method" is defined by Webster's as "an orderly arrangement, development, or classification."

Piecing these terms together, it would stand to reason that a partnership or limited liability would be unrestricted in its selection of an "alternate distribution method." As to the phrase "alternate distribution method", the dictionary definitions

further shed light on this term to mean an "alternative" device other than passing through on a pro rata basis, so long as the device was an "orderly arrangement." The Project Owner LPA, the General Partner OA and the Fund OA each, and collectively, lay out an orderly written arrangement by which the SHTCs are allocated to the end users. In the Transaction, the Project Owner is the original recipient of the SHTCs. Section 4.5.15 of the Project Owner LPA provides that "[n]otwithstanding anything to the contrary in this Agreement, the [Project Owner] shall allocate 100% of the [SHTCs] to the General Partner...and the General Partner shall not be permitted to allocate the [SHTCs] to any other party except the [Fund]." Section 5.09(v) of the General Partner OA provides that the managing member of General Partner "shall take all steps necessary to cause the Company to cause [Project Owner]...to allocated one hundred percent (100%) of the [SHTCs] to the Company", and to further cause General Partner to allocate 100% of the SHTCs to the Fund. Finally, Section 4.3 of the Fund OA provides that the Fund shall "allocate and distribute all [SHTCs] to the End-Users pursuant to one or more Tax Credit Allocation Agreements", all of which end-users would be members of the Fund. Clearly, through separate agreements at the Project Owner level, the General Partner level, and the Fund level, there is an intent to allocate the SHTCs received by the Project Owner to a partner or member of such entity, in an orderly arrangement and plan of distribution, rather than to such partners or members in accordance with their partner or membership interests.

Nevertheless, the plain language of 35 ILCS 5/228 must be considered in light of the above. 35 ILCS 5/228 states, in full, as follows:

For tax years beginning on or after January 1, 2019 and ending on or before December 31, 2023, a taxpayer who qualifies for a credit under the Historic Preservation Tax Credit Act is entitled to a credit against the taxes imposed under subsections (a) and (b) of Section 201 of this Act as provided in that Act. If the taxpayer is a partnership or Subchapter S corporation, the credit shall be allowed to the partners or shareholders in accordance with the determination of income and distributive share of income under Sections 702 and 704 and Subchapter S of the Internal Revenue Code. If the amount of any tax credit awarded under this Section exceeds the qualified taxpayer's income tax liability for the year in which the qualified rehabilitation plan was placed in service, the excess amount may be carried forward as provided in the Historic Preservation Tax Credit Act.

35 ILCS 5/228 would seem to counteract the flexibility of 35 ILCS 31/10(d), in that 35 ILCS 3/228 only permits SHTCs to be allowed to partners and shareholders in accordance with the determination of income and distributive shares of income under Sections 702 and 704 and Subchapter S of the Internal Revenue Code ("Code"). Although Section 704(a) of the Code permits income, gain, loss, deduction and credit to be allocated in accordance with an entity's partnership agreement, 704(b) of the Code also requires that gain, loss deduction, *and credit*

shall be determined in accordance with a partner's interest in the partnership if an allocation to a partner does not have "substantial economic effect".

Under IRC Regulation Section 1.704-1(b)(2)(i), the determination of whether an allocation of income, gain, loss or deduction to a partner has "substantial economic effect" involves a two-part analysis. The first portion of the analysis is to determine if the allocation has "economic effect" (within the meaning of paragraph (b)(2)(ii) of this section). *Id.* Further examining the exceptions in paragraph 1.704-1(b)(4)(ii), as allocations of tax credits and tax credit recapture are not reflected by adjustments to the partners' capital accounts, such allocation cannot have economic effect under paragraph (b)(2)(ii)(b)(i) 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." IRC Regulation 1.704-1(b)(4)(ii). Adhering to the allocation requirements of federal credits under the 1.704(b) regulations, which would be required *a priori* under 35 ILCS 5/228, the SHTCs would have to be allocated to the partners in accordance with partnership interests as such allocations cannot have "economic effect". The mandate that SHTCs be allocated to partners in accordance with partnership interests directly conflicts with the flexible regime of 35 ILCS 31/10(d), which permits SHTCs to be allocated pursuant to an executed agreement among the partners, members or owners documenting any alternate distribution method.

