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TESTING THE REACH OF UCC ARTICLE 9: THE QUESTION OF TAX CREDIT COLLATERAL IN SECURED TRANSACTIONS

Christopher K. Odinet*

I. INTRODUCTION

Whether you are a small start-up business taking out your first loan or a large and sophisticated commercial borrower looking to engage in a complex transaction, you can generally expect to be required to post a certain level of security to the lender for their loans.[1] While many lenders may be more willing to advance unsecured funds to borrowers who have valuable assets and large amounts of liquid capital than to a start-up company with few assets and little to no profits, most borrowers will nonetheless be required to provide some level of

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1. *See* WILLIAM D. WARREN & STEVEN D. WALT, SECURED TRANSACTIONS IN PERSONAL PROPERTY 1–2 (8th ed. 2011).

collateral to secure their borrowed funds.[2] The prudent lender wants to reduce the risk that the borrower will default and fail to repay the loan.[3] In the event the borrower defaults, the lender wants to know that something of value—preferably equal to or greater than the value of the loan itself—can be quickly converted into cash to satisfy the debt.[4] Thus, the availability of credit and the borrower's ability to post collateral have gone hand in hand since lending's earliest origins.[5] In the financing world, what you get depends in large part on what you can give.

As the history of secured financing goes, the most traditional form of collateral was real property.[6] Borrowers would receive funds and, in exchange, grant a security interest in their land.[7] This would typically come in the form of a conventional mortgage.[8] Alternatively, or along with the mortgage, some

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2. *See, e.g.*, *id.* at 1 (explaining that unsecured loans are most often obtained by large publicly-traded companies on the basis of projected cash flow and creditworthiness); BENTON E. GUP & JAMES W. KOLARI, COMMERCIAL BANKING: THE MANAGEMENT OF RISK 260–63 (3d ed. 2005) (discussing the use of collateral by lenders to reduce risk, especially with respect to small businesses with lower creditworthiness).

3. *See, e.g.*, SANDRA SCHNITZER STERN, STRUCTURING COMMERCIAL LOAN AGREEMENTS ¶ 5.01, at 5-3 to 5-4 (2d ed. 1990) (discussing the use of negative covenants in loan agreements to restrict borrowers' activities); Carl S. Bjerre, *Secured Transactions Inside Out: Negative Pledge Covenants, Property and Perfection*, 84 CORNELL L. REV. 305, 306–08 (1999) (discussing the use of negative pledge covenants as a tool of unsecured lenders to minimize the risk of borrower default); George G. Triantis, *Secured Debt Under Conditions of Imperfect Information*, 21 J. LEGAL STUD. 225, 235–36 (1992) (discussing the concern of lenders over the devaluation of existing debt due to the issuance of a subsequent debt of equal or higher priority).

4. *See, e.g.*, Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L.J. 857, 879 (1996) (describing how the use of covenants can be as effective, if not more effective, than a security interest by preventing the encumbrance of assets); Clifford W. Smith, Jr. & Jerold B. Warner, *On Financial Contracting: An Analysis of Bond Covenants*, 7 J. FIN. ECON. 117, 118 (1979) (examining ways to write debt contracts that lessen the conflict between stockholders and bondholders created when management attempts to maximize the value of the stockholders' equity claim to the detriment of bondholders).

5. *See* George Lee Flint, Jr., *Secured Transactions History: The Fraudulent Myth*, 29 N.M. L. REV. 363, 365 (1999) (chronicling the history of secured transactions); *see also* RICHARD E. SPEIDEL ET AL., SECURED TRANSACTIONS TEACHING MATERIALS 48–49 (5th ed. 1993) (discussing the history of pledging personal property in the form of chattel mortgages); H.F. JOLOWICZ & BARRY NICHOLAS, HISTORICAL INTRODUCTION TO THE STUDY OF ROMAN LAW 159, 298–303 (3d ed. 1972) (examining the history of primitive, private secured obligations); Douglas G. Baird & Thomas H. Jackson, *Possession and Ownership: An Examination of the Scope of Article 9*, 35 STAN. L. REV. 175, 179 (1983) (distinguishing secured and unsecured creditors in terms of their respective interest with regard to particular collateral); Roger J. Goebel, *Reconstructing the Roman Law of Real Security*, 36 TUL. L. REV. 29, 32 (1961) (explaining the historical use of penalties as a type of security for bailments).

6. *See* 2 EDWARD COKE, THE FIRST PART OF THE INSTITUTES OF THE LAWS OF ENGLAND § 332 (Francis Hargrave & Charles Butler, eds., Philadelphia, Robert H. Small 1853) ("[I]f he doth not pay, then the land which is put in pledge upon condition for the payment of the money, is taken from him for ever, and so dead to him upon condition, . . . [a]nd if he doth pay the money, then the pledge is dead as to the tenant.").

7. *See id.*

8. *See id.*; ROBERT M. LLOYD, SECURED TRANSACTIONS § 11.03, at 456 (1988) (defining mortgages on real property).

lenders would require the borrower to grant a security interest in goods or other personal property.[9] This category of collateral could include anything from farm equipment and cattle to cars, boats, and planes.[10] These more "movable" types of collateral were usually secured by a chattel mortgage and, in more recent times, by a security interest pursuant to Article 9 of the Uniform Commercial Code (UCC).[11]

But as time has progressed, business parties have become more sophisticated in their transactions.[12] Deals that before involved merely the lending of capital and the repayment of principal plus interest, all secured by personal and real property, have been surpassed by business imagination and innovation.[13] No longer do individuals and business entities expect to make only cash profits from their investments; they often expect to receive other forms of value as well.[14]

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9. *See, e.g.*, 1 GRANT GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 2.1, at 24–25 (1965) (noting the abandonment of the rule forbidding nonpossessory interests in personal property).

10. *See* DOUGLAS G. BAIRD & THOMAS H. JACKSON, CASES, PROBLEMS, AND MATERIALS ON SECURITY INTERESTS IN PERSONAL PROPERTY 579 (2d ed. 1987).

11. *See* WARREN & WALT, *supra* note 1, at 9–10.

12. *See* Christopher K. Odinet, *Toward a Convention for the International Sale of Real Property: Challenges, Commonalities, and Possibilities*, 29 QUINNIPIAC L. REV. 841, 842 (2011).

13. *See, e.g.*, Ken Belson & Jeff Z. Klein, *Canadian Communications Firms Agree to Buy Maple Leafs and Raptors*, N.Y. TIMES, Dec. 10, 2011, at D4 (reporting that large communications firms are purchasing interests in professional sports teams for $1.2 billion); C.J. Hughes, *The Tricky Task of Renovating a Building Without Altering Its Landmark Insides*, N.Y. TIMES, Nov. 23, 2011, at B6 (reporting owners of historical Fifth Avenue buildings are investing in costly renovations in order to attract retail tenants); Julie Satow, *Study Clarifies the Energy Savings in Retrofitted Buildings*, N.Y. TIMES, Nov. 9, 2011, at B5 (discussing Deutsche Bank Americas Foundation study of the potential energy savings of energy efficient retrofitted buildings); Julie Satow, *Visions of a Development Rising from the Sea*, N.Y. TIMES, Nov. 23, 2011, at B6 (reporting New York City's proposal of creating a new neighborhood that would generate billions of dollars in revenue for the city); Evelyn M. Rusli, *Gym, Tan, Raise Venture Capital?*, N.Y. TIMES (Nov. 18, 2011, 2:26 PM), http://dealbook.nytimes.com/2011/11/18/gym-tan-raise-venture-capital (discussing whether venture capitalists should get a spray tan before making a pitch); Evelyn M. Rusli, *I.B.M. to Buy DemandTec for $440 Million*, N.Y. TIMES (Dec. 8, 2011, 9:43 PM), http://dealbook.nytimes.com/2011/12/08/ibm-buys-demandtec-for-440-million (reporting major American technology company's purchase of web-based enterprise software company for $440 million); Evelyn M. Rusli & Michael J. de la Merced, *LivingSocial Set to Raise About $200 Million*, N.Y. TIMES (Nov. 18, 2011, 6:22 PM), http://dealbook.nytimes.com/2011/11/18/livingsocial-set-to-raise-near-200-million (reporting web site's goal to raise money as it enlarges its sales force and enters new markets); Evelyn M. Rusli, *Thoma Bravo Acquires Blue Coat Systems for $1.3 Billion*, N.Y. TIMES (Dec. 9, 2011, 8:33 AM), http://dealbook.nytimes.com/2011/12/09/thoma-bravo-acquires-blue-coat-systems-for-1-3-billion (reporting investment group's agreement to purchase an enterprise security and network software systems group for $1.3 billion); Vinod Sreeharsha, *Accel Invests in Brazilian Review and Search Site*, N.Y. TIMES (Dec. 1, 2011, 3:26 PM), http://dealbook.nytimes.com/2011/12/01/accel-invests-in-brazilian-review-and-search-site (reporting internet search web site's investment in consumer internet market from $500 million XI Venture Fund).

14. *See, e.g.*, Gary Glancy, *Commissioners to Discuss Economic Incentives, Sheriff Davis Monday*, BLUERIDGENOW.COM (Dec. 8, 2011, 10:58 PM), http://www.blueridgenow.com/article/20111208/ARTICLES/111209802?Title=Commissioners-to-discuss-economic-incentives-Sheriff-Davis-Monday- (reporting county board of commissioners' planned meeting to discuss a possible $3.75

Specifically, individuals and entities make investments not only for a return of profit but also for the receipt of valuable tax credits.[15]

The granting of tax credits to encourage individuals to engage in certain activities is a classic hallmark of tax policy in the United States.[16] Individuals and companies with heavy tax liabilities can use tax credits to reduce the amount

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million incentive package for a manufacturing company); Lauren Pack, *Retail Developer Seek Millions in Incentives from County*, MIDDLETOWN JOURNAL, http://www.middletownjournal.com/news/news/local/retail-developer-seek-millions-in-incentives-from-/nNR8F (last updated Dec. 8, 2011, 7:52 PM) (discussing retail developers who sought a $55 million tax incentive commitment from county); Kirsten Valle Pittman & Tim Funk, *In Scramble for New Jobs, States Bid Up Incentives*, KNOXNEWS.COM (Dec. 7, 2011, 11:59 AM), http://www.knoxnews.com/news/2011/dec/07/in-scramble-for-new-jobs-states-bid-up (discussing state incentive structures offered to companies in an attempt to create new jobs); Emily Schettler, *Developer Defends IRL Incentives*, IOWA CITY PRESS CITIZEN, Dec. 7, 2011, https://secure.pqarchiver.com/press_citizen/ (archived article available by subscription) (reporting city's use of tax increment financing to provide millions of dollars of incentives and infrastructure for retailers); Scott Sloan, *State Incentives Approved for Expanding Companies*, LEXINGTON HERALD-LEADER (Dec. 10, 2011), http://www.kentucky.com/2011/12/10/1988019/state-incentives-approved-for.html (discussing a tax incentive program approved by Kentucky Economic Development Finance Authority for various companies); *South Carolina County Approves Incentive Package for Amazon Warehouse*, HUFFINGTON POST (Dec. 9, 2011, 4:26 PM), http://www.huffingtonpost.com/2011/12/09/amazon-warehouse-spartanburg-county_n_1140145.html (reporting county council's decision to give an incentives package to a new Amazon.com Inc. warehouse, which is expected to create hundreds of jobs).

15. *See, e.g.*, Lily L. Batchelder et al., *Efficiency and Tax Incentives: The Case for Refundable Tax Credits*, 59 STAN. L. REV. 23, 26 (2006) (proposing an efficient way to structure tax incentives to encourage certain behavior); Roberta F. Mann & Mona L. Hymel, *Moonshine to Motorfuel: Tax Incentives for Fuel Ethanol*, 19 DUKE ENVTL. L. & POL'Y F. 43, 43 (2008) (discussing whether the IRS' three tax incentives for ethanol are economically and environmentally effective); Kirk J. Stark & Daniel J. Wilson, *What Do We Know About the* Interstate *Economic Effects of State Tax Incentives?*, 4 GEO. J.L. & PUB. POL'Y 133, 134 (2006) (describing the economic effects of state tax incentives in light of a Supreme Court decision on unconstitutional tax credit); Thomas Karier, *Business Tax Incentives and Investment* 1 (Jerome Levy Econs. Inst. & E. Wash. Univ., Working Paper No. 103, 1994) (arguing tax incentives designed to encourage investment do not result in higher investments, therefore alternatives to investment tax credits should be utilized); Michael S. Knoll, *International Competitiveness, Tax Incentives, and a New Argument for Tax Sparing: Preventing Double Taxation by Crediting Implicit Taxes* 4 (Univ. of Pa. Law Sch. Inst. of Law & Econ., Research Paper No. 08-21, 2008), *available at* http://ssrn.com/abstract=1259927 (describing tax sparing agreements as incentives for foreign investment companies); Jacques Morisset & Nede Pirnia, *How Tax Policy and Incentives Affect Foreign Direct Investment: A Review* (World Bank & Int'l Fin. Corp., Policy Research Working Paper No. 2509, 2000), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=632579 (reviewing literature on how tax policy impacts Foreign Direct Investment, issues resulting from globalization, and future research possibilities).

