



# Legal ALERT!

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## Federal Review of Income Received as a Refund of Empire Zone Tax Credits

The Department of Treasury Internal Revenue Service ("IRS") is instituting what appears to be a new initiative to review federal tax returns filed by taxpayers who claimed empire zone tax credits on their corresponding New York State tax returns for tax years 2007 through 2009. This initiative is an effort to determine whether or not taxpayers who received refunds of empire zone tax credits claimed those refunds as federal taxable income.

The IRS clarified in a Chief Counsel Advisory Memorandum dated September 23, 2008, that the portion of the Empire Zone tax credit that is refundable to a taxpayer is income in accordance with the tax benefit rule. An accrual taxpayer would claim any requested refund of empire zone tax credits (as opposed to credits used to reduce tax liability) as income in the same tax year as its state filing. A cash basis taxpayer would claim the refund as income in the year in which the refund was actually received.

The IRS has sent a letter to all taxpayers that have claimed empire zone tax credits on their New York State tax returns. The letter requires a response by August 15, 2010, either in the form of an affirmative statement that all refunds were treated as income on federal tax returns or the submission of amended federal tax returns. It appears that additional tax due will be subject to interest, but not penalties if an amended return is filed by August 15, 2010.

*If you have any questions regarding the federal tax treatment of refunds of empire zone tax credits or the IRS' initiative on this topic, please contact the Hiscock & Barclay lawyer with whom you normally work or any attorney in our Economic & Project Development or Tax practice area.*