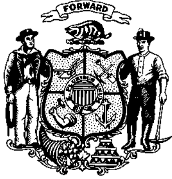

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Modifications to the Supplement to the Federal Historic Rehabilitation Tax Credit (General Fund Taxes -- Income and Franchise Taxes)

[LFB 2009-11 Budget Summary: Page 266, #19]

CURRENT LAW

Under current law, an individual or corporation may claim a credit against state income or franchise taxes due for up to 5% of qualified rehabilitation expenditures for certified historic structures.

GOVERNOR

Modify statutory provisions of the state supplement to federal historic rehabilitation tax credit as follows:

a. Require that, in order to claim the tax credit, a claimant must include, with the claimant's return, evidence that the rehabilitation was recommended by the state historic preservation officer for approval by the U.S. Secretary of the Interior before the physical work of construction, or destruction in preparation for construction, began, and that the Secretary of the Interior approved the rehabilitation.

b. Require that the credit must be claimed at the same time as the federal credit is claimed.

c. Provide that, for shareholders of a tax-option corporation, the credit may be allocated in proportion to the ownership interest of each shareholder. Credits computed by a partnership or limited liability company could be claimed in proportion to the ownership interests of the partners or members, or allocated to partners or members as provided in a written agreement among the partners or members that was entered into no later than the last day of the

taxable year of the partnership or LLC, for which the credit was claimed. For a partnership or LLC that placed property in service after June 29, 2008, and before January 1, 2009, the credit attributable to such property could be allocated, at the election of the partnership or LLC, to partners or members for a taxable year of the partnership or LLC that ended after June 29, 2008, and before January 1, 2010. Any partner or member who claimed the credit under these provisions would be required to attach a copy of the agreement, if applicable, to the tax return on which the credit was claimed. A person claiming the credit as provided under these provisions would be solely responsible for any tax liability arising from a dispute with the Department of Revenue (DOR) related to claiming the credit.

d. Specify that a person who elected to claim the credit based on claiming amounts for expenditures as the expenditures were paid, rather than when the rehabilitation work was completed, would be required to file an election form with DOR, in a manner prescribed by the Department. DOR would be authorized to adjust or disallow the credit claimed within four years after the date that the State Historical Society notified the Department that the expenditures for which the credit was claimed did not comply with the standards for certification promulgated by the Historical Society by rule.

These provisions would have a minimal fiscal effect.

DISCUSSION POINTS

1. Current law provides a state income or franchise tax credit for up to 5% of qualified rehabilitation expenditures for certified historic structures. A certified historic structure is defined as a building that is listed in the National Register of Historic Places, that is determined to be historic and will be listed in the National Register or that is contributing to a registered historic district. The building must be used for the production of income, such as commercial, industrial, or residential rental purposes. "Qualified rehabilitation expenditures" are amounts incurred that must be capitalized and added to the basis of the building rather than being deducted. Qualified expenditures do not include any amount being depreciated under an accelerated method, the cost of acquiring the building itself, or any expense for enlargement of an existing building. Expenses capitalized or properly chargeable to a capital account are those that are properly includable in calculating the basis of real property, such as architectural, engineering, and site survey fees, and construction period interest and taxes that are treated by the taxpayer as chargeable to a capital account. Also included are legal and development fees, insurance premiums, and construction costs.

Qualified rehabilitation expenditures are eligible for the credit only if incurred in connection with substantial rehabilitation of property located in the state, if the physical work of construction or destruction in preparation for construction begins after December 31, 1988, and the rehabilitated property is placed in service after June 30, 1989. The test of substantial rehabilitation generally is met if the qualified expenditures during a two-year period (60 months for phased rehabilitation) exceed the greater of $5,000 or the adjusted basis of the building. Unused credit amounts can be carried forward up to 15 years to offset future tax liabilities.

In order to claim a credit, the claimant must include, with the tax return, evidence that the rehabilitation was approved by the U.S. Secretary of the Interior.

Partnerships, LLCs, and S corporations may not claim the credit, but the eligibility for and the amount of the credit are based on each entity's eligible investments. The partnership, LLC, or S corporation must compute the amount of credit that each of its partners, members, or shareholders may claim and provide that information to each of them. Partners, members of LLCs, and shareholders of S corporations claim the credit in proportion to their ownership interest.