16. *See, e.g.*, David T. Ellwood, *The Impact of the Earned Income Tax Credit and Social Policy Reforms on Work, Marriage, and Living Arrangements*, 53 NAT'L TAX J. 1063, 1063 (2000) (discussing how alterations in the Earned Tax Income Tax Credit can incentivize some people to work, marry, or cohabitate); Wendy Gerzog Shaller, *On Public Policy Grounds, a Limited Tax Credit for Child Support and Alimony*, 11 AM. J. TAX POL'Y 321, 321–22 (1994) (discussing how alimony deduction provisions were enacted to allow payors sufficient funds to satisfy their tax burdens after paying alimony).

they owe the government.[17] Moreover, tax credits have become even more valuable as commercial lending and government policy have evolved to include programs that heavily incentivize certain activities and industries.[18] Tax credits have become a way of not only reducing one's tax liability, but also a way to make a profit.

An investor who loans money or invests in a project that qualifies for certain tax credits can take those credits and use them for the investor's benefit or even sell them on the market to a willing buyer.[19] These investors and buyers use the credits as relief from their high-tax-bracketed liabilities.[20] The ability for highly taxed groups to obtain relief, sometimes substantial, from their tax liabilities makes the holder of tax credits a powerful economic player in the commercial marketplace.[21]

Government policymakers know the value of tax credits and, in turn, have created many different incentive programs whereby investors advance funds for certain projects deemed to be for the public good.[22] In return, the investors receive valuable tax credits that can be traded and sold for a profit.[23] Tax credit programs in the United States are as varied and diverse as the American commercial landscape itself.[24] There are credits for purchasers of electric cars[25] and hybrid vehicles,[26] producers of clean fuels,[27] new enhanced oil recovery projects,[28] oil and gas from marginal wells,[29] refiners of low sulfur diesel fuel[30] and fuel from nonconventional sources,[31] inventors of energy-efficient appliances,[32] energy-producing equipment,[33] and technology to produce

17. *See* Stark & Wilson, *supra* note 15, at 137–38.

18. *See, e.g.*, Batchelder et al., *supra* note 15, at 24 (arguing that a uniform refundable tax credit encourages socially valued behavior).

19. *See* Karier, *supra* note 15, at 19–20.

20. *See* Batchelder et al., *supra* note 15, at 33 n.36.

21. *See* Karier, *supra* note 15, at 19–20.

22. *See, e.g.*, Miki Malul & Israel Luski, *The Optimal Policy Combination of the Minimum Wage and the Earned Income Tax Credit*, 9 B.E. J. ECON. ANALYSIS & POL'Y 1, 1–3 (2009) (discussing the impact the Earned Income Tax Credit and minimum wage have on human capital acquisition); Daniel Shaviro, *The Minimum Wage, the Earned Income Tax Credit, and Optimal Subsidy Policy*, 64 U. CHI. L. REV. 405, 408 (1997) (arguing the Earned Income Tax Credit is a better tool than the minimum wage for reaching the government objective of progressive wealth distribution).

23. *See* Batchelder et al., *supra* note 15, at 33 n.36.

24. *See generally* I.R.C. §§ 30–48 (2006) (federal statute providing tax credits).

25. *Id.* § 30.

26. *Id.* § 30B.

27. *Id.* § 30C.

28. *Id.* § 43.

29. *Id.* § 45I.

30. *Id.* § 45H.

31. *Id.* § 45K.

32. *Id.* § 45M.

33. *Id.* § 48.

electricity and synthetic gases from coal,[34] biomass,[35] and petroleum residue,[36] as well as for investors in low-income housing[37] and projects in low-income communities.[38] Whatever may be the government policy de jour, one can expect to see a tax credit produced to help push that policy along by giving an incentive to investors to choose to put their money in *this* project, as opposed to another.[39] And as long as individuals and businesses are looking for ways to reduce their tax burden, tax credits will become only more valuable.[40] With legislative bodies at both the state and local levels continuously producing large quantities of tax credits to further their policies, the cash-flushed investor has a myriad of options to choose from when determining which project is worth the investment (and which will produce the most credits).[41]

Lenders are also wise to the rush by individuals and corporations toward tax credit investments.[42] An investor might borrow money from a financial institution in order to make an investment in a certain business that intends to undertake a project qualifying for substantial tax credits.[43] The business will receive profits from the success of the project and, in turn, will transfer the tax credits it receives to the investor as repayment.[44] Traditionally, the financial institution would require that the typical collateral be posted to secure the loan.[45] This could include the investor's real property, goods and equipment, and deposit accounts and accounts receivable, to name a few.[46] However, as lenders have become aware that the true value in the hands of the investor and his business partners is the tax credit, the sufficiency of more traditional forms of

34. *Id.* § 48A.

35. *Id.* § 48B(4).

36. *Id.* § 48B(8).

37. *Id.* § 42.

38. *Id.* § 45D.

39. *See, e.g.*, CHRISTOPHER HOWARD, THE HIDDEN WELFARE STATE: TAX EXPENDITURES AND SOCIAL POLICY IN THE UNITED STATES 3–4 (1997) (theorizing that governmental policy objectives drive population targeted tax credits); C. EUGENE STEUERLE, CONTEMPORARY U.S. TAX POLICY 126–28 (2d ed. 2008) (discussing how the 1986 Tax Reform Act was used to reward innovation and incentivize the investment in productive assets).

40. *See, e.g.*, HOWARD, *supra* note 39, at 3, 34 (noting that the number of tax loopholes with social welfare objectives have nearly quadrupled in the last three decades); STEUERLE, *supra* note 39, at 34–35 (noting that, based on four decades of data, policy-driven tax expenditures have grown rapidly).

41. *See* HOWARD, *supra* note 39, at 25–26.

42. *See, e.g.*, Vanessa Houlder et al., *Tax Wars: A Fight Worth Billions*, FIN. TIMES (Sept. 25, 2011), http://www.ft.com/intl/cms/s/0/b21b51e0-e524-11e0-bdb8-00144feabdc0.html#axzz24aPJFptL (discussing the legal disputes among the IRS, American banks, and Barclays regarding foreign tax credits).

43. *See, e.g.*, Noah S. Baer, *Energy Investment Partnerships and the Allocation of the Sections 29 and 45 Energy Tax Credits*, 101 J. TAX'N 364, 366–67 (2004) (discussing how § 29 enables tax credits to flow to investors and § 45 encourages funding from investors).

44. *See* Baer, *supra* note 43, at 365–66.

45. *See* GUP & KOLARI, *supra* note 2, at 260.

46. *See* WARREN & WALT, *supra* note 1, at 12.

collateral has been called into question.[47] More and more lenders want a security interest in actual tax credits as a way to secure the loan.[48] While traditional forms of collateral may, if foreclosed upon, help make the lender whole, the potential proceeds from the sale of the tax credits can serve as a considerable supplement to this security.[49] In determining the level of collateral required to advance the funds, the prudent lender will assess the entirety of the borrower's assets and revenues.[50] The substantial economic value of tax credits produced from certain investments is ripe for the picking in terms of providing the lender with the security that it needs to substantiate the lending of funds.[51] Moreover, some borrowers—who might not necessarily have the requisite level of traditional collateral to entice a lending institution to advance funds—can use the allure of a tax credit allocation to persuade lenders that tax credit collateral will more than secure the loan and provide protections to reduce the lender's risk.[52]

While tax credit financing may be all the rage in the world of secured transactions, there remains an undercurrent of uncertainty regarding its legal efficacy. The exotic and economically profitable nature of the tax credit as collateral is what makes it both attractive to lenders but also uncertain to lawyers. Tax credits do not fit neatly into the traditional categories of collateral under Article 9 of the UCC. Although they may seem to fit into the UCC's category of "general intangibles" because of their amorphous and unique qualities, courts have struggled with how to properly label and deal with these rights.[53] For instance, general intangibles have been held to include copyrights, patents, trademarks, and intellectual property.[54] However, whether tax credits

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47. For an example of the shift by lenders to require more unconventional forms of collateral, such as intellectual property rights, see Claire Philpott & Susan Jahnke, *Intellectual Property: A New Form of Collateral*, PUGET SOUND BUS. J. (Mar. 6, 2005, 9:00 PM), http://www.bizjournals.com/seattle/stories/2005/03/07/focus9.html.

48. *See, e.g.*, Baer, *supra* note 43, at 366–67 (discussing an investor's interest in obtaining tax credits).

49. *See generally* GUP & KOLARI, *supra* note 2, at 260–63 (discussing traditional types of collateral).

50. *See, e.g.*, GUP & KOLARI, *supra* note 2, at 260–63 (discussing the types of collateral banks use to reduce their risk when making a loan); THOMAS J. PINKOWISH, RESIDENTIAL MORTGAGE LENDING: PRINCIPLES AND PRACTICES 385, 395–97 (Dave Shaut ed., 6th ed. 2012) (directing residential mortgage loan officers to consider assets, collateral, and any other compensating factors when evaluating a loan applicant).

51. *See, e.g.*, Baer, *supra* note 43, at 366–67 (noting that tax credit collateral can offset risk and result in a more attractive investment opportunity); Lisa Bennett, *Are Tradable Carbon Emissions Credit Investments? Characterization and Ramifications Under International Investment Law*, 85 N.Y.U. L. Rev. 1581, 1597–98 (2010) (arguing that tax credits are a form of intangible property investments).

52. *See, e.g.*, Baer, *supra* note 43, at 366–67 (noting that the transfer of § 45 tax credits entices project investments).

53. *See infra* Part III and accompanying discussion.

54. *See* Lars S. Smith, *General Intangible or Commercial Tort: Moral Rights and State-Based Intellectual Property as Collateral Under U.C.C. Revised Article 9*, 22 EMORY BANKR. DEV. J. 95, 96 (2005).

fall precisely into this category has yet to be determined. Some courts have avoided making an affirmative determination; others have engaged in confusing legal acrobatics to affirm them; and, in some cases, courts have denied their use as collateral at all. Moreover, cases on the issue are incredibly sparse. Despite the fact that more security agreements are being drafted to include tax credits as a part of the collateral in these types of transactions, very little judicial guidance exists in the way of tax credit financing.[55] In substantial transactions where a great deal of capital is at stake and a large portion of the security is bound up in tax credit allocations, the prospect of a court invalidating the security should give more than just a moment's pause to lawyers and businesspersons alike. Tax credit financing is an emerging trend in today's business world, but how solid is its foundation?

This Article attempts to lay that foundation by analyzing the theoretical underpinnings of the UCC's category for general intangibles and showing how classification as a general intangible can, and should, comport with the legal substance of tax credits as a form of secured financing. Part II investigates the theory and nature that form the basis of tax credits and their economic value, as well as provides some background and analysis of the UCC's collateral category for general intangibles. Part III gives an overview of the relatively meager case law on tax credit financing and explains how courts have struggled with this new concept. The Part highlights the courts' nonuniform and often times inaccurate analyses and points out that courts are focusing on the wrong feature of tax credits to support their holdings. Part IV calls for courts to jettison their current focus on refundability in analyzing tax credit collateral cases and to adopt a new judicial test that calls for assessing the substantive and procedural transferability of tax credits, thereby giving courts a new and more appropriate framework to employ when approaching cases involving tax credits and secured transactions. This Article concludes that tax credits should be treated as permissible collateral under Article 9 in certain circumstances when the credits comport with a test for substantive and procedural transferability and, further, that courts can use this new two-prong test for transferability when confronted with other types of emerging and nontraditional general intangible collateral.

II. UNDERSTANDING TAX CREDITS AND UCC ARTICLE 9

In trying to resolve the question of how courts should deal with security interests in tax credits granted under Article 9 of the UCC, one must first understand the fundamentals of both Article 9 and tax credits themselves. To the extent the tax credit device fits into the overall scheme, Article 9 requires delving into the nature, purpose, and history of both.

55. *See infra* Part III and accompanying discussion.

A. Exploring the Nature of Tax Credits

Tax credits are a public policy function of the overall tax system.[56] In general, the income tax system is meant to form a basis from which the government can derive function for activities related to the public good.[57] A portion of a person or entity's income is taxed, and the government then allocates the proceeds from this tax for public purposes.[58] The taxpayer's ability to direct and influence the expenditure of tax revenue is limited to the political process.[59] Stated another way, it is by and large the government itself that directs the funds into various projects and for various purposes, while the taxpayer plays only a supporting role.[60] However, the tax credit can be viewed as the opposite of this dichotomy.[61] Here, it is the individual who chooses where to direct his funds, investing in those projects that he deems to be most productive, and the government plays the secondary role by providing tax incentives to the individual for investing in those projects.[62] The individual controls the choice of expenditure, and the government provides the support through tax relief.[63]

Over time, Congress has created and reauthorized tax credits for a wide array of economic and social purposes.[64] Because of the immensely varied special interests that lobby and impact the decisions of Congress, the number and variety of tax credits are wide-ranging and exceedingly diverse.[65] Each credit is designed to influence the taxpayer's decisionmaking in one way or another.[66] Credits encourage the individual either to engage in certain activities for which he will be rewarded or to shy away from certain activities which will not yield tax benefits.[67]

The mechanics of how these benefits work are simple. After a taxpayer determines his gross income for a given calendar year, he deducts from this number whatever amounts to which he is entitled for certain legislatively-created deductions, then multiplies the remaining amount by the applicable rate table for that year.[68] This number will produce the taxpayer's tentative tax liability.[69] The taxpayer will then subtract whatever tax credits he is entitled to receive from

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56. *See* SANFORD M. GUERIN & PHILIP F. POSTLEWAITE, PROBLEMS AND MATERIALS IN FEDERAL INCOME TAXATION 879 (6th ed. 2002).

57. *See id.* at 1.

58. *See id.* at 1–3.

59. *See id.*

60. *See id.*

61. *See id.* at 879.

62. *See id.*

63. *See id.*

64. *Id.*

65. *See id.* at 879–83.

