Transferability of Tax Credits

Preserving the Energy Efficient Residential Tax Credit

The following thoughts are for your consideration as you study the various bills that propose to end certain tax credits and/or to end the transferability of tax credits.

* The general purpose behind giving a tax credit is the legislature recognizing a certain **need exists** in the economy and then **incentivizing an action** so that the need is met. Consider the following example.
  + In 2006 the legislature determined the need to incentivize the building of high performance energy efficient homes to assist workforce housing - those in the median income category. Energy costs were on the rise and the need for building electrical power plants were contemplated. High performance energy efficient homes would create tremendous energy savings, leaving more disposable income in the pocketbooks of the consumers.
  + The credit was extended only to those homes that met a strict performance standard and was two thousand (2000) square feet or less.
  + To qualify, this tax credit *required* third-party verification from a Home Energy Rating System (HERS) rater. Those in the industry understood this meant
    - *Verification* by the HERS rater of the plans before building
    - *Inspect* the home before the sheetrock stage
    - *Testing* of the home upon completion.
  + The newly constructed home had to achieve the designated performance level defined in the law to qualify for the credit.
  + This credit meets the criteria as outlined in the Attorney General’s opinion:
    - Public purpose – eliminating or reducing the need for more power generating plants benefits all utility customers. In fact, utility companies are working with the Corporation Commission to lower the demand for electric generation.
    - Safety – this tax credit is only available post construction and after third-party verification.
* Once a tax credit is authorized (passed by the legislature and signed into law by the governor) and the action that was incentivized took place, *then the State is obligated* to give the credit. Again, let’s summarize – need, incentive, action, then obligation.
* The tax credit becomes an asset of the company. They have **met the need** as conditioned by the legislature. What then are the options of the company, the holder of the tax credits?
  + They use the tax credits to offset any tax liability incurred by the operation of their business.
  + They hold the tax credits to offset future liability
  + They can transfer the tax credit to someone with tax liability in exchange for funds (cash flow) to assist in the operation of their business.
    - This is no different than selling any other asset of a business.
* The question that needs to be asked is this – does the State incur more or less liability through the transfer of tax credits?
* The answer is no. The State incentivized an action to meet a need. The need was met according to the requirements set forth. The State incurred a liability. If the liability, the tax credit, is transferred from Party A to Party B, it is still the same as far as the State is concerned.
* The historical problem of transferability was when the legislature authorized a credit prior to any action being taken – e.g., Great Plains Airlines.
* There is a tax effect on tax credit transferability
  + The **transferor** of the tax credit pays Oklahoma income tax on the cash proceeds from the sale of the credit.
    - Using an example of a $100,000 sale of tax credits, the transferor would pay between $5,000 and $6,000 of Oklahoma income tax on the transfer depending on their tax structure
  + The **transferee** receiving the tax credit pays Oklahoma income tax on the gain associated with the transfer
    - Using the example of $100,000 of tax credits sold to the transferee for $80,000, this would result in Oklahoma income tax of approximately $1,100 based on the $20,000 of income
  + This is not a free credit. Taxes are paid to Oklahoma based on the transfer
* Governor Fallin’s recent Energy Plan emphasizes the need for energy efficient single-family residences and is supportive of preserving the existing tax incentives in this effort.
* High performance energy efficient homes will continue to enhance the economic development efforts of enticing companies looking to relocate to our great state.

We submit that transferability is not the evil that some would make it out to be. The overarching question that needs to be decided by the legislature, without demagoguery, is whether there are legitimate needs that need to be incentivized. If so, then the wisdom of the legislature is how best to incentivize an action. It may reason that a tax credit is the best response. If it does, then such credits should be transferable.

If one Googles tax transferability, one will see that it is a very successful tool in economic development. Is the lack of this tool, if the Oklahoma legislature decides to quit using, going to come back and haunt our economic development efforts in the future?