2. The historic preservation tax credit is designed to promote urban and rural revitalization and to encourage private investment in rehabilitating historic buildings. In order to take advantage of historic preservation tax incentives (the federal government provides a 20% tax credit for rehabilitating certified historic structures) an individual must: (a) own a "certified historic structure"; (b) use the building for the production of income, according to IRS regulations; (c) substantially rehabilitate the building; (d) design and carry out work in conformance with the Secretary of the Interior's "standards for rehabilitation"; and (e) formally apply to the National Park Service, through the Division of Historic Preservation of the Wisconsin Historical Society (Division) for certification of the project. However, the Division does not have the authority to approve historic tax credit applications. The National Park Service approves or denies tax credit requests.

3. The general application process is as follows:;

a. Contact the Division to determine if the building is a certified historic structure and if the work on the building meets Park Service standards.

b. Prepare the Part 1 application used to evaluate the significance of the property. The application is used to determine if the rehabilitated building is likely to contribute to the significance of a national or local historic district, or be listed on the National Register of Historic Buildings.

c. Prepare and submit the Part 2 application, that includes a detailed description of the rehabilitation/preservation work. The application must be submitted with the Part 1 application. Generally, the Park Service responds within 60 days of the Division's receipt of the application.

d. Carry out the rehabilitation/preservation work. Once the Part 2 application has been approved, an individual may begin the rehabilitation/preservation work.

e. Apply for certification, in the calendar year in which the rehabilitation/preservation work is completed and the building is placed in service. The individual must submit Part 3 of the application (request for certification) to the Park Service. The Park Service can then approve the application, which must be submitted to the IRS along with tax credit claims.

4. Aggregate statistics compiled by the Department of Revenue indicate that for tax year 2006, nine corporations claimed about $1.2 million in historic preservation tax credits and used

approximately $1.2 million to offset tax liabilities. For tax year 2006, a total of $1.9 million in historic rehabilitation tax credits were claimed by 447 individual income tax claimants, and about $1.5 million was used to offset tax liabilities. For tax year 2007, approximately $2.2 million in credits were claimed by 447 individuals, and about $1.7 million was used to offset tax liability. The attachment provides a summary of historic rehabilitation tax credits provided by other states.

5. The 2008 annual report for federal tax incentives for rehabilitating historic buildings, prepared by the U.S. Park Service indicates that rehabilitation/preservation projects for which the federal tax incentives were claimed generated $5.64 billion in rehabilitation work, and created 67,705 jobs. A 2002 study of the economic impacts of historic preservation in the State of Missouri found that $346 million was spent annually for the rehabilitation of historic buildings. The rehabilitation work annually generated an estimated 8,060 jobs in the state, and $249 million in income. An estimated $70 million in state and local taxes was also generated. A 2006 study of the impact of the federal historic preservation tax credit on the state of Washington's economy indicated that, between 2000 and 2004, $83.5 million was spent rehabilitating historic buildings in the state. The spending generated approximately $220 million in annual sales, supported approximately 2,320 jobs, and generated about $87 million in labor income in the state.

6. The changes to the historic preservation tax credit included in the bill would allow credits to be claimed after the state historic preservation officer recommended the rehabilitation project for approval by the Secretary of the Interior. In addition, credits claimed by a partnership or limited liability company could be allocated to partners or members through a written agreement among the partners or the members, rather than in proportion to their ownership interest, as required under current law. In testimony supporting the budget provisions, the state historic preservation officer indicated that allowing written agreements for distributing the credits would attract out-of-state investors. According to his testimony, in many states, the investor who claims a federal tax credit differs from the state tax credit claimant. Allowing credits to be distributed through agreements would permit developers to attract additional investors. Also, allowing the credit to be claimed before federal approval would allow developers to begin work earlier, since federal approval takes about 60 days. Representatives of the National Trust for Historic Preservation also indicated that the budget provisions would allow for greater and more substantial use of the state historic preservation tax credit. The attachment shows that other states, such as Missouri, allow for disproportionate allocation of credits to partners.