66. *See id.*

67. *Id.*

68. SAMUEL A. DONALDSON, FEDERAL INCOME TAXATION OF INDIVIDUALS 37, 37 (2005).

69. *Id.*

his tentative liability.[70] Whatever amount remains after all tax credits have been subtracted from the tentative tax liability is the individual's final tax liability to the government.[71]

Taxpayers prefer tax credits to tax deductions.[72] While the deduction is also used for social and economic policy purposes (i.e., to encourage or discourage certain activity), the tax credit, as a general matter, has vastly more worth.[73] Deductions have a much weaker impact on an individual's tax liability, and scholars and policymakers have argued that they disproportionately benefit the wealthy.[74] The tax credits' value is, in part, what makes them such attractive candidates for collateral in secured transactions.[75] Specifically, credits reduce the tax liability on a dollar-for-dollar basis.[76] If one has $15,000 in tentative tax liability, and $10,000 in tax credits, then the final tax liability is $5,000.[77] However, with deductions, the value is captured on the front end before the marginal rate is applied.[78] Some scholars have described the tax deduction as "regressive" in that its value is dependent on the taxpayer's marginal tax rate and the actual amount of the deduction.[79] Tax credits, however, because they reduce one's tax liability dollar-for-dollar regardless of income level, are more evenhanded.[80]

A particularly valuable aspect of tax credits is that they are sometimes refundable. As a general notion, the value of the credit depends on the amount of one's tax liability.[81] If the tax credit is greater than the tax liability, then the tax liability is zeroed out and the remaining unused credits are seemingly worthless. However, Congress often provides for certain credits to be refundable or carried over for use in the next tax year.[82] In other words, once the tax liability has been reduced to zero, any remaining credits can either be returned to the taxpayer by the government in the form of a cash refund or claimed to reduce the taxpayer's liability in the following year.[83] In the case of refundable credits, since the credits can come in the form of cash payments, their value does not necessarily depend upon an available tax liability. Thus, credits themselves have

70. *Id.*
71. *Id.*
72. *See* GUERIN & POSTLEWAITE, *supra* note 56, at 879–80.
73. *Id.*
74. *Id.*
75. *See id.*
76. *Id.* at 879.
77. *See id.* at 879–80.
78. *Id.*
79. *Id.* at 880.
80. *See id.* at 879–80.
81. *See id.* at 879.
82. JAMES J. FREELAND ET AL., FUNDAMENTALS OF FEDERAL INCOME TAXATION 925 (14th ed. 2006); *see also* I.R.C. §§ 31–37 (2006) (subpart of Internal Revenue Code relating to refundable credits).
83. *See* FREELAND ET AL., *supra* note 82, at 925.

an independent value, separate and apart from the particular qualities of the holder.[84]

In broad terms, tax credits exist for everything from homeownership, education, retirement plans, and healthcare expenses, to charitable giving, life insurance policies, municipal bond investments, and labor.[85] For example, a historically popular credit for investors was the Low-Income Housing Credit, which provided tax credits for investment in housing for depressed areas and low-income individuals.[86] The research credit also provides an attractive opportunity for investors to take advantage of a substantial tax credit for research and experiment related expenditures.[87] With the advent of the sustainability movement, more and more tax credits are now geared toward incentivizing investments in green and renewable resources.[88] One such credit is for individuals who make energy-efficient improvements to their homes, such as installing solar panels or biofuel cells.[89] As the variety and value of tax credits continue to grow, the economic strength of these intangible rights have come to the forefront of the commercial and business scene.[90]

B. Combining Tax Credits and UCC Article 9

While both the value of tax credits and the creative ways in which investors are taking advantage of government programs that yield them have increased, the procedure for using tax credits as collateral for financing remains a separate inquiry. Understanding the basics of Article 9 of the Uniform Commercial Code and how tax credits fit into the overall Article 9 structure is where the true issue lies.

As a general matter, prior to the advent of Article 9, security in personal property encompassed a myriad of different devices including chattel mortgages, conditional sales, trust receipts, factors' liens, and assignments of accounts receivable (each imperfect in its own way).[91] Each state had its own laws and nuanced provisions pertaining to each of these devices, making them provincial and nonuniform across the country.[92] In the late 1940s, Professors Grant Gilmore and Allison Dunham—the primary drafters of Article 9—began constructing a unified system of secured financing in personal property that

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84. GUERIN & POSTLEWAITE, *supra* note 56, at 879–80.

85. *See* Batchelder et al., *supra* note 15, at 43.

86. *See* 1 BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS ¶¶ 27.5.3, at S27-60 (Supp. No. 2 2012).

87. *See id.* ¶ 27.4.1, at S27-30.

88. *See id.* ¶ 27.6.1, at S27-67 to -68.

89. *Id.*; *see also* I.R.C. § 25C (2006) (credit for nonbusiness energy property); *id.* § 25D (credits for maintaining energy efficient residential property).

90. *See, e.g.*, Bennett, *supra* note 51 and accompanying text (describing tax credits as intangible property investments).

91. WARREN & WALT, *supra* note 1, at 10.

92. *Id.*

would completely displace the old patchwork system and create a single, multipurpose statute that other states could adopt.[93] The result was Article 9 of the Uniform Commercial Code.[94] The drafters of Article 9 did not intend to eliminate the traditional security devices mentioned above, but rather, intended to wipe away the differences between them.[95] The old terms and labels could still be used to describe security devices in personal property, but these age-old devices now had to conform to the baseline requirements of Article 9 to be effective.[96] The general rule found in section 9-109(a) of Article 9 provides, "this Article applies to: (1) a transaction, regardless of its form, that creates a security interest in personal property."[97] The comment to this section states, "the principal test whether a transaction comes under this Article is: is the transaction intended to have effect as security?"[98] In this way, the local and traditional trappings of certain security devices were preserved, while the true effectiveness of the security, whatever its label, depended upon requirements that were uniform across jurisdictions.[99]

Article 9 relates to transactions involving the granting of security in personal property as well as fixtures or component parts.[100] Particularly significant in the Article 9 process is the categorization of personal property into different types of collateral.[101] For instance, the rules that govern securities in an account receivable are distinguishable from those involved in collateralizing a bus, airplane, or truck.[102] For the purposes of analyzing tax credit security, the applicable collateral category is that of "general intangibles."[103] This category was added last in the list of Article 9 collateral classes as a catch-all provision.[104] Anything that does not fall under one of the other categories can, in most cases, be classified as a general intangible.[105] This includes things in action, such as

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93. *Id.*; GILMORE, *supra* note 9, § 9.1, at 288–89 & n.1.

94. *See* WARREN & WALT, *supra* note 1, at 10.

95. *Id.*

96. *See id.*

97. U.C.C. § 9-109(a) (2011).

98. ROBERT L. JORDAN ET AL., SECURED TRANSACTIONS IN PERSONAL PROPERTY 14 (5th ed. 2000) (quoting U.C.C. § 9-102 cmt. 1 (1972)).

99. *See* LLOYD, *supra* note 8, § 1.03[F], at 8; WARREN & WALT, *supra* note 1, at 10.

100. *See* U.C.C. § 9-109 (2011).

101. LESTER E. DENONN, SECURED TRANSACTIONS UNDER THE UCC 36 (Practising Law Institute rev. ed. 1965); *see also* Terry M. Anderson et al., *Attachment and Perfection of Security Interests Under Revised Article 9: A "Nuts and Bolts" Primer*, 9 AM. BANKR. INST. L. REV. 179, 187–89 (2001) ("Whatever record the debtor adopts must contain a description of the collateral. . . . [S]uper-generic descriptions like 'all personal property' will not be sufficient for security agreements.").

102. *See* DENONN, *supra* note 101, at 36–38; Kenneth C. Kettering, *True Sale of Receivables: A Purposive Analysis*, 16 AM. BANKR. INST. L. REV. 511, 514–16 (2008).

103. *See* U.C.C. § 9-102(a)(42).

104. *See id.* § 9-102 cmt. 5(d); Paul M. Shupack, *Making Revised Article 9 Safe for Securitizations: A Brief History*, 73 AM. BANKR. L.J. 167, 170 (1999).

105. WILLIAM H. LAWRENCE ET AL., UNDERSTANDING SECURED TRANSACTIONS § 1.04[c][2], at 35 (3d ed. 2004).

patent rights, rights to royalties, and rights under certain types of performance contracts.[106] Section 9-102(a)(42) of Revised Article 9 states that a general intangible is:

> any personal property, including things in action, other than accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, investment property, letter-of-credit rights, letters of credit, money, and oil, gas, or other minerals before extraction. The term includes payment intangibles and software.[107]

The definition is broad, sweeping, and rather short. In essence, if personal property does not fall into one of the other categories, then it is most likely a general intangible.[108] It is often described as a residual category because of its global effect.[109]

However, according to section 9-102, an account is "a right to payment of a monetary obligation . . . (i) for property that has been or is to be sold, leased, licensed, assigned, or otherwise disposed of, [and] (ii) for services rendered or to be rendered."[110] Therefore, an account is always defined as a certain type of right to demand payment, while a general intangible is a right to payment owed for a reason other than the provision of goods and services or a right of ownership in intangible property that does not involve payment.[111] Since the definition of account is drawn broadly, one may wonder what exactly general intangibles would cover and why tax credits would not be classified as accounts. Courts have defined the following examples of personal property as general intangibles: "patent rights, trademark rights, rights to tax refunds, rights to refunds for overpayments to an employee pension plan, claims for breach of contract, liquor licenses, FCC licenses," a refundable lease security deposit, a beneficial interest in a land trust, rights under a cable television agreement, and water permits.[112] Sometimes courts arrive at the conclusion that property is a

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106. U.C.C. § 9-102 cmt. 5(d).

107. *Id.* § 9-102(a)(42).

108. LAWRENCE ET AL., *supra* note 105, § 1.04[c][2], at 35.

109. *See* U.C.C. § 9-102 cmt. 5(d).

110. *Id.* § 9-102(a)(2).

111. *See* Anderson et al., *supra* note 101, at 183.

112. LAWRENCE ET AL., *supra* note 105, at 35–36 (citing *In re* Emergency Beacon Corp., 23 U.C.C. Rep. Serv. 766 (S.D.N.Y. 1977) (patent rights); Roman Cleanser Co. v. Nat'l Acceptance Co. of Am. (*In re* Roman Cleanser Co.), 43 B.R. 940 (Bankr. E.D. Mich. 1984), *aff'd*, 802 F.2d 207 (6th Cir. 1986) (trademarks); Sterling Nat'l Bank & Trust Co. v. Bornstein (*In re* Metric Metals Int'l, Inc.), 20 B.R. 633, 636 (S.D.N.Y. 1981) (rights to tax refund); *In re* Long Chevrolet, Inc., 79 B.R. 759 (Bankr. N.D. Ill. 1987) (rights to overpayments into employee pension plan); Merchs. Nat'l Bank of Mobile v. Ching, 681 F.2d 1383 (11th Cir. 1982) (breach of contract claims); Queen of the N., Inc. v. LeGrue, 582 P.2d 144 (Alaska 1978) (liquor license); *In re* Ridgely Commc'ns, Inc., 139 B.R. 374 (Bankr. Md. 1992) (Federal Communications Commission broadcasting license); Lake Region Credit Union v. Crystal Pure Water, Inc., 502 N.W.2d 524 (N.D. 1993) (water permits)); *see also* Bus. Bank v. White (*In re* Timonthy Dean Rest. & Bar), 342 B.R. 1, 11–14

general intangible through unconventional means.[113] For instance, in *United States v. Antenna Systems, Inc.*,[114] the United States District Court for the District of New Hampshire held that drawings, plans, and other technical data produced by engineers were general intangibles as opposed to goods because the true value of the items was in the intellectual labor that went into creating them, rather than the paper and ink used to write them down.[115] The court held that supporting materials such as cost estimates, bid information, and proposals were also within the general intangible category because the value of the concepts and designs, not the actual documents, represented the true collateral to the creditor.[116]

In general, lenders will seldom allow the only security for a loan to be copyrights, trademarks, literary rights, and the like, when making a loan to a borrower.[117] These general intangibles, though valuable, do not represent the kind of traditional collateral that lenders have come to solely rely upon when advancing funds.[118] However, many lenders will use general intangibles as a kind of backup or supplementary security for the loan, while traditional collateral such as machinery, goods, equipment, and accounts receivable serve as the primary security.[119] This is not to say that lenders have never looked to a general intangible as the sole form of security.[120] Patent rights, for example, which create a certain level of dominance in a given market, can be deemed sufficient. This is because the patent—granting exclusivity over a market—produces great value to the borrower.[121] Moreover, there is a recent trend in the entertainment industry for producers and their companies to borrow money and secure the funds with rights in the performance itself.[122] If the show fails, the lender can still seize the production materials and perhaps sell them to another performance medium that can use the material to create a book, movie, or television program.[123] Thus, while not made whole, the lender can use the rights in the show to recoup some of its losses.[124] These lenders have often been termed "Broadway angels" because of their expertise in determining which shows are

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(Bankr. D.D.C. 2006) (security deposit for restaurant lease); Elgin Nat'l Bank v. Cowsert (*In re* Cowsert), 14 B.R. 340, 343 (Bankr. S.D. Fla. 1981) (beneficial interest in land trust); James Cable Partners, L.P. v. Citibank, N.A. (*In re* James Cable Partners, L.P.), 141 B.R. 772, 776–77 (Bankr. M.D. Ga. 1992) (cable television subscriptions).

