

PLR 201024036 (June, 2010). Emission Credits are Like-Kind

This ruling holds that Parent corporation of consolidated group can acquire Sub's emission reduction credits for nitrous oxide (NOx) and then exchange them under Section 1031 for volatile organic chemical compounds (VOCs) credits.

These credits are used by the holder to "offset" emissions that would otherwise exceed permitted levels. Each credit is a grant to the holder of the right to emit a specified amount of the pollutant per year for an indefinite period of time. Credits may be transferred temporarily or permanently. Apart from the underlying pollutant, the terms and conditions of the two types of credits are identical. NOx credits may be used to offset VOCs emissions and VOCs credits may be used to offset NOx emissions, as long as the holder of the credits demonstrates that such use of the credits will not cause or contribute to a violation of state or federal air quality standards.

Sub holds NOx credits in excess of its needs, while Parent needs VOCs credits. Therefore, Sub will make a distribution of its NOx credits to Parent, and Parent will exchange the NOx credits for VOCs credits held by unrelated third parties.

The ruling first cites Rev. Proc. 92-91, 1992-2 C.B. 503, section 3, Q&A 5, which provides that emission allowances are treated as like-kind property for purposes of § 1031. It then goes on to analyze the like-kind standard with respect to these particular credits. It notes that NOx credits and VOCs credits are government licenses or permits and constitute intangible personal property for federal income tax purposes. The terms and conditions of the credits are identical. Thus, the nature and character of the rights involved are the same. Although NOx and VOCs are different chemical compounds, they are both ozone-causing pollutants, and controlling ozone is the primary purpose of the credits. As such, the differences between the two chemical compounds, insofar as they relate to the credits and the purposes for issuing the credits, should be regarded as differences in grade or quality, not nature or character. As evidence that they are of the same nature or character, the credits are interchangeable when certain conditions are met. Furthermore, both NOx and VOCs are emitted in the same process. NOx credits are more valuable than VOCs credits because of their relative scarcity, but this indicates a difference in grades or quality between the two types of credits but not of their nature or character.

Sub's gain under § 311(b) on the excess of the fair market value of the NOx credits over Sub's basis in the credits is not be taken into account upon the distribution of the NOx credits to Parent, but will be taken into account under the matching rules of § 1.1502-13(c). Surprisingly, the ruling does not analyze the qualified use issues presented by the distribution of the credits from the Sub to the Parent immediately before the exchange. It simply states that Parent is considered to have, prior to the exchange, held the NOx credits for productive use in its trade or business. This may be due to the matching rule, which includes tacking of tax attributes between the consolidated group.