

Record Nos. 10-1333(L), 10-1334, 10-1336

In the United States Court of Appeals for the Fourth Circuit

VIRGINIA HISTORIC TAX CREDIT FUND 2001, LLC, Tax Matters Partner of
Virginia Historic Tax Credit Fund 2001, LP, *Petitioner-Appellee*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent-Appellant,*

VIRGINIA HISTORIC TAX CREDIT FUND 2001, LLC, Tax Matters Partner of
Virginia Historic Tax Credit Fund 2001, SCP, LLC, *Petitioner-Appellee*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent-Appellant,*

VIRGINIA HISTORIC TAX CREDIT FUND 2001, LLC, Tax Matters Partner of
Virginia Historic Tax Credit Fund 2001, SCP, LLC, *Petitioner-Appellee*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent-Appellant,*

On Appeal from the United States Tax Court

**AMICUS BRIEF OF THE COMMONWEALTH OF VIRGINIA
IN SUPPORT OF VIRGINIA HISTORIC TAX CREDIT FUND 2001**

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July 30, 2010

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT
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Nos. 10-1333(L), 10-1334, 10-1336 Caption: Virginia Historic Tax Credit Fund 2001 et al. v. Commissioner of Internal Revenue

Pursuant to FRAP 26.1 and Local Rule 26.1,

Commonwealth of Virginia who is Amicus, makes the following disclosure:
(name of party/amicus) (appellant/appellee/amicus)

1. Is party/amicus a publicly held corporation or other publicly held entity? YES NO
2. Does party/amicus have any parent corporations? YES NO
If yes, identify all parent corporations, including grandparent and great-grandparent corporations:
3. Is 10% or more of the stock of a party/amicus owned by a publicly held corporation or other publicly held entity? YES NO
If yes, identify all such owners:
4. Is there any other publicly held corporation or other publicly held entity that has a direct financial interest in the outcome of the litigation (Local Rule 26.1(b))? YES NO
If yes, identify entity and nature of interest:
5. Is party a trade association? (amici curiae do not complete this question) YES NO
If yes, identify any publicly held member whose stock or equity value could be affected substantially by the outcome of the proceeding or whose claims the trade association is pursuing in a representative capacity, or state that there is no such member:
6. Does this case arise out of a bankruptcy proceeding? YES NO
If yes, identify any trustee and the members of any creditors' committee:

/s/ Stephen R. McCullough
(signature)

July 30, 2010
(date)

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BRIEF OF THE COMMONWEALTH AS AMICUS CURIAE

The Attorney General of the Commonwealth of Virginia, Kenneth T. Cuccinelli, II, pursuant to Rule 29(a) of the Rules of this Court, on behalf of the Commonwealth of Virginia as *amicus curiae*, submits this Amicus Brief.

INTEREST OF AMICUS

Virginia is justly proud of its long and rich history. That history includes many architecturally significant buildings. In enacting Virginia Code § 58.1-339.2, the Virginia General Assembly sought to ensure these historical structures would be preserved for the benefit of future generations. Virginia files this brief under Rule 29(a) of this Court in support of the petitioners/appellees. While Virginia agrees with the arguments made by the Partnership, Virginia writes separately to provide the Court with the Commonwealth's perspective on the tax credit at issue. Because the IRS position would significantly undermine the effectiveness of this important program, Virginia urges the Court to affirm the judgment of the Tax Court.

SUMMARY OF THE ARGUMENT

Virginia makes two fundamental points in this brief. The first is the importance of this program to the Commonwealth. The Virginia General Assembly provided a program of tax credits to protect and preserve historically significant buildings. Without these tax credits, many of these structures would fall into disrepair or be demolished because the cost of renovating these buildings often exceeds their post-renovation market value. The General Assembly expressly contemplated that partnerships like the one at issue here would be formed to attract capital for the purpose of historic preservation. The IRS's aggressive position threatens the effectiveness of the program and its benefits for all Virginians. Those benefits stretch beyond simply preserving buildings. The tax credit program is an important contributor toward urban revitalization and tourism, and it provides jobs.