113. *See* LAWRENCE ET AL., *supra* note 105, § 1.04[c][2], at 36.

114. 251 F. Supp. 1013 (D.N.H. 1966).

115. *See id.* at 1015–16.

116. *See id.* at 1016.

117. LEONARD LAKIN & HOWARD J. BERGER, A GUIDE TO SECURED TRANSACTIONS 121–22 (1970).

118. *See id.*

119. *Id.*

120. *See id.*

121. *Id.*

122. *Id.*

123. *Id.*

124. *See id.*

likely to be successful—thus embodying general intangible rights which would make reliable collateral for a loan.[125] Similarly, publishers often advance money to a successful writer to fund the writer's next work.[126] The funds are then secured by the literary rights of the writer, even before the writer has written the first page.[127] The publishing company uses its expertise to make a judgment call—based on the writer's skill—on whether the work will be successful.[128] The use of general intangibles is not, however, limited to the arts and literature.[129] A general contractor will often assign his rights to completed performance payments to an insurance company in return for the company's issuance of a payment and performance bond.[130]

A major subcategory of general intangibles implicated in the discussion of tax credit collateral is that of payment intangibles.[131] This subcategory is defined in section 9-102(a)(61) as "a general intangible under which the account debtor's principal obligation is a monetary obligation."[132] The key phrase in this definition is "principal obligation."[133] It could be said that practically all obligations can involve the payment of money in some form or another.[134] However, merely because the payment of money is implicated in a particular obligation does not mean that it rises to the level of a payment intangible.[135] Rather, the principal obligation of the debtor must be the payment of money.[136] For instance, the right to bring suit under a tort or breach of contract claim can be seen as involving the payment of money to the obligee if he or she is successful on the merits; however, these rights are not payment intangibles because the primary obligation does not involve a monetary performance.[137] On the other hand, Article 9 does not distinguish between principal and ancillary obligations.[138] Therefore, it is often up to courts to determine whether, based on the facts and circumstances, an obligation is a payment intangible.[139]

It can be argued that tax credits, in certain circumstances, fall into the payment intangible subcategory of general intangibles. If the credit is indeed refundable, then the credit represents a right to receive payment from the government.[140] The government is the obligor, and it could be said that the

125. *See id.*
126. *Id.*
127. *See id.*
128. *Id.*
129. *See* U.C.C. § 9-102 cmt. 5(d) (2011).
130. LAKIN & BERGER, *supra* note 117, at 122.
131. *See* WARREN & WALT, *supra* note 1, at 171.
132. U.C.C. § 9-102(a)(61).
133. *See* WARREN & WALT, *supra* note 1, at 171.
134. *Id.*
135. *See id.*
136. *Id.*
137. *See id.* at 171–72.
138. *See id.* at 170.
139. *See id.*
140. *See* FREELAND ET AL., *supra* note 82, at 925.

government's principal obligation to the taxpayer is a monetary one.[141] The government is obligated, once the taxpayer's tax liability has been reduced to zero and excess credits remain, to pay the taxpayer in money.[142] However, one can also argue that the principal obligation requirement may not be met in many cases, since the initial purpose of the credits is to reduce the taxpayer's tax liability and the receipt of excess credits in the form of a refund is only an ancillary purpose.[143] This argument is buttressed by the fact that credits must first go to reduce tax liability before they can be used to create an actual payment.[144] However, the contrary argument is equally compelling. Whether the value is in the reduction of liability or in the actual payment of money, the obligation is monetary in nature. In each instance, the credit is giving some benefit to the taxpayer through a pecuniary channel. In both cases the currency or coinage of the government is being used, either directly or indirectly, to benefit the monetary position of the taxpayer. Hence, the tax credit principally involves a monetary obligation by the government to the taxpayer.

More broadly, even if tax credits do not always—or hardly ever—fit into the payment intangible category, they arguably fit fairly well into the larger general intangible category. As with all general intangibles, the personal property must not fall within one of the other categories in order to qualify pursuant to the definition.[145] The most obvious contender is that of an account receivable.[146] However, the account receivable represents the right to demand payment for goods sold or leased or for services rendered, which is not evidenced by an instrument or chattel paper.[147] The tax credit is not given for the selling or leasing of goods or the rendering of services;[148] tax credits are generated through the expenditure of capital, chiefly in certain investment areas.[149] Nevertheless, an argument can be made that, in an indirect way, some tax credits are generated through the rendering of services or through the sale of goods. A New Markets Tax Credit, which is generated by a qualified, active low-income business that provides services to certain low-income communities, may tangentially represent payment for the rendering of services.[150] However, the actual rendering of services is not what calls for the payment of credits. Rather, it is the investment in the qualified, active low-income business that creates the credits.[151] The

141. *See id.*; *see also* U.C.C. § 9-102(a)(59) (2011) (defining "obligor" as one who "owes payment or other performance" for the obligation secured by a security interest).

142. *See* FREELAND ET AL., *supra* note 82, at 925.

143. *See id.*

144. *See id.*

145. *See* U.C.C. § 9-102(a)(2), (42).

146. *See id.*

147. *See id.* § 9-102(a)(2).

148. *See id.*; *id.* § 9-109(d)(4).

149. *See generally* I.R.C. §§ 38–45R (2006) (granting tax credits for certain business-related investments).

150. *See id.* § 45D.

151. *See id.*

qualifying business must render services to be eligible to receive the investment.[152] When carefully tracing the activity which actually produces the credits directly, it is logical to conclude that the tax credits fall into the category of general intangibles and, with certain credits, into the subcategory of payment intangibles.

Despite the urgings stated above, whether tax credits fall, be it neatly or not, into the category of general intangibles or any other Article 9 category has vexed courts confronted with the issue.[153] Although the basic concepts behind general intangibles and payment intangibles appear to contemplate the tax credit scenario, case law has not found the avenues easy to travel.[154] As explained in greater detail below, the judicial analysis relative to these new forms of collateral is in need of further refinement.[155]

III. AN OVERVIEW OF CURRENT TAX CREDIT SECURITY CASE LAW

Because the use of tax credits as collateral is new to business transactions, there is very little case law dealing with the topic.[156] This is likely due, in part, to the fact that many of these tax credit-driven transactions have either succeeded, in which case there has been no need to litigate or foreclose on the security; or, in the alternative, the projects have failed, but either the lenders and borrowers were able to reach a compromise or the lenders were able to foreclose on more traditional forms of collateral to satisfy the debt. This lack of case law does not bode well for future courts. With tax credits becoming so prevalent and their use as security so widespread in tax credit-related transactions,[157] it is likely that courts will need to address waves of tax credit foreclosures. The lack of established jurisprudence to provide an analytical framework for rendering judicial decisions will make collateral liquidations difficult. However, in looking to the current, albeit limited, case law and analysis of courts that have dealt with tax credit financing, we are able to predict, in part, which issues courts

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152. *See id.* § 45D(d)(2)(A).

153. *Compare* Sterling Nat'l Bank & Trust Co. v. Bornstein (*In re* Metric Metals Int'l, Inc.), 20 B.R. 633, 636 (Bankr. S.D.N.Y. 1981) (noting the lack of authority on the classification of tax refunds under Article 9, and concluding that such refunds are general intangibles), *and In re* Richardson, 216 B.R. 206, 219 (Bankr. S.D. Ohio 1997) (concluding that federal income tax credits are general intangibles), *with* City of Chi. v. Mich. Beach Hous. Coop., 609 N.E.2d 877, 885 (Ill. App. Ct. 1993) (noting that "no court has yet determined whether income tax credits constitute general intangibles for purposes of Article 9," and concluding that income tax credits cannot be considered intangible personal property).

154. *See supra* note 153 and accompanying text.

155. *See infra* Part III.

156. *See Mich. Beach Hous. Coop.*, 609 N.E.2d at 885 (noting that, as of 1993, "no court has yet determined whether income tax credits constitute general intangibles for the purposes of Article 9").

157. *See supra* Part I; *see also* Batchelder et al., *supra* note 15, at 24 ("Each year the federal individual income tax code provides over $500 billion worth of incentives intended to encourage socially beneficial activities, such as charitable contributions, homeownership, and education.").

may struggle with in making the ultimate determination as to the effectiveness of the security.[158] Further, in reviewing the existing case law, we are able to see how the current state of the law in the area of tax credit financing is ill-defined, and therefore lacks an overarching analytical framework that future courts dealing with the subject can use as a guide.[159]

A. In re Metric Metals International, Inc.

The United States Bankruptcy Court was one of the first courts to address the question of Article 9 tax-related financing in *In re Metric Metals International, Inc.*[160] In this case, the debtor agreed to execute an agreement giving the bank a security interest in

> all the Debtor's Receivables present and future, whether or not now or hereafter specifically assigned or pledged . . . whether now existing or hereafter created; all proceeds of such Receivables in whatever form, including cash, deposit accounts, negotiable instruments and other instruments for the payment of money; . . . [and] all other accounts due from Account Debtors to Debtor . . . .'[161]

Further, the security agreement included a rider stating,

> the collateral for the security interest includes but is not limited to accounts and contract rights which . . . are created or otherwise arise out of the sale of merchandise or the supplying of services . . . in the regular course of [debtor's] business or otherwise. This includes any of the foregoing classified under the Uniform Commercial Code as . . . general intangibles . . . .[162]

When the debtor received a tax refund, both the trustee and the bank made claims to the funds.[163] The trustee argued that tax refunds did not constitute accounts receivable as the term was defined in the security agreement because the rights in question were "limited to those which are 'created or otherwise arise out of the sale of merchandise or the supplying of services.'"[164] The trustee further argued that the inclusion of general intangibles in the collateral description failed to capture the tax refund because the security agreement

158. *See supra* note 153 and accompanying text.
159. *See supra* note 153 and accompanying text.
160. Sterling Nat'l Bank & Trust Co. v. Bornstein (*In re* Metric Metals Int'l, Inc.), 20 B.R. 633 (Bankr. S.D.N.Y. 1981).
161. *Id.* at 634 (alteration in original) (internal quotation marks omitted).
162. *Id.* at 635 (alteration in original) (internal quotation marks omitted).
163. *Id.* at 636.
164. *Id.* at 635.

contemplated only general intangibles that were related to the receivables arising out of the sale of merchandise or the providing of services.[165] Based on this narrow and limited reading of the security agreement, the trustee argued that the tax refunds constituted a type of property that was not encumbered.[166] In contrast, the bank argued that such a restricted reading was incorrect.[167] Among other things, the bank contended that the security agreement's statements regarding "all other accounts due from Account Debtors" extended the list of eligible account debtors beyond those for the sale of merchandise or providing of services.[168]

The court acknowledged that while there was little to no authority on whether a tax refund constituted a general intangible under Article 9—a point similarly noted by other courts addressing tax credit collateralization—commentators and doctrine seemed to favor a broad reading of the collateral category.[169] Further, the court noted that an indirectly related Colorado appellate case had concluded that money that was to be collected by a claimant in a lawsuit was a general intangible.[170] The bankruptcy court concluded that the tax refund constituted a general intangible—in which a security interest was properly perfected—and thus the bank had a superior claim to the funds.[171]

While the court did not specifically address tax credits, its analysis of tax refunds is instructive. Like tax credits, tax refunds are rights against the government to demand payment in connection with tax laws.[172] With a tax refund—also called a rebate—the taxpayer typically withholds and pays over to the government a certain amount from his estimated taxes throughout the taxable year, and when calculating his tax liability in light of all deductions, exclusions, and credits, his overall liability is less than the amount actually withheld and paid.[173] The overage comes back to the taxpayer in the form of a refund from the government.[174] In other words, the government is returning to the taxpayer the amount he paid in advance, but did not end up owing.[175] Tax credits operate in a

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165. *Id.*

166. *See id.*

167. *Id.*

168. *Id.*

169. *Id.* at 636 (citing *In re* Certified Packaging, Inc., 8 U.C.C. Rep. Serv. (Callaghan & Co.) 95, 102 (Bankr. D. Utah 1970); P. COOGAN ET AL., 1 SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE § 5A.09[1] (19—) [hereinafter COOGAN UNDATED]); *see also* Julian B. McDonnell, *Revised Article 9: A Complete Restatement of Personal Property Security Transactions*, *in* PETER F. COOGAN ET AL., 1 SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE § 1A.04[4], at 1A-31 (2006) (citing U.C.C. § 9-102 cmt. 5(d) (2001)).

170. *See In re Metric Metals*, 20 B.R. at 636 (citing Bd. of Cnty. Comm'rs v. Berkeley Vill., 580 P.2d 1251, 1255 (Colo. App. 1978)).

171. *See id.* at 636–38.

172. *See* MARVIN J. GARBIS ET AL., FEDERAL TAX LITIGATION: CIVIL PRACTICE AND PROCEDURE ¶ 17.01, at 17-2 to -3 (1985).

173. *See id.*

174. *See id.* ¶ 20.04, at 20-11.