As noted above, there are no regulations issued by the Illinois DOR on these conflicting statutes, nor has the discrepancy ever been the topic of case law. However, the DOR addressed the matter in a general information letter issued on April 3, 2020, IL 20-0007-GIL ("General Information Letter"). In the General Information Letter, the DOR was asked to opine on whether a member's interest in an investment fund "need only be structured so that it qualifies as a recognized owner interest" in such fund "for purposes of being able to receive allocations of [SHTCs] from the [fund] in accordance with [such fund's] operating agreement." The facts of the General Information Letter involved a project partnership wishing to allocate 100% of certain SHTCs to such fund, and the fund wishing to allocate 100% of such SHTCs to its members, not necessarily in accordance with the partner's interests in each partnership. In fact, the ultimate recipient of such SHTCs would merely qualify as holding a recognized ownership interest in the fund for state law purposes only. In the General Information Letter, the DOR addressed the discrepancy between the two statutes also at issue in the Transaction, suggesting that "under [35 ILCS 31/10(d)], a partnership may allocate the historic preservation credit to partners in the same manner partners share income or loss, *or otherwise as provided in the partnership agreement, regardless of whether the agreed upon allocation is in accordance with the partners' interests in the partnership.*" *Id.* at p. 12 (emphasis added). Furthermore, the General Information Letter explained "[35 ILCS 31/10(d)] allows partners to divide the credit pursuant to an executed agreement documenting *any* alternative distribution method." *Id.* (emphasis in original). The General Information Letter infers that the two statutes can work in tandem, in that if an executed agreement documenting an "alternative distribution method" does not exist, the default of allocating SHTCs in accordance

with a partner's share of loss or income would apply. In its final application of the statutes to the facts at hand, the General Information Letter provided that "[p]ursuant to [35 ILCS 31/10(d)]", the fund at issue and its members "may claim the respective shares of the historic preservation credit as provided in their agreement". Id. at p. 12.

Conclusion

The Transaction is nearly identical to the factual scenario present in the General Information Letter. The Project Owner desires to allocate SHTCs to the General Partner, the General Partner desires to allocate SHTCs to the Fund, and the Fund desires to allocate SHTCs to its members based upon an "alternative distribution method" memorialized by the operating agreements for such entities, but not in accordance with the partner's share of loss and income for such entity. Also similar to the makeup of the parties in the General Information Letter, each of the General Partner, Fund, and end users hold membership or partnership interests in the Project Owner, General Partner, and Fund, respectively. The General Information Letter is directly on point for the Transaction, and the conclusions reached therein should be applied to permit the parties in the Transaction to allocate the SHTCs in accordance with their alternate distribution method.

For this Transaction, we would request DOR issue a Private Letter Ruling rather than a general information letter. We are mindful that the DOR previously chose to issue only a general information letter to address the inconsistencies within the Act's provisions. However, the transaction undergirding the General Information Letter had not yet closed, triggering an argument that the transaction was not yet ripe, and such transaction involved the possibility of multiple projects delivering SHTCs. In the Transaction, all parties have executed the Operating Agreements which provide for the allocation of the SHTCs, and the SHTCs are generated from only one Project in which the Fund will indirectly invest. Providing a Private Letter Ruling specific to this Project and to the allocation of the SHTCs in this closed, ripe transaction will give the parties more comfort to mitigate structural risk and mitigate against reallocation of the SHTCs.

RULING

Section 228 of the Illinois Income Tax ("ITA" 35 ILCS 5/228) provides:

Historic preservation credit. For tax years beginning on or after January 1, 2019 and ending on or before December 31, 2023, a taxpayer who qualifies for a credit under the Historic Preservation Tax Credit Act is entitled to a credit against the taxes imposed under subsections (a) and (b) of Section 201 of this Act as provided in that Act. If the taxpayer is a partnership or Subchapter S corporation, the credit shall be allowed to the partners or shareholders in accordance with the determination of income and distributive share of income under Sections 702 and 704 and Subchapter S of the Internal Revenue Code. If the amount of any tax

credit awarded under this Section exceeds the qualified taxpayer's income tax liability for the year in which the qualified rehabilitation plan was placed in service, the excess amount may be carried forward as provided in the Historic Preservation Tax Credit Act.

Section 704(b) of the Internal Revenue Code ("IRC") provides:

(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.

Treasury Regulations Section 1.704-1(b)(4)(ii) provides, regarding a partner's distributive share of credits of the partnership:

Credits. Allocations of tax credits and tax credit recapture are not reflected by adjustments to the partners' capital accounts (except to the extent that adjustments to the adjusted tax basis of partnership section 38 property in respect of tax credits and tax credit recapture give rise to capital account adjustments under paragraph (b)(2)(iv)(j) of this section). Thus, such allocations cannot have economic effect under paragraph (b)(2)(ii)(b)(1) of this section, and the tax credits and tax credit recapture must be allocated in accordance with the partners' interests in the partnership as of the time the tax credit or credit recapture arises. With respect to the investment tax credit provided by section 38, allocations of cost or qualified investment made in accordance with paragraph (f) of § 1.46-3 and paragraph (a)(4)(iv) of § 1.48-8 shall be deemed to be made in accordance with the partners' interests in the partnership. With respect to other tax credits, if a partnership expenditure (whether or not deductible) that gives rise to a tax credit in a partnership taxable year also gives rise to valid allocations of partnership loss or deduction (or other downward capital account adjustments) for such year, then the partners' interests in the partnership with respect to such credit (or the cost giving rise thereto) shall be in the same proportion as such partners' respective distributive shares of such loss or deduction (and adjustments). See example 11 of paragraph (b)(5) of this section. Identical principles shall apply in determining the partners' interests in the partnership with respect to tax credits that arise from receipts of the partnership (whether or not taxable).