Second, a partnership that harnesses the availability of tax credits to attract beneficial investment does not lack a valid business purpose. Fostering an objective that both the United States Congress and the General Assembly of Virginia have embraced should not be suspect in

the eyes of the law. Finally, considerations of comity and federalism support the decision of the Tax Court.

ARGUMENT

I. VIRGINIA HAS BENEFITTED GREATLY FROM HISTORIC REHABILITATION TAX CREDITS.

A. Virginia is home to many architectural treasures.

In 2007, Virginia celebrated its 400-year anniversary. The events that occurred throughout the Old Dominion that year showcased for an international audience the many historically significant buildings and sites in the Commonwealth. The Virginia Landmarks Register, a program managed by the Virginia Department of Historic Resources to officially recognize state landmarks, and the National Register of Historic Places, established and managed by the United States Park Service to officially recognize the nation's historic sites, designate more than 2700 properties as historically significant and worthy of public attention and preservation.¹ Although many of the Virginia landmark buildings are well cared for, many others are in danger of being lost.

¹ <http://www.dhr.virginia.gov/register/register.htm>. The complete list can be found at <http://www.dhr.virginia.gov/register/RegisterMasterList.pdf>. The National Register currently lists 2731 properties and the Virginia Landmarks Register lists 2829 properties.

The problem is that, as the Tax Court noted, the cost of rehabilitation often exceeds the post-rehabilitation fair market value of the structures. Without an incentive to preserve these buildings, many of them would decay or be demolished.

B. Virginia has created a flexible tax incentive to preserve historic structures.

As many other States have done,² the Virginia General Assembly enacted a program (“the Program”) to provide an incentive for the preservation and restoration of historic buildings. Virginia Code § 58.1-339.2 permits individuals and businesses seeking to rehabilitate historic structures to receive tax credits against their state taxes. These credits, which are offset from the state income tax of an individual or business, can constitute up to 25 percent of the costs associated with the restoration. *Id.*

The credits are not easily obtained, however. Developers must follow specific guidelines and procedures. A “certified historic

² A report prepared by Virginia Commonwealth University’s Center for Public Policy discusses some of these programs. *See An Economic Analysis of Virginia’s Historic Rehabilitation Tax Credit Program* 5-20 (2007) (reviewing the research regarding the impact of historic rehabilitation tax credit programs in other States) (hereafter “VCU Report”). *See* Trial Exh. 13p.

structure” is one that is either (1) “listed individually on the Virginia Landmarks Register;” (2) “certified by the Director of the Virginia Department of Historic Resources as contributing to the historic significance of a historic district that is listed on the Virginia Landmarks Register;” or (3) “certified by the Director of the Virginia Department of Historic Resources as meeting the criteria for individual listing on the Virginia Landmarks Register.” Virginia Code § 58.1-339.2(D). Some projects also qualify for a 20 percent federal income tax credit. 26 U.S.C. § 47(a)(2).

The Virginia General Assembly contemplated that partnerships and corporations would benefit from these tax credits by providing that

[c]redits granted to a partnership or electing small business corporation (S corporation) shall be passed through to the partners or shareholders, respectively. Credits granted to a partnership or electing small business corporation (S corporation) shall be allocated among all partners or shareholders, respectively, either in proportion to their ownership interest in such entity or as the partners or shareholders mutually agree as provided in an executed document.

Virginia Code § 58.1-339.2(A).

Because the cost of rehabilitating historic structures often exceeds the fair market value of the structures, conventional lenders often are

unwilling to finance the entire cost of the rehabilitation. Tr. 204, 331-32-357. The tax credits fill an important “gap” between what conventional lenders are willing to finance and the costs of the rehabilitation project.

- C. The tax credit program has proven successful in preserving historically significant structures and in providing other benefits.