175. *See id.*

somewhat similar manner.[176] In return for making certain investments or for satisfying certain conditions, the government grants a credit to the taxpayer that can be used to offset his final tax liability.[177] In the case of refundable credits, the government will actually remit any excess credits to the taxpayer in the form of a refund once all liability has been extinguished.[178] Thus, the credit refund and the tax refund both represent payments accorded to the taxpayer that can be demanded from the government.[179]

Further, *Metric Metals* was one of the first cases to address tax-related rights in connection with security interests under Article 9.[180] However, the court reached its ultimate conclusion with respect to the tax refund in a very summary fashion.[181] The court's full analysis consisted of one paragraph where it acknowledged the lack of authority on the matter but noted that the case law and commentators leaned toward finding that tax refunds fall within the parameters of general intangibles.[182]

One case relied on by the court in *Metric Metals* was *In re Certified Packaging, Inc.*,[183] where the court stated in dicta that security for the loan did not include rights to any tax refunds because the financing statement did not include "general intangibles."[184] The crux of the case dealt with whether the security interest in accounts receivable would extend to a check from the U.S. government, namely, the IRS, to the debtor for its tax refund.[185] The court's statement that tax refunds fell within the category of general intangibles was made in a brief and conclusory fashion and did not form a basis for the ultimate disposition of the case.[186]

The *Metric Metals* court also looked to *Board of County Commissioners v. Berkeley Village*[187] for the proposition that money a claimant expects to recover in a lawsuit is the kind of right that would constitute a general intangible.[188] In turn, the court in *Berkeley Village* buttressed its conclusion upon Pennsylvania[189] and Oregon[190] state court cases, finding that the right to collect money from a

176. *See supra* Part II.A.
177. *See supra* Part II.A.
178. *See supra* Part II.A.
179. *See* GARBIS ET AL., *supra* note 172, ¶ 17.01, at 17-2 to -3.
180. *See* Sterling Nat'l Bank & Trust Co. v. Bornstein (*In re* Metric Metals Int'l, Inc.), 20 B.R. 633, 636 (Bankr. S.D.N.Y. 1981).
181. *See id.*
182. *See id.* (citing *In re* Certified Packaging, Inc., 8 U.C.C. Rep. Serv. (Callaghan & Co.) 95, 102 (Bankr. D. Utah); COOGAN UNDATED, *supra* note 169, § 5A.09[1]); *see also* McDonnell, *supra* note 169, 1A-31 (citing U.C.C. § 9-102 cmt. 5(d) (2001)).
183. 8 U.C.C. Rep. Serv. (Callaghan & Co.) 95 (Bankr. D. Utah 1970).
184. *See id.* at 102.
185. *See id.* at 97–98.
186. *See id.* at 102.
187. 580 P.2d 1251 (Colo. App. 1978).
188. *See In re Metric Metals*, 20 B.R. at 636 (citing *Berkeley Vill.*, 580 P.2d at 1255).
189. *See* Sams v. Redevelopment Auth. of New Kensington, 261 A.2d 566 (Pa. 1970).
190. Great W. Nat'l Bank v. Hill (*In re* Estate of Hill), 557 P.2d 1367 (Or. App. 1976).

potential lawsuit is not the same as a right to collect under a judgment, but rather, is more akin to the right to proceeds from a condemnation action.[191]

The foregoing authorities served as the rationale behind the *Metric Metals* decision that the right to a tax refund constitutes a general intangible.[192] While tax refunds do share many of the same qualities as tax credits, the court's rationale is not flawless. The right to collect money from a lawsuit is markedly different from that under a tax rebate.[193] The right to collect from a suit depends upon many subjective factors, such as the deliberations of the trier of fact—be it judge or jury—as well as the arguments and law brought forward by counsel for both sides. Whether the anticipated funds materialize from the suit depends on numerous shifting and uncertain events. However, with a tax refund, one is able to calculate with certainty the amount that one will receive.[194] The process merely involves determining one's gross taxable income, making the appropriate deductions, applying the applicable marginal tax rate, and then reducing this amount by any allowable tax credits.[195] Any amounts that were withheld and paid to the IRS in excess of the amount owed, or any amounts left in credits, if applicable, after the reduction of tax liability to zero, result in a tax refund.[196] These determinations are not left to a trier of fact, but are rather predictable and certain.

Notwithstanding the weaknesses in the rationale used to support the proposition that tax refunds should be deemed general intangibles, courts have found comfort in this holding.[197] This conclusion also seems to hold water because of the payment nature of the right.[198] The right to a tax refund involves the principal right of a debtor to collect money from the creditor; a right derived from a personal property right other than one in connection with goods, accounts, chattel paper, documents, instruments, and money.[199] If such is the case, then the right to demand a refund of cash from the government based on excess refundable tax credits would also be deemed a general intangible.[200] While a tax refund is generally the result of an overpayment of funds during the

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191. *See Berkeley Vill.*, 580 P.2d at 1255 (citing Friedman, Lobe & Block v. C.L.W. Corp., 512 P.2d 769, 771 (Wash. Ct. App. 1973); *In re Estate of Hill*, 557 P.2d at 1372; *Sams*, 261 A.2d at 570).

192. *See In re Metric Metals*, 20 B.R. at 636 (citing *In re Certified Packaging*, 8 U.C.C. Rep. Serv. (Callaghan & Co.) at 102; *Berkeley Vill.* 580 P.2d at 1255).

193. *See supra* Part II.A (discussing the mechanics of tax credits); *see also* GARBIS ET AL., *supra* note 172, ¶ 17.01, at 17-2 to -3 (discussing the taxpayer's right to receive a tax refund under certain circumstances).

194. *See supra* Part II.A.

195. *See supra* Part II.A.

196. *See supra* Part II.A.

197. *See In re Metric Metals*, 20 B.R. at 636; *In re Certified Packaging*, 8 U.C.C. Rep. Serv. (Callaghan) at 102; *Berkeley Vill.*, 580 P.2d at 1255.

198. *See supra* Part II.B (noting that tax credits could be considered payment intangibles).

199. *See supra* Part II.B (noting that tax credits could be considered general intangibles); *see also* U.C.C. § 9-102(a)(42) (2011) (defining "general intangibles").

200. *See supra* notes 172–75 and accompanying text.

tax year, and a tax credit is a separate and independent disposition by the government, both result in the payment of funds.[201]

The only counter to this conclusion, as discussed above, is the case of nonrefundable credits.[202] These credits are used purely to reduce tax liability, and any excess credits that cannot be claimed must either be carried forward to be used in the next year or lost altogether.[203] Therefore, nonrefundable tax credits do not represent a right to demand payment. If a taxpayer does not withhold more than is necessary to fulfill his tax obligations, and if his credits can only be used to reduce tax liability, then there is no right to demand payment. Rather, nonrefundable tax credits reduce the amount that one has to pay to the government, but they do not entail the right to demand payment from the government. One could still argue, however, that this merely means that nonrefundable credits can only fall into the broader category of general intangibles and cannot be deemed payment intangibles, which are merely a subset of general intangibles.[204] Although *Metric Metals* opened the door for tax credits to be deemed general intangibles, the court did not arrive at this ultimate conclusion.[205] Because tax credits share similarities with, but also differences from, tax refunds, the court left the final determination open for another day.

B. City of Chicago v. Michigan Beach Housing Cooperative

The first case to address the question of tax credit financing was *City of Chicago v. Michigan Beach Housing Cooperative*.[206] In *Michigan Beach Housing Cooperative*, the developers of a 240-unit low-income housing facility obtained financing through a mortgage insured by the U.S. Department of Housing and Urban Development (HUD).[207] When the developers defaulted on the loan, HUD foreclosed on the property, and the developer declared bankruptcy.[208] In an effort to obtain approval for a plan of reorganization, the developers suggested turning the complex into a cooperative, whereby the residents of the complex would manage the facility through a nonprofit entity.[209] In order to effectuate the new plan, the defendant-cooperative obtained a loan from the City of Chicago (City) to be secured by the building and other assets.[210]

201. *See supra* notes 172–79 and accompanying text.

202. *See* FREELAND ET AL., *supra* note 82, at 925.

203. *See id.*; *see, e.g.*, I.R.C. § 25B(g) (2006) (prohibiting credits for retirement savings exceeding the sum of the regular tax liability, plus certain other taxes, over the sum of the credits allowable under this section and § 27).

204. *See supra* notes 131–39 and accompanying text.

205. *See* Sterling Nat'l Bank & Trust Co. v. Bornstein (*In re* Metric Metals Int'l, Inc.), 20 B.R. 633, 636 (Bankr. S.D.N.Y. 1981).

206. 609 N.E.2d 877 (Ill. App. Ct. 1993).

207. *Id.* at 880.

208. *Id.*

209. *Id.*

210. *Id.* at 881.

When the defendant-cooperative's financial position looked negative, it approached the City and HUD to receive approval of a new plan.[211] The new plan involved operating the building as a rental complex owned by a limited partnership—as opposed to a cooperative—and the City and HUD granting low-income housing tax credits to the limited partnership in order to syndicate with additional investors.[212] After the deal was agreed upon, the City and the Illinois Housing Development Authority, as local grantors of the credits, committed a combined $780,000in low-income housing tax credits to the developers.[213] Shortly thereafter, the City objected to the change in ownership structure from a cooperative to a limited partnership.[214] Notwithstanding the City's objection, the ownership change was consummated, and the new owners of the limited partnership were the defendant, as the general partner, and National Tax Credit Investors II, as the limited partner acting as the syndicated investor.[215]

Once the City learned of the transfers and syndication of funds, it filed suit to enforce its rights under the loan and security documents.[216] Among other things, the City claimed that, under Article 9 of the Illinois Commercial Code, it was entitled to recover from the cash proceeds of the low-income housing tax credits because the debtors had granted an interest in the credits through the loan's security agreement.[217] Specifically, the City argued that the syndication funds received by the limited partnership from the investors were, in essence, "proceeds"[218] of the tax credits.[219] The security agreement described the City's collateral, in part, as "'all . . . interests . . . in and to all . . . personal property of

211. *Id.*

212. The credits at issue in this case are Low-Income Housing Tax Credits (LIHTC):

> The tax credits . . . derive from Congress' Tax Reform Act of 1986 (Pub. L. No. 99-514). Each year, State and local agencies are granted low-income housing tax credits by the Federal government. The local entities then award the tax credits to eligible low-income properties. Once awarded, the low-income housing tax credits cannot be transferred from the property to which they were awarded—if they are not used because the property does not become a low-income residence, the Federal government reclaims them. Once tax credits are allocated to a property, the owner can sell limited partnership interests in the property so that investors can take advantage of the tax credits. This is called syndication.

See id. at 881 & n.1.

213. *Id.* at 881.

214. *Id.*

215. *Id.* at 881–82.

216. *Id.* at 882.

217. *Id.* at 882, 884.

218. The court explained the handling of proceeds from a sale of collateral as follows:

> Generally, under sections 306(2) and (3) of Article 9, as long as the creditor has a perfected security interest in the underlying collateral, he will also have a perfected security interest in the identifiable proceeds of the sale of the collateral, even if the term "proceeds" is absent from the security agreement or the financing statement.

Id. at 885 (citing 26 ILL. COMP. STAT. ANN. 9/306(3) (West 1991); *In re* Keneco Fin. Grp., Inc., 131 B.R. 90, 94 (Bankr. N.D. Ill. 1991); Farns Assocs., Inc. v. S. Side Bank, 417 N.E.2d 818, 821 (Ill. App. Ct. 1981)).

219. *Id.* at 884.

any kind or character now or hereafter owned by Borrower and . . . used or useful in connection with the Real Estate and Improvements.'"[220] The City asserted that the low-income housing tax credits were general intangible personal property used "in connection" with the building.[221] Therefore, the syndication funds would be considered "proceeds" of the tax credits and, thus, security for the loan.[222]

The court rejected the City's argument, stating that the security agreement did not cover the tax credits.[223] Aside from specifically naming the tax credits in the description of collateral, the argument that they were "in connection with" the real estate subject to the mortgage was "a fire too distant to give any warmth to the [C]ity."[224] The court observed that the "in connection with" clause was meant to be limited to only those types of personal property with a physical connection to the building.[225] While the court could have stopped at this juncture and moved on, it continued to opine on the use of tax credits as collateral in any Article 9 transaction.[226] Specifically, the court stated, "[w]e find the [C]ity's argument unavailing also because income tax credits cannot be intangible personal property subject to a security interest under Article 9."[227] The court acknowledged, as is stated many times herein, that "no court has yet determined whether income tax credits constitute general intangibles for purposes of Article 9."[228] However, the court looked to the United States Supreme Court's decision in *Randall v. Loftsgaarden*[229] for instruction.[230] In *Randall* the Court held, for purposes of the Securities Act of 1933, that:

> The tax benefits attributable to ownership of a security initially take the form of tax deductions or tax credits. These have no value in themselves; the economic benefit to the investor—the true "tax benefit"—arises because the investor may offset tax deductions *against* income received from other sources or use tax credits to reduce the taxes otherwise payable on account of such income. Unlike payments in cash or property received by virtue of ownership of a security—such as distributions or dividends on stock, interest on bonds, or a limited partner's distributive share of the partnership's capital gains or profits—the "receipt" of tax deductions or credits is not itself a taxable event, for

220. *Id.* at 885.
221. *Id.*
222. *Id.*
223. *Id.*
224. *Id.*
225. *Id.*
226. *See id.*
227. *Id.*
228. *Id.*
229. 478 U.S. 647 (1986).
230. *See Mich. Beach Hous. Coop.*, 609 N.E.2d at 885.

the investor has received no money or other "income" within the meaning of the Internal Revenue Code.[231]

In developing its arguments, the City pointed to the various cases affirming the analysis in *Metric Metals*, which held that tax refunds can be used as collateral, in order to further the argument that tax credits could also be used as security.[232] Nevertheless, the *Michigan Beach Housing Cooperative* court rejected the City's arguments, noting that income tax refunds are "vastly different" than tax credits.[233]

> Income tax refunds are quite obviously a property right because they constitute a present or future right to receive money which can be freely transferred after receipt. . . . [however], unlike income tax refunds, tax credits do not constitute a right to a payment of money, have no independent value, and are not freely transferable upon receipt.[234]

The court in *Michigan Beach Housing Cooperative* made several broad statements regarding tax credits that are in need of closer review and refinement.[235] First, the court used *Randall*—a case that dealt with tax credits and deductions in the context of federal securities law[236]—as an analytical guidepost.[237] Arguably, the narrowness of this field, as well as the particular facts of *Randall*, should caution one from extrapolating broad principles of law from specific scenarios involving the tax benefits derived from ownership in stocks, bonds, and other securities.[238] Secondly, the court stated that tax credits

231. *Randall*, 478 U.S. at 656–57.

