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# Tax Credit Sale Favorably Taxed

Paying long term capital gain tax of 15% is a lot better than paying ordinary income tax of 35%. That's why what is capital gain is one of the biggest controversies in tax law. See Litigation Settlements: Are They Ordinary Income or Capital Gain. The IRS and taxpayers have opposing incentives. If you have gain, ***you*** want it to be capital. The IRS wants it to be ordinary. If you have a loss, ***you*** want it to be ordinary. The IRS wants it to be capital.

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Such are the push-me-pull-you issues tax lawyers address. Yet occasionally the IRS says flatly that something ***does*** qualify for capital gain. That's just what the IRS said recently about the sale of tax credits. Yup, they qualify for long-term capital gain treatment. See IRS Chief Counsel Advice 201147024.

These are only state tax credits, not federal. They included these Massachusetts state tax credits:

- Brownfields Tax Credit;
- Motion Picture Tax Credit;
- Historic Rehabilitation Tax Credit;

- Low-Income Housing Tax Credit; and
- Medical Device Tax Credit.

They are transferrable credits, so there was nothing untoward here. The taxpayer with the credits could transfer them to someone else who could use them. The IRS Chief Counsel says the sale of state tax credits is taxable but is capital gain.

A capital asset is defined as property held by the taxpayer, whether or not connected with his trade or business, unless the property is one of eight statutory exclusions for capital assets in Code Section 1221(a) (for example, inventory). The Supreme Court has said "capital asset" should be narrowly construed. See *Commissioner v. Gillette Motor Transport Inc*. These were assets and they weren't on the exclusion list so qualified.

In fact, the U.S. Tax Court has held state tax credits qualify. A taxpayer with nonrefundable state tax credits realizes capital gain on the sale of the credits. See *Tempel v. Commissioner* and *McNeil v. Commissioner*. The fact that these state tax credits were transferable doesn't change anything.

If you transfer a tax credit for value, you must recognize gain because the transaction was a sale. Since the original recipient did not purchase the tax credit, he generally had no tax cost basis in the tax credit.

For more, see:

Don't Look For (Tax) Shelter Under Wells Fargo Wagon

Don't Fail To Consider Taxes When Settling Litigation

Selling Your Business? Taxes Are Key

Tax Tips For Selling Your Home

Capital Gain: Three-Year or Six-Year Statute of Limitations?

IRS Tax Topics – Topic 409 Capital Gains and Losses

IRS: Ten Important Facts About Capital Gains and Losses

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