The benefit to Virginia is not simply restoring or preserving existing structures. Historic “restorations have many benefits for the Commonwealth. They preserve our history, showcase building methods that are no longer used, help beautify older residential areas, and increase property values.” VCU Report at i. Restoration projects also foster urban revitalization and tourism. Restoration projects are particularly significant in urban areas because they can serve as a catalyst for attracting new residents and business activity to a struggling neighborhood. Finally, restoration projects require fewer new materials and rely on existing developed land and infrastructure. Therefore, these projects reduce pressure on landfills and minimize the need to expend resources on new infrastructure. See Stipulation of Facts ¶ 23 (detailing the benefits of the tax credit program).

The Program also “generates significant economic activity.” *Id.*

Rehabilitation expenditures of \$1.74 billion supported an estimated 5,804 jobs (“direct employment”) within Virginia during this 13-year period . . . This included both full-time and part-time jobs. The economic activity associated with this level of employment supported 7,083 additional jobs in other sectors of the economy and generated a total economic impact to Virginia of \$1.91 billion. This economic impact included \$771 million of value added for the region, and was responsible for \$531 million of labor income (wages and benefits).

2010 Update, VCU report at 4.

Most of these benefits would not occur without the program.

Nearly all of the respondents to a survey conducted by VCU stated that the tax credits were either “very important” (67 percent) or “somewhat important” (26 percent) in their decision to rehabilitate the property.

Id.

II. RESPECT FOR THE POLICY GOALS OF STATE AND FEDERAL GOVERNMENTS COUNSELS AGAINST ADVERSE TAX TREATMENT OF PARTNERSHIPS WHEN THAT ADVERSE TREATMENT WOULD THWART IMPORTANT PUBLIC POLICY GOALS.

A. A Partnership that advances the legislative goals of the State and federal governments does not lack a valid business purpose.

Throughout this case, the IRS perplexingly has attacked the legitimacy of the Partnerships, claiming that they lack a valid business

purpose. The IRS originally complained that the Partnerships constituted an abusive tax shelter, an argument it later expressly abandoned. The IRS still complains that the partnerships were “marketed to the investors as a means to reduce their Virginia income tax liability.” IRS Br. at 38. It is not clear why this should count against the Partnerships.

It should not be surprising that in attracting partners to the Partnerships the marketing should highlight the benefits of the tax credit. It is precisely “because investment in historic preservation generally would not otherwise be made due to low profitability” that the State had to provide tax incentives to generate investment. Tax Ct. Op. 33. Furthermore, “tax credits issued to the owner of a historic property often exceed the owner’s State tax liabilities.” *Id.* at 5. Therefore, “[t]he Virginia program includes a partnership allocation provision that allows owners to use their excess credits to attract capital contributions from other entities or individuals.” *Id.* This includes capital contributions from partnerships, who can then allocate the tax credits among all partners as they see fit. *Id.* at 5-6.

The economic gain offered to investors through the state tax incentive program does not undermine the validity of the partnerships. To hold otherwise would be to diminish the effectiveness of tax programs established to accomplish beneficial ends. The Ninth Circuit observed in *Sacks v. Commissioner*, 69 F.3d 982 (9th Cir. 1995), in the context of assessing tax deductions, that

A tax advantage such as Congress awarded for alternative energy investments is intended to induce investments which otherwise would not have been made . . . If the Commissioner were permitted to deny tax benefits when the investments would not have been made but for the tax advantages, then only those investments would be made which would have been made without the Congressional decision to favor them. The tax credits were intended to generate investments . . . that would not otherwise be made because of their low profitability. Yet the Commissioner in this case at bar proposes to use the reason Congress created the tax benefits as a ground for denying them.

Id. at 992 (internal citations omitted). *Cf. Helvering v. Bliss*, 293 U.S. 144, 151 (1934) (when legislative bodies reduce the rate of tax from “motives of public policy,” as occurred here, such provisions “are not to be narrowly construed”).