232. *See Mich. Beach Hous. Coop.*, 609 N.E.2d at 886.

233. *Id.* (citing *Randall*, 478 U.S. at 656–57).

234. *Id.*

235. *See id.* at 885–86.

236. *Randall*, 478 U.S. at 650.

237. *See Mich. Beach Hous. Coop.*, 609 N.E.2d at 885–86 (citing *Randall*, 478 U.S. at 656–57, 666–67).

238. *See Randall*, 478 U.S. at 650–55. The court in *Michigan Beach Housing Cooperative* acknowledged that *Randall* was decided as a securities case, but the court pointed to other cases that have upheld the *Randall* analysis of income tax credits in other scenarios as well. 609 N.E.2d at 886 (citing Bove v. Worlco Data Sys., Inc., No. 86-1419, 1987 WL 5715, at *1 (E.D. Pa. Jan. 21, 1987) (recognizing that "the Court's analysis in *Randall* extends to 'out-of pocket' damages outside the context of the securities laws"); Fed. Deposit Ins. Corp. v. WH Venture, No. 84-5673, 1987 WL 11946, at *2 (E.D. Pa. May 29, 1987) ("Although *Randall* was decided in the context of the federal securities laws, its analysis of the nature of tax benefits is equally applicable in other contexts.")). The distinction the court does not make, however, is that the *Bove* and *WH Venture* courts used the *Randall* analysis when reviewing whether damages in a litigation suit should be reduced due to tax benefits that were received in connection with a limited partnership interest. *See Bove*, 1987 WL 5715, at *1; *WH Venture*, 1987 WL 11946, at *1–2. The particular facts at play do not bear upon whether a valid security interest can be created in tax credits. While it may seem obvious that no creditor would take a security interest in valueless property, it is not for the court to decide whether

and deductions "have no value in themselves" because the benefit derived from these rights requires that there first be income and a resulting tax liability.[239] The court compared these tax rights to distributions and dividends from the ownership of certain securities, which, in and of themselves, constitute independent economic value.[240] However, the court neglected to realize that tax credits can, and do, have independent value.[241] Credits that are nonrefundable may require income in order to be useable, but this requirement does not render them worthless to an investor.[242] Simply because there is a requirement of tax liability—a requirement which most all persons and entities would fulfill to some extent—does not mean that the credits have no value.[243] There is no requirement in Article 9 that collateral have a certain level of value in order to be legally used as security for an obligation.[244] Rather, the type of property must merely have some value and fit within the collateral categories provided in the code.[245] To superimpose an additional requirement of some roving, undefined level of value would be to add to the law in a way that neither the drafters of Article 9 nor the state legislatures that have adopted it envisioned. Moreover, refundable tax credits do have independent economic value under *Michigan Beach Housing Cooperative*'s test because they can produce a refund.[246] In this regard, tax credits are no different than a tax refund, which the court acknowledged as valid collateral for purposes of Article 9.[247] Tax credits constitute a right to demand payment because, once earned, they produce a payment from the government that can be enforced by the individual to whom the credits are entitled.[248]

Also, the court in *Michigan Beach Housing Cooperative* stated that

> [t]he investors cannot transfer or sell the tax credits separate from the security [in the entity] itself. . . . The tax credits they received along with their interest in the partnership were incidental benefits of that investment—not separate intangible personal property which could

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the "value" in a given piece of personal property rises to the level of sufficiency such that it would be acceptable to a lender. Such determinations are business decisions and are better left to the parties to decide. The only body of law that need be at play in questions of security over personal property is that of Article 9 and its related case law.

239. *Randall*, 478 U.S. at 656–57.

240. *See id.* at 657.

241. *See supra* Part II.A.

242. *See supra* Part II.A.

243. *See supra* Part II.A.

244. *See supra* Part II.A.

245. *See supra* Part II.A.

246. *See* City of Chi. v. Mich. Beach Hous. Coop., 609 N.E.2d 877, 886 (Ill. App. Ct. 1993).

247. *See, e.g.*, Sterling Nat'l Bank & Trust Co. v. Bornstein (*In re* Metric Metals Int'l, Inc.), 20 B.R. 633, 636 (Bankr. S.D.N.Y. 1981) (holding that a "debtor had property rights in the claims for tax refunds").

248. *See supra* Part II.A.

collateralize the city's loan—and whatever benefit they conferred on the investor renders no comfort to the city.[249]

While the court is correct in stating that *these* particular federal low-income housing tax credits are not transferable—as the investor must actually have an equity interest in the entity that earns the credits and then have the credits allocated to the investor through the entity—that is not to say that all tax credits are treated this way.[250] Tax credits vary and their assignability and transferability differ depending on the statutory and regulatory provisions governing the tax credit program.[251] Some credits can be claimed only by the individual who earns them, while some can be transferred to an investor through an equity allocation, provided the investor is an equity owner in the entity that earns the credits.[252] Further still, some credits are certificated and can be freely transferred, just as one buys and sells other assets.[253] The exact nature of how the credits can flow and be transferred is not uniform throughout the Internal Revenue Code or between state and federal schemes.[254] Rather, each credit has its own parameters, particulars, and rules that help effectuate the underlying government policy at play.[255] The court in *Michigan Beach Housing Cooperative* made broad statements regarding the sale and transfer of credits which—although perhaps applicable to the federal low-income housing tax credit—are not applicable to all credits across the board.[256] Further, making such global statements regarding the lack of value of tax credits, regardless of their refundability or assignability, serves as a poor roadmap for future courts to deal with an area of the law that is unchartered and complex. Unfortunately, in a regime where each tax credit is governed by its own particular set of rules, and can vary greatly between federal and state counterparts, the court in *Michigan Beach Housing Cooperative* was too aggressive in laying down blanket rules and broad policy statements to provide a useful and accurate groundwork on which future courts could rely when dealing with security interests in tax credit transactions.[257]

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249. *See Mich. Beach Hous. Coop.*, 609 N.E.2d at 886.

250. *See id.*

251. *See supra* Part II.A.

252. *See supra* Part II.A.

253. *See* Jeffrey D. Gaulin, *Allocated and Certificated Credits: What Matters When Combining State Tax Credits and NMTCs*, NOVOGRADAC NEW MARKETS TAX CREDIT REPORT (Novogradac & Co., S.F., Cal.), Mar. 2008, at 1, *available at* http://www.novoco.com/new_markets/resource_files/article_month/nmtc_article_of_month_0308.pdf.

254. *See generally* MOLLY F. SHERLOCK, CONG. RESEARCH SERV., R41641, REDUCING THE BUDGET DEFICIT: TAX POLICY OPTIONS 13 (2011), *available at* http://www.pgdc.com/pgdc/crs-analyzes-tax-policy-options (discussing the characteristics of various tax credits in an analysis of various revenue options for deficit reduction).

255. *See id.*

256. *See Mich. Beach Hous. Coop.*, 609 N.E.2d at 886.

257. *See id.*

C. *In re* Richardson

A more recent case addressing tax credit financing originated in an Ohio bankruptcy court.[258] In the case of *In re Richardson*, the petitioner took out three loans from a bank in anticipation of a future tax refund that she would receive at the end of the year.[259] As part of the loan application, the bank's tax agent assisted the petitioner in the preparation of her tax return and filed it electronically with the IRS.[260] Additionally, the petitioner was required to sign a loan agreement which provided that, among other things, the bank would receive "'a security interest *in and to my tax refund*, my account at the Credit Union into which my tax refund will be deposited, any other accounts at the Credit Union I may have, and any amounts that are deposited into such accounts from time to time.'"[261] Under the terms of the loan, the IRS would deposit the petitioner's refund directly into a designated account at the bank, and the bank would then apply the funds toward the repayment of the loan.[262] However, the IRS erroneously deposited the funds directly into the petitioner's account at the bank instead.[263] Upon receiving the refund, petitioner realized that the bank's tax agent who prepared her return failed to claim the "earned income tax credit" to which the petitioner was entitled.[264] Petitioner then returned to the bank and requested additional funds be advanced in an amount equal to the refund she would have received if the earned income tax credit would have been included.[265] The bank, which typically did not make loans in connection with the earned income tax credit, agreed to advance the funds at a lesser amount, provided the petitioner enter into additional loan agreements.[266] Prior to the petitioner's receipt of the long-awaited refund from the tax credits, she sought protection under Chapter 13 of the bankruptcy code.[267] Upon receipt of the

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258. *See In re* Richardson, 216 B.R. 206 (Bankr. S.D. Ohio 1997).

259. *See id.* at 208–09. The court noted at the outset:

> Here, we examine the largely unregulated practice by financial institutions of lending funds to taxpayers based upon their anticipated income tax refund. While not expressly condoned by the federal government, the practice as far as bankruptcy courts are concerned appears to be growing more popular with debtors who find themselves having to seek the protection under the bankruptcy laws. Too often, already strapped debtors view these programs as a quick answer to their immediate cash problems without the benefit of a long term strategy for addressing the problems at their roots. These debtors very often find themselves worse off than when they started. This case is no exception.

Id. at 209.

260. *Id.* at 209.

261. *Id.* (emphasis added).

262. *Id.*

263. *Id.* at 210.

264. *Id.*

265. *Id.*

266. *Id.*

267. *Id.* at 211.

refund, petitioner turned the funds over to her attorney instead of forwarding them to the bank.[268]

Among other theories, the bank claimed that it had been granted a security interest in the earned income tax credit.[269] However, the petitioner argued that the bank needed to have actual possession of the tax proceeds in order to establish that the security interest had been perfected under state law.[270] Nevertheless, the bank argued that regardless of whether the interest was perfected, it was still effective between the parties and thus could be enforced against the petitioner who still held the funds.[271] In its analysis, the court characterized the collateral as "the right to receive the proceeds from a check the Debtor received from the IRS representing an earned income tax credit."[272] The court went on to state that this particular type of security right was analogous to

> a right to receive a check representing a refund of excess state unemployment taxes [representing] "a kind of property known in the law as a chose in action or a thing in action."
>
> Furthermore, a property right known in the law as a "chose in action" or "thing in action" falls under the definition of "general intangible."[273]

After identifying the rights in the earned income tax credit as a general intangible, which could be secured under Article 9, the court went on to analyze whether such a security right had indeed been created.[274] Interestingly, the court held that the language in the loan agreement that granted a security interest "in and to my tax refund" was sufficient to encapsulate rights to the tax credit proceeds as well.[275] Because, in this case, the refund from the tax credit was transmitted to the petitioner through her annual tax refund, the security rights in the broader category of the entire refund necessarily captured any refund benefits derived from the tax credits.[276] The court concluded that the security was effective between the parties, but since no financing statement had been filed, it was not effective against third parties.[277] Since there were no other secured creditors attempting to establish priority over the collateral, the court resolved that the bank had the right to enforce its security rights over the proceeds from the tax credits, which came in the form of the refund.[278]

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268. *Id.*
269. *Id.* at 219.
270. *Id.*
271. *Id.*
272. *Id.*
273. *Id.* at 219 (quoting *In re* Gross-Feibel Co., 21 B.R. 648, 649 (Bankr. S.D. Ohio 1982)).
274. *Id.*
275. *Id.*
276. *Id.*
277. *Id.* at 219–20.
278. *Id.* at 220.