Section 10(d) of the Historic Preservation Tax Credit Act ("Credit Act") 35 ILCS 31/10(d) states:

If the taxpayer is (i) a corporation having an election in effect under Subchapter S of the federal Internal Revenue Code, (ii) a partnership, or (iii) a limited liability

company, the credit provided under this Act may be claimed by the shareholders of the corporation, the partners of the partnership, or the members of the limited liability company in the same manner as those shareholders, partners, or members account for their proportionate shares of the income or losses of the corporation, partnership, or limited liability company, or as provided in the bylaws or other executed agreement of the corporation, partnership, or limited liability company. Credits granted to a partnership, a limited liability company taxed as a partnership, or other multiple owners of property shall be passed through to the partners, members, or owners respectively on a pro rata basis or pursuant to an executed agreement among the partners, members, or owners documenting any alternate distribution method.

In order to obtain a tax credit, Section 10(b) of the Credit Act requires a taxpayer to apply with the Department of Natural Resources ("DNR"). Section 10(b) also authorizes DNR to determine the amount of rehabilitation expenditures eligible for the credit. Section 10(f) of the Credit Act allows DNR to adopt rules to implement Section 10. Section 20 of the Credit Act authorizes DNR to award not more than an aggregate of \$15,000,000 in total annual tax credits pursuant to qualified rehabilitation plans for qualified historic structures and limits awards to \$3,000,000 with regard to a single qualified rehabilitation plan. Section 25 of the Credit Act authorizes DNR to adopt rules for the administration of the Credit Act.

As indicated above, in the case of a partnership, IITA Section 228 states that the historic preservation credit is allowed to partners in accordance with sections 702 and 704 of the IRC. Under IRC Section 704(b), credits must be allocated to partners in accordance with the partners' interests in the partnership as of the time the credit arises. However, Section 10(b) of the Credit Act allows partners to claim the credit in the same manner as the partners account for their proportionate shares of the income or losses of the partnership or as otherwise provided in the partnership agreement. In addition, Section 10(b) of the Credit Act provides that in the case of multiple owners of property, including credits awarded to a partnership, credits may be divided between partners pursuant to an executed agreement documenting any alternative distribution method. Accordingly, under Section 10(b) of the Credit Act, a partnership may allocate the historic preservation credit to partners in the same manner partners share income or loss, or otherwise as provided in the partnership agreement, regardless of whether the agreed upon allocation is in accordance with the partners' interests in the partnership. In addition, Section 10(b) of the credit Act allows partners to divide the credit pursuant to an executed agreement documenting any alternative distribution method. In the absence of either a provision in the partnership agreement or an executed agreement among partners documenting an alternative distribution method, a partnership may allocate credits to partners in accordance with distributive shares of income or loss, or in accordance with the partners' interests in the partnership. Section 10(c) of the Credit Act requires the taxpayer to attach

the certificate or legal documentation of her or his proportional share of the certificate to the tax return on which the credits are claimed.

Your letter indicates that in the second round of 2019, DNR awarded up to \$3,000,000 of State Historic Tax Credits ("SHTCs") to the Project. The Project was to be developed, owned and operated by the Project Owner, an Illinois limited partnership. Pursuant to the Project Owner LPA, the Project Owner is required to allocate 100% of the SHTCs to the General Partner, an STATE limited liability company. According to the Operating Agreements, your client, the Fund, was admitted as a member of the General Partner. Pursuant to the General Partner OA, the General partner shall take all steps necessary to cause the General Partner to allocate one hundred percent (100%) of the SHTCs allocated by the Project Owner to the General Partner to the Fund. The Fund OA permits the Manager of the Fund to admit, as members into the Fund, certain end users, who will further receive allocations of the SHTCs.

The Project Owner desires to allocate SHTCs to the General Partner, the General Partner desires to allocate SHTCs to the Fund, and the Fund desires to allocate SHTCs to its members based upon an "alternative distribution method" memorialized by the operating agreements for such entities, but not in accordance with the partner's share of loss and income for such entity. Pursuant to Section 10(d) of the Credit Act, the Fund and its members may claim the respective shares of the historic preservation credit awarded by DNR as provided in their operating agreements. Pursuant to Section 10(c) of the Credit Act, each partner should attach to the partner's tax return claiming the credit a copy of their executed agreement documenting the partner's proportional share of the credit certificate. In no event may a partner claim an amount of credit exceeding the partner's agreed upon share, nor may the aggregate credits claimed by the partners exceed the amount of credit awarded by DNR.

As stated above, this is a GIL. A GIL does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you have questions regarding this GIL you may contact Legal Services at (217) 782-72844. If you have further questions related to Illinois income tax laws, visit our website at www.revenue.state.il.us or contact the Department's Taxpayer Information Division at (217) 782-3336.

Sincerely,

Michael D. Mankowski
Associate Counsel - Income Tax

bc: Daily File
Correspondence File:

