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Recent amendments to Illinois' Historic Preservation Tax Credit Program provide clarity for investors

The Illinois Historic Preservation Tax Credit Program is administered by the Illinois State Historic Preservation Office in the Illinois Department of Natural Resources. This program provides a state income tax credit (the "IL-HTC") equal to 25% of a project's qualified rehabilitation expenditures – not to exceed $3 million per project – to owners of certified historic structures who undertake certified rehabilitations. The IL-HTC can be claimed to offset income tax imposed on individuals, corporations, and trusts and estates.

Developers often look to sell historic tax credits earned during the rehabilitation of a historic structure as a source of financing for the project. However, the IL-HTC is not freely transferable between unrelated parties.

Many state tax credit programs that award non-transferable state tax credits allow a developer partnership to "disproportionately allocate" the credits to its partners. This allows investors to purchase a small ownership interest (e.g., 1% or .01%) in the development partnership, and in return, the investor could negotiate to receive an allocation of up to 100% of the state tax credits.

Until recently, the IL-HTC statutes have been unclear as to whether the IL-HTC could be disproportionately allocated to investors in IL-HTC partnerships.

Specifically, 35 ILCS 31/10(d) provides that:

"[IL-HTCs] 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***" (emphasis added).

This language suggests that the IL-HTC could be disproportionately allocated to the owners of a pass-through entity if the disproportionate allocation is agreed to in the pass-through entity's operating agreement.

On the other hand, until recently, 35 ILCS 5/228 provided that:

"If the taxpayer is a partnership or Subchapter S corporation, the [IL-HTC] 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" (emphasis added).

This language suggests that IL-HTCs awarded to a pass-through entity could only be allocated to the owners of the pass-through entity according to their ownership percentages. This would effectively prevent an investor who owns a small ownership interest from receiving an allocation of IL-HTCs in excess of that small ownership interest (i.e., the owner of a 1% ownership interest could only receive an allocation of 1% of the IL-HTCs).

Thus, 35 ILCS 31/10(d) and 35 ILCS 5/228 appeared inconsistent as to whether an investor in a pass-through entity could receive a disproportionate allocation of IL-HTCs.

Effective May 6, 2022, the Illinois legislature sought to resolve this inconsistency in favor of flexibility, by revising 35 ILCS 5/228 to state the following, which is consistent with the language in 35 ILCS 31/10(d):

“If the taxpayer is a partnership, Subchapter S corporation, or a limited liability company the [IL-HTC] shall be allowed to the partners, shareholders, or 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 ***provided that 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***” (emphasis added).

Accordingly, the Illinois legislature has removed the inconsistencies between these statutes and clarified that IL-HTCs can be disproportionately allocated pursuant to the terms of an agreement among the partners, members, or owners of a pass-through entity. This should provide additional comfort to investors looking to receive a disproportionate allocation of IL-HTCs from development partnerships.

For further guidance on the recent changes to the IL-HTC program, or about how to invest in the IL-HTC program, contact Garrett Fischer or Janette Lohman, state and local tax partners at Thompson Coburn LLP.

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