While the court in *Richardson* held that tax credits were valid as collateral for financing purposes, its analysis did little to help clarify the framework in which these types of collateral operate.[279] First, if tax credits are susceptible to collateralization, they most likely fall under the category of general intangibles under Article 9.[280] In order to grant an interest in general intangibles, the debtor must describe the collateral as such within the security agreement.[281] However, in *Richardson* the debtor granted a security interest solely in the tax refund.[282] As stated before, the proceeds from a tax refund amount to a repayment of funds that have been withheld or paid by the taxpayer over the course of the taxable year in excess of what was truly owed.[283] Further, tax credits that are refundable and that cannot be used to reduce the taxpayer's liability any further—for example, when an individual's total tax liability has been extinguished—also come back to the taxpayer in the form of a payment as part of the annual tax refund.[284] Thus, the amount that is refunded comes both from excess payments or withholdings beyond that which is owed by the individual and, if applicable, any refundable tax credits which cannot be used to reduce the overall liability.[285] It is incorrect to presume that an interest in a tax refund will always produce, as a part of such refund, a payment related to tax credits claimed by the individual.[286] Many tax credits can be used only to reduce tax liability, and if there are excess credits after the liability has been reduced to nothing, they must be carried forward for use in the next tax year.[287]

The analysis in *Richardson* suggests that every time a security interest is granted in a tax refund it also necessarily grants a security interest in any credits claimed.[288] But the result in *Richardson* is not inconsistent because, under those facts, the tax credit was refundable and was coming to the taxpayer in the form of a payment.[289] Therefore, it was not difficult for the court to find that the credit proceeds were subject to the security interest in favor of the bank.[290] However, if the tax credit was not refundable, but rather, was one which must be carried forward for use in another taxable year, then it would be more difficult to say that the loan agreement's statements about granting a security interest "in and to my tax refund" also contemplated a security interest in any applicable tax credits.[291] The court's limited analysis glossed over the necessary steps to

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279. *See id.* at 219.
280. *See* WARREN & WALT, *supra* note 1, at 171.
281. *See id.*; U.C.C. § 9-203(b)(3)(A) (2011).
282. *See In re Richardson*, 216 B.R. at 209.
283. *See supra* Part II.A.
284. *See* FREELAND ET AL., *supra* note 82, at 925.
285. *See id.*
286. *See supra* Part II.A.
287. *See supra* Part II.A.
288. *See In re* Richardson, 216 B.R. 206, 219 (Bankr. S.D. Ohio 1997).
289. *Id.*
290. *See id.* at 219–20.
291. *See id.*

connect the language in the agreement granting the security to the ultimate holding of the case.[292] By drawing lines between the interest-granting provisions in the tax refund and the conclusion that the interest included the general intangible earned income tax credit, the court failed to recognize the proper method of attaching a security interest under Article 9 and further helped obfuscate the ultimate issue.[293]

Moreover, a security interest under Article 9—although it need not involve the specificity that is required when granting a mortgage over real property—calls for a description of the collateral.[294] Typically, the collateral is described in terms of the general categories laid out in Article 9, such as all accounts, all inventory, or all general intangibles.[295] Sometimes, however, debtors will name specific types of collateral, like a specific deposit account, instead of saying "all deposit accounts."[296] In *Richardson*, the security agreement did not state "all general intangibles"—which arguably would have been an unequivocal grant of a security interest in any tax credits—but instead named a specific type of general intangible—the rights in and to the tax refund.[297] The court, in its conclusory analysis, held that this amounted to the granting of a security interest in the tax credits as well, without specifically setting forth how this conclusion was reached.[298] The implication of this broad rationale is to conclude that every security interest in a tax refund would also include a security interest in and to any tax credits that the taxpayer may be entitled. Under the holding in *Richardson*, borrowers are left to ponder exactly what collateral they grant when security is pledged in the form of a tax refund.[299] Without more careful discussion and analysis, the question of tax credit financing remains open-ended, if not further muddied.

IV. SUGGESTING A NEW TEST FOR ASSESSING TAX CREDIT COLLATERAL

As courts have struggled with the issue of how to treat tax credits when used as collateral, the analytical framework at play in supporting each holding leaves much to guesswork.[300] Courts have drawn parallels to other types of rights in order to make assessments about tax credit collateral, oftentimes in ways that

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292. *See id.* at 219.
293. *See id.*; U.C.C. § 9-203(b)(3)(A) (2011).
294. *See* U.C.C. § 9-203(b)(3)(A).
295. *See* WARREN & WALT, *supra* note 1, at 25.
296. *See id.*
297. *See In re Richardson*, 216 B.R. at 219.
298. *See id.* at 219–20.
299. *See id.*
300. *See, e.g., id.*; Sterling Nat'l Bank & Trust Co. v. Bornstein (*In re* Metric Metals Int'l, Inc.), 20 B.R. 633, 636 (Bankr. S.D.N.Y. 1981); City of Chi. v. Mich. Beach Hous. Coop., 609 N.E.2d 877 (Ill. App. Ct. 1993); *see also* Va. Historic Tax Credit Fund 2001, LP v. Comm'r, 639 F.3d 129, 141–42 (4th Cir. 2011) (discussing that, although tax credits were not transferrable, they maintained inherent value as property).

seem inconsistent with the very nature of tax credits.[301] Alternatively, some interpretations comport with the nature of tax credits but not necessarily with the nature of the rights to which credits are being compared.[302] Moreover, the courts have made broad and sweeping pronouncements about the nature of Article 9 collateral in general, at times even suggesting that additional requirements—outside those articulated in the statute—are required in order to properly perfect the security right.[303] Lastly, courts have taken one or more nuanced aspects of a specific tax credit and extrapolated them over the broad field of all tax credits without carefully considering the maxim that not all credits are created equal.[304] Without a more coherent framework to work within, courts will continue to struggle and produce varying, inconsistent holdings in tax credit secured transaction cases.

A. Adjusting the Focus

Despite these varying analytical fine points which have contributed, in no small part, to the overall thicket of conflicting case law, the one element that all of the cases have in common is that the courts tend to focus, even if only by implication, on the refundability of tax credits.[305] For instance, in *Michigan Beach Housing Cooperative* the court held that tax credits have no economic value because there first must be a tax liability in order for the credits to be of use.[306] In this case, the court was confronted with Low-Income Housing Tax Credits, which are not refundable and can be used only to reduce liability.[307] Here, the court was focusing on the specific payment nature of the credit.[308] However, the specific tax credit at issue could not be used to generate a refund, but rather, could be used only to reduce the taxpayer's liability; therefore, the court held that the credit could not be used as collateral.[309] Setting aside the fact that the Low-Income Housing Tax Credits in this case were nonrefundable, not all credits are such, and the court's analysis hinged on the refundability question.[310] The focus was on whether this credit could, in essence, ever be used to produce a cash payment.[311] Further, in *Richardson* the court suggested that because the earned income credit produced a cash refund, and because that cash refund would come to the taxpayer in the form of her annual tax refund, the bank

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301. *See supra* notes 235–48 and accompanying text.
302. *See supra* notes 279–99 and accompanying text.
303. *See supra* notes 235–48 and accompanying text.
304. *See supra* notes 235–48 and accompanying text.
305. *See supra* Part II.
306. City of Chi. v. Mich. Beach Hous. Coop., 609 N.E.2d 877, 886 (Ill. App. Ct. 1993).
307. *See id.* at 881 & n.1.
308. *See id.* at 886.
309. *See id.*
310. *See id.*
311. *Id.*

had obtained an interest in the tax credits themselves.[312] However, the debtor did not grant an interest in general intangibles in the security agreement but rather only in the tax refund.[313] The court's holding suggests that, because the tax credit came in the form of a refund and the security interest was granted in the refund, a security interest was effectively in the tax credits.[314] However, if the tax credit at issue represented a nonrefundable right, would the court's holding be the same? The court made no specific distinction as to whether a different type of credit would produce a different result.[315] But again, as in *Michigan Beach Housing Cooperative*, the court focused—albeit perhaps subconsciously—on the refundability question.[316] Whether the credit was refundable determined the court's analysis or, at the very least, guided the court to its ultimate conclusion.[317]

A key issue at play in producing the varying results from the courts that have faced the tax credit issue is precisely this misplaced focus on refundability. By focusing on refundability, courts are presupposing that only those tax credits that produce a refund actually have enough value to be eligible for collateralization.[318] In essence, unless a particular credit can be turned to cash, it cannot be used as collateral.[319] Further, this conclusion seems to rest on the supposition that a credit must take an interest in its collateral in a certain threshold amount.[320] As stated above, Article 9 does not require a particular level of value for collateral to be eligible as security; rather, the property must simply have some value.[321] These value decisions are—as they should be—left to the parties to the transaction.[322] The parties are in the best position to determine whether the debtor's offering is of enough significance to the creditor to entice him to advance funds.[323] Courts should not look further into the minds of the parties when attempting to ameliorate any of the creditor's risk miscalculations.[324] All Article 9 requires is some level of value and compliance

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312. *See In re* Richardson, 216 B.R. 206, 219 (Bankr. S.D. Ohio 1997).

313. *Id.*

314. *See id.*

315. *See id.*

316. *See id.*; City of Chi. v. Mich. Beach Hous. Coop., 609 N.E.2d 877, 886 (Ill. App. Ct. 1993).

317. *See supra* Part II.B.

318. *See supra* Part III.

319. *See, e.g., Mich. Beach Hous. Coop.*, 609 N.E.2d at 886 (concluding that tax credits have no independent value, and therefore cannot serve as collateral).

320. *See id.* at 884–86.

321. *See* LYNN M. LOPUCKI & ELIZABETH WARREN, SECURED CREDIT: A SYSTEMS APPROACH 197 (6th ed. 2009) ("Article 9 places no express limits on what may serve as collateral.").

322. *See id.* at 150–52, 197.

323. *See* Benjamin E. Hermalin et al., *Contract Law*, *in* 1 HANDBOOK OF LAW AND ECONOMICS 3.1.2, at 59–60 (A. Mitchell Polinsky & Steven Shavell eds., 27th ed. 2007).

324. *See generally* David E. Bernstein, *Freedom of Contract* (George Mason Univ. Sch. of Law, Working Paper No. 08-51, 2008), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract

with the procedural aspects of the statute in order to perfect a security interest in personal property.[325] Therefore, the imposition of an additional value requirement would seem to be purely judicial, thereby developing only through a succession of cases addressing the issue of value. This imposition would create uncertainty in the market and could result in many creditors requiring more collateral than would traditionally be necessary based on fear that a court may find their value determination to be invalid because of a failure to meet some invisible value threshold.[326]

Further, the other essential pillar to the refundability focus is the supposition that nonrefundable tax credits have no value.[327] Because credits are merely statutorily relegated to the pure reduction of tax liability, it would seem, based on the cases above, that tax credits are disqualified from collateralization.[328] In fact, many credits are nonrefundable and, despite this aspect, are readily traded, bought, and sold on the open market.[329] An individual with a high tax liability would find no less value in a credit used to reduce the amount of money he is forced to pay to the government than a credit that could be converted to cash if his liability was zeroed out. The value is the same in either case because the credit is conveying certain economic benefits—be it the reduction of tax liability or the payment of a refund—to the taxpayer.[330] It is not necessary for the taxpayer to receive a refund in order for credits to be valuable.[331] If that were the case, then all tax credits would be refundable, and that is certainly not the case.[332] Further, even refundable tax credits will produce only a refund if that taxpayer's liability has been reduced to zero.[333] In many cases, tax credits are used to *reduce* a taxpayer's liability—not completely wipe it out—but the easing

_id=1239749 (surveying United States Supreme Court cases on the liberty of contract doctrine). *But see* Zvika Neeman, *The Freedom to Contract and the Free-Rider Problem*, 15 J.L. ECON. & ORG. 685, 686, 699 (1999) (arguing that the freedom to voluntarily contract should be restrained in certain transactions).

325. *See, e.g.*, U.C.C. § 9-203 (2011) (setting forth requirements for attachment and enforceability of security interests); *id.* § 9-309 (security interests, such as payment intangibles, attached and perfected immediately upon sale); *id.* § 9-312 (security interests in chattel paper and deposit accounts perfected by filing or control); *id.* § 9-313 (perfection by possession).

326. *See supra* notes 318–22 and accompanying text.

327. *See* City of Chi. v. Mich. Beach Hous. Coop., 609 N.E.2d 877, 886 (Ill. App. Ct. 1993).

328. *See id.*

329. *See* Michael J. Novogradac, *Investing in Low-Income Housing Tax Credits*, COMMUNITY DEVELOPMENTS, U.S. OFFICE OF THE COMPTROLLER OF THE CURRENCY, http://www.occ.gov/static/community-affairs/community-developmentsinvestments/spring06/investinginlowincome.htm (Mar. 2010); *see also Why Invest in Tax Credits?*, AFFORDABLE EQUITY PARTNERS, INC. (Mar. 24, 2012), http://aepartners.com/why_invest.aspx (arguing that tax credits are safe investments that can generate high returns); David Weaver & Jeff Cornwall, *Should Angel Investors Get Tax Credits to Invest in Small Businesses?*, WALL ST. J., Mar. 19, 2012, at R5 (providing contrasting views on whether investors should receive tax credits for investing in small businesses).

330. *See* GUERIN & POSTLEWAITE, *supra* note 56, at 879–83.

331. *Id.*

332. *See* Batchelder et al., *supra* note 15, at 25.

333. *See id.* at 33.

of the overall liability is valuable to the taxpayer nonetheless.[334] Would courts then suggest that only those taxpayers who have tax credits that can effectively both zero out their tax liability and leave enough left over to produce a refund pledge their credits as collateral? Such a litmus test for tax credit collateral certainly departs from the economic realities of how tax credits operate in the marketplace[335] and surely goes far beyond what the drafters of Article 9 envisioned when they created the general intangibles category.[336]

The focus on refundability is flawed because it creates assumptions regarding the value and variability of tax credits that departs from the economic realities of the transaction, and it adds a requirement for creating a security interest under Article 9 that should not exist.[337] Courts should recognize this focus on refundability and jettison it for a more accurate and appropriate approach in analyzing tax credit collateral; specifically, an approach that focuses on transferability.

B. A Two-Pronged Approach to Transferability

Courts should focus on the transferability characteristics of tax credits—the aspect that is most important in terms of providing security. If the credit can be effectively transferred to a third party, then the credit can be seized in the event of a default, and a forced sale can ensue.[338] However, if the transfer of the credit is limited to the taxpayer only, then the ability to assign the rights in the credit as collateral for an obligation is impermissible.[339] In essence, a creditor who would take a security right in a nontransferable credit would, for all practical purposes, have a useless security interest because the creditor would be without an avenue to actually possess the credit.[340] Transferability—not refundability—is what matters most in assessing the viability of the security. This transferability inquiry involves the intersection of Article 9 and the laws and regulations applicable to the tax credit in question. This examination can be further broken down into its more theoretical and practical aspects. In order to make a full

334. *See* GUERIN & POSTLEWAITE, *supra* note 56, at 879–83.

335. *See supra* note 329 and accompanying text.

336. *See supra* notes 91–109 and accompanying text.

337. *See generally* Part III.A and accompanying discussion.