7. Typically, all state tax credits must be claimed be partners, LLC members, and S-corporation shareholders in proportion to their ownership interest. The provisions in the budget would provide special treatment to partners and members for the purpose of claiming the historic preservation tax credits. A major justification is that it would attract additional investment in the state. As noted, the fiscal effect of the change would be minimal, primarily due to the relatively low amount of credit claims. However, the same argument could be made to allow partner and shareholder agreements for other state tax credits. For example, angel investment tax credits must be claimed by partners, shareholders, and members in proportion to their ownership interest. Angel investment tax credits are designed to attract investment into entrepreneurial ventures. Studies have shown that regions with a higher level of entrepreneurship exhibit higher levels of output and

productivity (Andretsch and Keilbach, 2007). An argument could be made that the provision should apply to other tax credits to attract more of the investment those credits are designed to attract. However, adopting such provisions for other tax credits could have significant fiscal and administrative impacts on state individual income taxes, in terms of reduced revenues and increased complexity in administering and collecting income taxes.

ALTERNATIVES

1. Adopt the Governor's recommendation to: (a) require that, in order to claim the tax credit, a claimant must include, with the claimant's return, evidence that the rehabilitation was recommended by the state historic preservation officer for approval by the U.S. Secretary of the Interior; (b) require that the credit must be claimed at the same time as the federal credit is claimed; (c) provide that credits computed by a partnership or limited liability company could be claimed in proportion to the ownership interests of the partners or members, or allocated to partners or members as provided in a written agreement among the partners or members; and (d) specify that a person who elected to claim the credit based on claiming amounts for expenditures as the expenditures were paid, rather than when the rehabilitation work was completed, would be required to file an election form with DOR, in a manner prescribed by the Department.

2. Delete the Governor's recommendation.

Prepared by: Ron Shanovich
Attachment

ATTACHMENT

State Historical Rehabilitation Tax Credits

Colorado
20% credit for income-producing and homeowner properties. No aggregate statewide dollar cap, but per project cap of $50,000 per year. Minimum investment: $5,000. Carry forward: 10 years. U.S. Department of Interior (DOI) standards apply and work must be completed within two years of inception date of project. CLG can review and approve project. Sunset date for credit is 2009.

25% credit for mixed residential (includes owner-occupied and rental) and nonresidential uses where at least 33% of total square footage of rehab is for residential use. 5% add-on credit for affordable housing. Cap: $50 million over three years and $5 million per project. Carry forward: five years. Freely transferable either by direct sale or disproportionate allocation among partners of a syndication partnership.

Connecticut
25% credit for rehabilitating commercial or industrial buildings for "residential use." Cap: $2.7 million per project and $15 million annual aggregate. Carry forward: five years. Freely transferable either by direct sale or disproportionate allocation among partners of a syndication partnership. Minimum expenditure: 25% of assessed building value.

30% credit for eligible rehab of owner-occupied residence, including apartments up to four units. Eligible properties: National and/or State Register of Historic Places, must be located in areas targeted as distressed. Cap: $30,000/dwelling, $3 million statewide/ year. Recapture period five years. Carry forward: four years. Minimum expenditure: $25,000.

Delaware
20% credit for income-producing properties and a 30% homeowner credit. A 10% bonus credit applies for both rental and owner-occupied projects that qualify as low-income housing. Carry forward: ten years. Homeowner credit cannot exceed $20,000. Credits are freely transferable either by direct transfer or disproportionate allocation. The credit to be claimed in annual progress-based installments with phased projects.

Georgia
20% credit for eligible income-producing properties; 10% for owner-occupied properties in non-target area and 15% for owner-occupied properties in target area. Project limit of $5,000 in credits over ten years. Transfer permitted by disproportionate allocation.

Indiana
20% of rehab costs up to $100,000 for qualifying commercial, rental housing, barns and farm buildings. Minimum investment $10,000. Per-project cap: $100,000. $450,000 annual statewide cap for commercial credits and $250,000 for owneroccupied residences. State register properties qualify. Carry forward: 15 years. Preapproval of work required. No fees. DOI standards apply. Owner-occupied residential: 20% of rehab costs. Costs must exceed $10,000.

