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Alert | State & Local Tax

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Refundable State Tax Credits: Maybe Don't Take the Money and Run

On April 25, 2019, the United States Court of Appeals for the Federal Circuit decided that refundable state tax brownfield credits are taxable income for federal purposes. The court held in *Ginsburg v. United States*, "The excess amount of the brownfield redevelopment tax credit received by the Ginsburgs in 2013 is taxable gross income because it is an undeniable accession to wealth over which the Ginsburgs have complete dominion and control."

The case dealt with New York's brownfield credits that may be used to reduce a taxpayer's state tax obligations and, if there are excess credits beyond the state tax liabilities, can be refunded to the taxpayer. The court's decision makes that refunded credit subject to federal tax. The taxpayers argued that the brownfield redevelopment tax credit "is a reimbursement of a portion of the capital costs," i.e., costs relating to investments made by them for the cleanup and redevelopment of the property. Accordingly, the Ginsburgs claimed they "neither realized an undeniable accession to wealth nor an economic gain" because the payment was a reimbursement of expenses. They also argued they do not have complete dominion and control over the tax credits because there were many strings attached. The court was not persuaded and found that the Ginsburgs neither alleged a payment was made to New York nor explained why the payment of the excess amount of the brownfield redevelopment tax credit was a return of their basis to restore impaired capital.

While the holding in this case is not extraordinary, it has implications for taxpayers facing a choice to take the brownfield and similar credits as a reduction of state and local taxes or getting cash by electing the refundable credit. There are many tax credits providing for refundability in many states, including film tax credits, historic renovation credits, and various economic development incentives and tax credits. Even before the Ginsburg case, a taxpayer who sold state tax credits had income subject to federal tax.

Before the Tax Cuts and Jobs Act of 2017 (TCJA), the difference between taking the credit against state and local tax (SALT) liabilities or electing to make such a credit refundable was minimal. Taking the cash would make the cash subject to federal tax, and taking the credit to reduce the SALT obligation would reduce the SALT deduction on a federal tax return, making the result of the choice equivalent – get taxed on the income or reduce your deductions. However, the TCJA placed a limit of $10,000 on the deductibility of SALT for individual taxpayers. This alters the financial effect, making it more desirable for those subject to the federal SALT limitations to reduce their nondeductible SALT liabilities rather than take a refundable credit in cash that would be subject to federal tax.

For example, if a taxpayer has a refundable tax credit of $100,000 and takes the cash, there would be federal income tax due at the rate of 21% for a corporation or up to 37% for an individual for 2019. Using that same credit to reduce SALT obligations beyond the $10,000 annual limit eliminates the federal income tax on the refund and reduces the nondeductible SALT liabilities, providing a greater net tax benefit.

Of course, if the individual or entity expects to have little or no SALT liabilities over time due to losses or for other reasons, taking a credit would be worthless, and electing to take the refundable credit would make economic sense even if the credit is subject to federal tax. A careful and thorough examination of projections of income and forecasts of tax liability are essential to the effort of maximizing the benefits of these tax credit programs.

Greenberg Traurig's SALT practitioners are available to help with the analysis and help you get the most out of these programs.

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