338. *See* LOPUCKI & WARREN, *supra* note 321, at 38–40.

> An enforceable right to possession also has strategic value. The creditor who can make a credible threat to dispossess the debtor—even if only temporarily—has extraordinary leverage over the debtor. . . .
>
> This kind of leverage can flow in the other direction as well. The debtor who can credibly threaten to retain possession of the collateral for a long time, to run up the cost of repossession, or to reduce the value of the collateral before the creditor can gain possession may be able to take advantage of the creditor in post-default negotiations.

Id.

339. *See id.*

340. *See id.* ("The ability to gain or retain possession during foreclosure can have a value far in excess of the use value of the property during the period in question.").

assessment of transferability, a two-pronged approach is suggested—one that looks to both the substantive and procedural nature of the granting of the security interest.

First, does the collateralized tax credit meet the substantive transferability prong? In other words, does the statute creating the tax credit, and the accompanying tax rules and regulations promulgated thereunder, allow for the tax credit to be transferred? As stated before, some tax credits may only be claimed by the person entitled to them and cannot be transferred.[341] This may be for public policy reasons, such as with certain credits that are enacted in order to provide economic relief to the poor or those who have suffered from a crisis or natural disaster.[342] In this case, public policy dictates that, because the credit is aimed at a specific population or demographic, it should not be transferable so as to create value for unintended parties.[343] However, also stated above, many credits are transferable because government policy desires that they be traded, exchanged, bought, and sold on the open market in order to further enhance and develop the particular activity the government wishes to encourage.[344] In analyzing this first prong, courts must look beyond the mere requirements of Article 9 and delve into the substance of the tax credit itself. This calls for a more intensive analysis; one that courts of general jurisdiction are often times uncomfortable making in light of the specialized nature of tax law.[345] Nevertheless, the nuances of tax credits in the collateral context require a crossing-over of disciplines in order to conduct a full and coherent analysis. Determining whether the credit has the legal properties that allow for transfers to

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341. *See generally* John J. Infranca, Note, *The Earned Income Tax Credit as an Incentive to Report: Engaging the Informal Economy Through Tax Policy*, 83 N.Y.U. L. REV. 203, 204 (2008) (discussing the Earned Income Tax Credit and tax and transfer program reporting policies); V. Joseph Hotz & John Karl Scholz, *The Earned Income Tax Credit* 1–15 (Nat'l Bureau of Econ. Research, Working Paper No. 8078, 2001), *available at* http://www.nber.org/papers/w8078 (discussing the history and evolution of the Earned Income Tax Credit).

342. *See generally* Dennis J. Ventry, Jr., *The Collision of Tax and Welfare Politics: The Political History of the Earned Income Tax Credit, 1969–99*, 53 NAT'L TAX J. 983, 986 (2000) (discussing the political history and policies behind the Earned Income Tax Credit and its precursors); Dorothy A. Brown et al., *The Undeserving Poor?: Welfare, Tax Policy, and Political Discourse* (Wash. & Lee Pub. Law & Legal Theory Research Paper Series, Working Paper No. 04-02, 2004), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=530223 (comparing the Earned Income Tax Credit to welfare).

343. *See supra* note 342 and accompanying text.

344. *See, e.g.*, William J. Luther, *Movie Production Incentives: Blockbuster Support for Lackluster Policy*, TAX FOUND. SPECIAL REPORT (Tax Found., Wash., D.C.), Jan. 2010, at 1, 2–5, 16, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1538687 ("In the last decade, state governments have 'gone Hollywood,' or tried to, by enacting dozens of movie production incentives (MPIs), including tax credits for film production."). *See generally* Michael S. Knoll, *Taxes and Competitiveness* 6, 16 (Univ. of Pa. Law Sch. Inst. for Law & Econ., Working Paper No. 06-28, 2006), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=953074 (discussing how tax incentives affect competitiveness).

345. *See* Michael Livingston, *Congress, the Courts, and the Code: Legislative History and the Interpretation of Tax Statutes*, 69 TEX. L. REV. 819, 826–31 (1991).

third parties is the first and most foundational question in determining whether it can be effectively collateralized.

Second, does the collateralized tax credit meet the procedural transferability prong? Stated another way, have the creditor and the debtor engaged in those activities, made those arrangements, and procured those necessary approvals so as to mechanically allow for the tax credits, in the event of a default, to be seized and sold by the creditor in order to obtain relief? While a scenario may pass the substantive prong, the procedural prong is equally important because it asks the practical question of whether the parties have engaged in the correct activity so as to make the first prong effective. The answer to this question similarly requires a case-by-case inquiry into the tax credit. For instance, some tax credits are certificated—when the taxpayer receives the credit, it comes in the form of a certificate or other tangible document which evidences the right to claim the credit.[346] If the credit is granted as collateral, the certificate might need an addendum or a notation evidencing the fact that it is being used as collateral.[347] Typically the regulating agency will need to be notified as well as give approval to the third party—the creditor—who is taking an interest in the credit. This is important because, in the event there is a default and the creditor seizes the certificates, the creditor will want to ensure that the governmental body will respect the transfer of ownership of the security rights, even though the government itself was not involved in approving the granting of those rights.[348] In such a case, perhaps the governmental agency would become an intervening party in the security agreement to show its intent to recognize the creditor's right in the event of a seizure.[349] However, some credits, even though they can be substantively transferred, cannot be procedurally transferred for use as collateral. Specifically, many tax credits can be transferred only through an allocation to the members of the taxpayer.[350] For instance, New Market Tax Credits and

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346. *See* Gaulin, *supra* note 253, at 1 ("Certificated tax credits, on the other hand, are sold to investors like a piece of property. The state provides a certificate indicating a tax credit amount and this certificate is transferable to (almost) anyone. This means that the investor need not be a partner of the entity generating the credit.").

347. *See* U.C.C. § 9-203(b) (2011) (requiring the security agreement to identify collateral).

348. *See id.* § 9-309 cmt. 4 (reflecting the policy that "[a]ny person who regularly takes assignments of any debtor's accounts or payment intangibles should file" a financing statement or security agreement describing the collateral).

349. *See, e.g., id.* §§ 9-310, -312, -313, -322, -325, & -330 (providing general rules on perfection and priorities of secured interests).

350. *See* Gaulin, *supra* note 253, at 1. As noted by Jeffrey Gaulin:

> Allocated tax credits (a category that includes all federal tax credit programs) are allocated to the owners of a pass-through entity, such as a partnership or limited liability company treated as a partnership for federal income tax purposes. Therefore, to obtain an allocated tax credit, the investor must be a partner in the entity that is generating the tax credit. Most states that have allocated tax credits also allow for a "special allocation" of these tax credits. A special allocation enables the investor to receive a disproportionate amount of state tax credits compared to the partner's ownership percentage in the entity.

Id.

Low-Income Housing Tax Credits can be allocated only in this manner.[351] When the tax credits are awarded to the taxpayer entity, those credits can be passed through to all or just select members of the entity.[352] Although the credits are being transferred in a sense, they are not being transferred as freely as credits that are certificated.[353] Rather, they are being passed along through the ownership structure of the entity; for example, from a limited liability company to its members or from a partnership to its partners.[354] Not just any third party can receive the credits; that party must have an equity interest in the entity that is entitled to the credits, and the transfer must come through the allocation of tax benefits to the members.[355] In such a case, the credits are substantively transferable, but there would be no way to procedurally allow the credits to be seized by a creditor in the event of a default.[356] There would be no way for the seizure to take place because the tax law governing the credits would not allow for it.[357] This is where Article 9, which can be completely adhered to in the granting of the security interest in the credits, conflicts with the tax law governing the credits, which does not allow for the practical collateralization of the credits.

The satisfaction of each prong is essential to granting an effective security interest in a tax credit. By adopting this two-pronged approach to transferability, courts will be able to sift through the many questions and considerations involved in the collateralization of tax credits, while still maintaining the integrity of the Article 9 regime. This test provides a guidepost for courts, which generally do not deal with tax issues on a regular basis,[358] to use in conducting a full and complete analysis of the issue. Aside from the typical Article 9 perfection and attachment inquiry,[359] this extra analysis in assessing the proper collateralization of tax credits resolves the inter-legal issues of tax law and Article 9—issues which reach a critical intersection when dealing with tax credit financing.

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351. *See id.* at 1–3.

352. *Id.* at 3.

353. *Id.*

354. *Id.*

355. *See id.*

356. *See generally id.* at 1–3 (discussing transferability restrictions associated with allocated tax credits).

357. *Id.*

358. *See generally* HAROLD DUBROFF, THE UNITED STATES TAX COURT: AN HISTORICAL ANALYSIS 1, 23 (1979) (theorizing that the United States Tax Court was formed to address the inadequacy of judicial dispositions on tax issues).

359. *See generally* LAWRENCE ET AL., *supra* note 105, § 2.01, at 67 (discussing attachment of security interests), § 4.01, at 112 (discussing perfection of security interests); LOPUCKI & WARREN, *supra* note 321, at 131–39 (providing general information regarding the creation and perfection of security interests).

V. CONCLUSION

As commercial policy changes in order to accommodate increasingly complex business transactions, the law governing these transactions must stay attuned to these desires.[360] This is particularly true with regard to security rights, which comprise such a substantial portion of commercial transactions today.[361] As tax credits become more and more a part of our commercial policy and, in turn, a part of our business transactions, the law must be designed to effectively deal with situations where these types of taxation rights are used as collateral. Article 9 of the Uniform Commercial Code was designed to give stability to the law of security rights in personal property.[362] However, the types of collateral that parties once used in business transactions are having to make room for new and nontraditional types of personal property rights.[363] Tax credit financing is becoming a major part of many transactions; yet the law governing the collateralization of these credits is uncertain.[364] Courts that have been forced to confront the issue have come to varying, and often inconsistent, conclusions.[365] The result has been the compilation of an unpredictable, and in some cases incorrect, body of precedent that creates more confusion than it does stability.[366]

A core fault in the courts' analysis of tax credit financing is their focus on the refundability aspect of tax credits.[367] By honing in on whether the credits can in fact produce a refund—as opposed to merely reducing tax liability—courts have hindered their examination of the law by missing the larger and more relevant question of transferability. Credits have value regardless of whether they can produce a refund.[368] The ability of a credit to reduce one's tax liability

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360. *See generally* Christopher K. Odinet, Comment, *Laying to Rest an* Ancien Régime*: Antiquated Institutions in Louisiana Civil Law and Their Incompatibility with Modern Public Policies*, 70 LA. L. REV. 1367, 1368 (2010) (arguing legislatures should adapt existing laws to account for changes in the modern business landscape).

361. *See generally* Hannah L. Buxbaum, *Unification of the Law Governing Secured Transactions: Progress and Prospects for Reform*, 8 UNIFORM L. REV. 321, 322 (2003) (discussing various national laws related to secured transactions, and the need to develop a globalized body of securities law); Mark J. Sundahl, *Iraq, Secured Transactions, and the Promise of Islamic Law*, 40 VAND. J. TRANSNAT'L L. 1301, 1304 (2007) (discussing the need to reform Iraqi secured transactions law); Roderick J. Wood, *Journey to the Outer Limits of Secured Transactions Law: Caisse Populaire Desjardins De L'Est De Drummond*, 48 CAN. BUS. L.J. 482, 482 (2009) (analyzing a 2009 Canadian case dealing with security interests); Alejandro Alvarez de la Campa, *Increasing Access to Credit Through Reforming Secured Transactions in the MENA Region* (The World Bank, Working Paper No. 5613, 2011) (analyzing secured transactions law in the Middle East and North Africa, and subsequently discussing the need for reform).

362. *See* WARREN & WALT, *supra* note 1, at 10.

363. *See supra* Part I.

364. *See supra* Part II.B.

365. *See supra* Part III.

366. *See supra* Part III.

367. *See supra* Part II.B–III.

368. *See supra* Part II.

carries great value.[369] It is the ability to transfer the credit which matters because it is this aspect that governs whether, in practical terms, the creditor will have the ability to seize the tax credit in the event of a default.[370] Further, the analysis of the transferability aspect of tax credits should be further broken down into its substantive and procedural aspects.[371] Specifically, courts should—in addition to employing the traditional Article 9 inquiries—ask whether the law governing the tax credit allows for it to be transferred to parties other than the taxpayer, and then ask whether the parties can, and have, engaged in the type of procedures and activities that would actually allow the creditor to seize and exercise control over the credit in order to monetize it in the event of a default.[372] By undertaking such an analysis that cuts to the heart of whether tax credits truly can be collateralized, courts will have a reasoned and appropriately inter-legal framework to help them in making clear and consistent decisions and private parties will have a roadmap in structuring their commercial transactions.[373]

As commercial transactions become increasingly intertwined with the granting of security rights in tax credits, it is necessary to understand and assess the viability of collateralizing other forms of general intangibles as well. Tax credits and other forms of nontraditional collateral were arguably envisioned by the drafters of Article 9, evidenced by their broad definitions of general intangibles.[374] However, because this category is so expansive, it lacks some of the reliable, intricate, and precise legal rules that many of the other collateral categories, such as deposit accounts and investment property, enjoy in Article 9.[375] Further analysis is required in order to determine whether the two-prong test for transferability suggested in this Article could be used to aid courts and private parties in their future understanding of business transactions that involve the collateralization of these and other nontraditional forms of property.

369. *See supra* Part II.
370. *See supra* Part III.
371. *See supra* Part III.
372. *See supra* Part III.
373. *See supra* Part III.
374. See WARREN & WALT, *supra* note 1, at 171.
375. *See id.* at 12–13.