Iowa
25% credit for eligible commercial, income-producing and non-income-producing residential properties and barns built before 1937. Annual cap: $15 million SFY2009, and $20 million SFY2010 and each fiscal year thereafter. Cap: $100,000 per residential unit. Fully refundable with interest or may be credited for the following year. Minimum expenditure: 50% of the assessed value of the commercial property, excluding the land; $25,000 or 25% of the fair market value of the residential or barn property, excluding the land. Set asides: 10% of credits for small projects; 40% for projects located in Cultural and Entertainment Districts.

Kansas
25% income tax credit for commercial and residential properties. Carry forward: ten years. $5,000 minimum on qualified expenditures necessary. Credit freely transferable either by direct transfer or disproportionate allocation. No annual program cap, and no per-project cap.

Kentucky
30% income tax credit for owner-occupied residential properties. A minimum investment of $20,000 is required, with the total credit not to exceed $60,000. 20% income tax credit for all other properties including properties owned by entities exempt from tax under the Internal Revenue Code (IRC) and state and local governments. Minimum investment of $20,000 or the adjusted basis, whichever is greater, subject to $400,000 per project cap. Credit is freely transferable. $3 million total program cap annually.

Louisiana
25% credit for income-producing properties in “downtown development districts.” $5 million cap per taxpayer for structures within a downtown development district. No statewide cap for commercial credits. Directly transferable. five-year carry-forward for commercial credits. 25% rate for owner-occupied residences, adjusted down based on income. $1 million statewide cap for owner-occupied residences. Homeowner credit must be taken in five equal annual installments and is fully refundable. Minimum investment: $10,000 for income-producing properties; $20,000 for owner-occupied residences.

Maine
20% credit for rehab of income-producing properties eligible for the federal tax credit. Minimum expenditures: same as federal tax credit. Cap: $100,000/year, per taxpayer; no annual statewide cap.

Maryland
20% credit for commercial and tax exempt entities under IRC and owneroccupied residences. Through FY2010, annual appropriation required for commercial credit; no annual cap for owner-occupied residences. Per-project cap: commercial - $3 million; Owner-occupied – $50,000. Competitive award process for commercial credits. No competition for credits for owner-occupied structures. No more than 75% of funds available in any year may go to any single jurisdiction. Minimum investment: $5,000 for homeowners and a rehab cost that exceeds the adjusted basis of the property for commercial applicants. Fully refundable.

Massachusetts
20% credit for eligible income-producing properties. 25% credit for projects with affordable housing. $50 million annual statewide cap. Carry forward: five years. DOI standards apply. Permits direct transfer of credit or transfer by disproportionate allocation. Minimum investment: 25% of adjusted basis.

Michigan
25% credit for qualified rehab of historic commercial and owner-occupied residential buildings. Commercial credit reduces to 5% when federal 20% credit is claimed. Eligibility: National, state, or local designated properties. DOI standards apply. Minimum expenditures: 10% of State Equalized Value of the property. Five-year recapture period. Carry forward: ten years. Commercial credit permits transfer by disproportionate allocation.

Mississippi
25% credit for commercial property and for owner-occupied residences. Upcapped credit with minimum investment of 50% of the total basis for commercial properties; $5,000 for owner-occupied residences. Carry forward: ten years.

Missouri
25% credit for commercial and owner-occupied residential properties listed in National Register or in a certified historic district. Minimum investment: 50% of adjusted basis of the structure. Rehab work must meet DOI standards. Carry back: three years. Carry forward: ten years. No annual or per-project cap. Transfer permitted by direct transfer or disproportionate allocation.

Montana
Income-producing certified historic properties automatically receive 5% state tax credit if the property qualifies for the 20% federal credit. Carry forward: seven years.

New Mexico
50% of rehab costs for all properties listed in the State Register of Cultural Properties. Also applies to stabilization and protection of archeological sites listed in the State Register of Cultural Properties. No annual statewide cap. Per-project cap: $25,000 outside an Arts and Cultural District; $50,000 located within an Arts and Cultural District. DOI standards apply. Carry forward: four years. Pre-approval required.