Indeed, the IRS itself recognized in a past ruling that endeavors involving tax incentives should be held to a different profit-motive

standard. See Rev. Rul. 79-300, 1979-2 C.B. 112 (addressing low-income housing credits). Thus the economic incentive in the scenario here and the ruling fulfill the role of the private gains sought by private investors. The situation here does not resemble the situation in *Commissioner v. Culbertson*, 337 U.S. 733 (1949) (family cattle business attempting to use partnership form to artificially shield income from taxation); or *Commissioner v. Tower*, 327 U.S. 280 (1946) (manufacturing concern seeking to shield income through artificial use of partnership form).

Far from a sinister, aggressive manipulation of the tax code, Virginia specifically contemplated that parties would make arrangements of the sort at issue. No adverse inference should be drawn from the fact that the Partnerships were designed to take advantage of tax credits. Those tax credits were enacted to foster a beneficial purpose and harnessing them does not render a partnership suspect.

B. Federalism and comity support the conclusion of the Tax Court.

When a partnership takes advantage of tax credits as the legislature intended, and in so doing advances an important public

policy objective, principles of federalism counsel in favor of protecting the effectiveness of a governmental objective. The Court's point in *Younger v. Harris*, 401 U.S. 37 (1971), although made in a different context, bears mentioning:

the notion of 'comity,' that is, a proper respect for state functions, a recognition of the fact that the entire country is made up of a Union of separate state governments, and a continuance of the belief that the National Government will fare best if the States and their institutions are left free to perform their separate functions in their separate ways. This, perhaps for lack of a better and clearer way to describe it, is referred to by many as 'Our Federalism,' and one familiar with the profound debates that ushered our Federal Constitution into existence is bound to respect those who remain loyal to the ideals and dreams of 'Our Federalism.' The concept does not mean blind deference to 'States' Rights' any more than it means centralization of control over every important issue in our National Government and its Courts ... What the concept does represent is a system in which there is sensitivity to the legitimate interests of both State and National Governments, and in which the National Government, anxious though it may be to vindicate and protect federal rights and federal interests, always endeavors to do so in ways that will not unduly interfere with the legitimate activities of the States.

Id. at 44-45.

It also should be noted that the "legitimate activity of the State[]" at issue here, namely, encouraging investment in historic preservation, is not only a policy of Virginia, but also is a policy objective of Congress. Congress stated in the National Historic Preservation Act of 1966 that:

It shall be the policy of the Federal Government, in cooperation with other nations and in partnership with the States, local governments, Indian tribes, and private organizations and individuals to ...

(4) contribute to the preservation of nonfederally owned prehistoric and historic resources and give maximum encouragement to organizations and individuals undertaking preservation by private means; and ...

(6) assist State and local governments ... to expand and accelerate the historic preservation programs and activities.

16 U.S.C. § 470-1 (emphasis added).

As the Tax Court found, many smaller historic renovation projects had difficulty obtaining financial support. Tax Ct. Op. at 10. The Virginia Historic Tax Credit Fund 2001 was started to fill that gap. *Id.* at 11. The Director of the Department of Historic Resources and the President of the National Trust Community Investment Corporation both testified that the investors in these partnerships “were critical partners in the success of the developer partnerships and the Virginia program.” *Id.* at 29. A ruling against the Partnerships would needlessly damage the policy objectives of the Virginia General Assembly and of the United States Congress.

CONCLUSION

For the reasons stated above, the judgment of the tax court should be **AFFIRMED**.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE WITH RULE 32(A)

1. This brief has been prepared using fourteen point, proportionally spaced, serif typeface: Microsoft Word 2007, Century Schoolbook, 14 point.

2. Exclusive of the disclosure statement, table of contents, table of citations and the certificate of service, this brief contains 2,433 words.

/s/ Stephen R. McCullough
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CERTIFICATE OF SERVICE

I hereby certify that on this 30th day of July, 2010, this Amicus Brief of the Commonwealth of Virginia was electronically filed with the Clerk of Court using the CM/ECF system, which will send notice of such filing to the following attorneys, who are registered CM/ECF users:

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