New York
Credit equal to 30% credit of the federal credit value (approximately 6% of the rehab cost) for commercial properties receiving federal rehab credit. 20% credit for eligible residences listed on the State or National Register and located in federally-recognized distressed census tracts. Cap: $100,000 per commercial project; $25,000 per residential project with a minimum $5,000 investment. Carry forward: unlimited. Residential credit requires municipal authorization. Pre-approval and completed work certification required. New York State Historic Barns Tax Credit: 25% rehab credit for historic barns. Must be income-producing, built or placed in agricultural service before 1936 and rehab cannot "materially alter the historic appearance."

North Carolina
30% credit for historic homeowners and 20% for income-producing properties. Minimum investment for 30% credit: $25,000. Credit must be taken in five equal annual installments. Carry forward: five years. Minimum investment for commercial: same as federal credit. State tax credit of 30% or 40%, depending on location, for rehabilitating historic industrial buildings.

North Dakota
25% credit for eligible historic property that is part of a Renaissance Zone Project. Project cap of $250,000. Carry forward: five years.

Ohio
25% credit. No annual statewide or per-project dollar cap. Cap: 100 projects per year for two years through June 30, 2009. Applications accepted in the order filed; only projects that will result in a net gain in state and local taxes will be approved and ODOD must determine that the tax credit is a major factor in applicant's decision to rehabilitate the building or increase the level of investment in the building. Pre-approval of work required; DOI Standards for Rehabilitation apply. Fully refundable.

Oklahoma
20% income tax credit for all eligible commercial and rental residential properties that qualify for the federal tax credit. Minimum investment: same as federal credit. No statewide or per-project caps. Carry forward: ten years. Freely transferable for five years.

Rhode Island
30% credit for income-producing projects. Minimum investment must exceed 50% of adjusted basis of structure. No yearly cap, and no project cap. Freely transferable. Carry forward: ten years. 20% credit for owner-occupied residential. Minimum investment: $2,000. Maximum credit allowable per-project per year: $2,000. Unused credits may be carried forward as long as property maintained. Interior work ineligible for owneroccupied residences. State register properties qualify.

South Carolina
10% credit for commercial properties eligible for federal credit; 25% for other eligible properties. Minimum investment for non-commercial properties: $15,000. All credits must be taken in five equal annual installments. No statewide or per-project dollar caps. Pass-through entities (other than "S" corporations) may transfer credit by means of disproportionate allocation. Credits for owner-occupied residences limited to one per structure each ten years. Pre-approval required.

Utah
20% credit for residential owner-occupied and non-owner-occupied. Cap: none. Minimum investment: $10,000 over three years. DOI standards apply. No fees.

Vermont
All credits limited to commercial buildings located in designated downtowns or village centers. 10% credit for projects approved for federal credit. 25% credit for façade improvement projects, limited to $25,000 per project. 50% credit for certain code improvement projects, with maximum credit of $50,000. nine-year carry-forward. Credits may be transferred to bank in exchange for cash or interest rate reduction. Annual total program cap: $1.5 million.

Virginia
25% for commercial and owner-occupied residential properties. Reconstruction and improvements must amount to at least 25% of the assessed value for owner-occupied buildings and at least 50% for non-owner-occupied buildings. Carry forward: ten years. National and state register properties eligible. DOI standards apply. No caps. Transfer by disproportionate allocation permitted.

West Virginia
10% credit for buildings eligible for federal credit; 20% credit for eligible owner-occupied residences. Commercial buildings entitled to same carry-back and carry-forward provisions as are available for federal credit. Owner-occupied residences entitled to five-year carry forward. Both commercial credits and homeowner credits may be directly transferred or transferred by disproportionate allocation. Minimum investment in homeownership projects: 20% of assessed value. No statewide or per project dollar caps.

Wisconsin
25% credit for owner-occupied residential properties. Per-project cap: $10,000. Minimum investment: $10,000 over two years; extendable to five years. 5% credit for commercial properties, not subject to statewide or per-project caps. Minimum investment: expenses equal to building's adjusted basis.