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HISTORIC RESTORATION INCOME TAX CREDIT

House Bill 4670 (Substitute H-2)
First Analysis (5-19-98)

Sponsor: Rep. Kirk Profit
First Committee: Tax Policy
Second Committee: Urban Policy and Economic Development

THE APPARENT PROBLEM:

Historic preservation groups are advocating for tax credits that will encourage people to rehabilitate or restore older properties, both residential and commercial. A tax credit, they argue, would be a very useful kind of assistance to those people putting an enormous amount of time, energy, research, technical knowledge, and money into historically accurate improvements. Owners who lovingly restore older properties -- bring them up to code and eliminate hazards, adapt them to modern living styles, and restore their original character -- are often rewarded with increased assessments and higher property taxes. A state tax credit would partially offset increased local taxes and decrease rehabilitation costs. It could encourage more people (and people of low and moderate means) to revitalize properties in old urban neighborhoods, stabilizing or increasing property values and increasing home ownership in previously neglected areas. Credits would also provide incentives to restore historic structures in rural areas and small towns. The benefits of historic preservation tax credits, say supporters, extend beyond the property owners receiving them, by encouraging the preservation of our state's history, helping the revitalization of old downtown districts, and promoting the re-development of existing residential and commercial districts, thus reducing the development of open space and the pressures for "urban sprawl". A federal tax credit currently exists, but only for income-producing property. Legislation has been introduced that would provide tax credits for both commercial and residential property.

THE CONTENT OF THE BILL:

House Bill 4670 would amend the Income Tax Act (MCL 206.266) to provide a tax credit for a percentage of qualified expenses incurred in the rehabilitation of a "historic resource" for the 1998 tax year and each year thereafter. Historic properties would require approval of the Historic Preservation Office of the Michigan Historical Center of the Department of State or its successor agency (historical center).

Historic resource. The term "historic resource" would include publicly or privately owned historic buildings, structures, sites, objects, features, or open spaces that were 1) located within a historic district designated by the national register of historic places, the state register of historic sites, or a local unit acting under the Local Historic Districts Act, or 2) that were individually listed on the state register of historic sites or national register of historic places. A property could be an owner-occupied personal residence or a historic resource within such a residence; an income-producing commercial, industrial, or residential property or a historic resource located within such property; property owned by a governmental body, nonprofit organization, or tax-exempt entity used primarily by a taxpayer lessee in an unrelated trade or business; property occupied or used by a governmental body, nonprofit organization, or tax-exempt entity under a long-term lease or lease-with-option-to-buy agreement; or any other resource that could benefit from rehabilitation.

Qualified expenditures. The term "qualified expenditures" would refer to capital expenditures that were paid not more than five years after the initial certification of the rehabilitation plan that included those expenditures had been approved by the State Historic Preservation Office of the Michigan Historical Center of the Department of State or its successor agency. (The expenditures also would have to have been made after December 31, 1997.) Capital expenditures for non-historic additions would not be included except for an addition that was required by state or federal regulations relating to historic preservation, safety, or accessibility.

Qualified taxpayers. In order to qualify for a tax credit under the bill, a taxpayer would have to be an owner of a historic resource or have a long-term lease agreement with the owner and would have to have made qualified expenditures equal to or greater than 10 percent of the state equalized valuation (SEV) of the historic resource. (A long-term lease would mean a lease term of at least 27.5 years for a residential property and 31.5 years for a non-residential property.) If the historic resource to be rehabilitated was a portion of a property, the local assessor would have to determine the SEV of that portion. If that determination was not possible, qualified expenditures would have to equal or exceed 5 percent of the appraised value as determined by a certified appraiser.

Credit. A taxpayer could not claim a credit under the bill for expenditures that were eligible for the federal rehabilitation credit under section 47(a)(2) of the Internal Revenue Code, unless the taxpayer had claimed and received the federal credit. Furthermore, any credit allowed under the bill would have to be reduced by the amount of the federal rehabilitation credit received for the same expenditures in the same tax year. (Under section 47(a)(2) of the IRC, a taxpayer may claim a rehabilitation credit for 20 percent of the qualified expenditures made for a certified historic structure.) The bill would allow a credit equal to 25 percent of the qualified expenditures allowed as federal rehabilitation credit under section 47(a)(2) of the Internal Revenue Code; or if the taxpayer was not eligible for the federal rehabilitation credit, 25 percent of the qualified expenditures that were eligible under the bill's provisions.

The total amount of credits allowed under the bill and under the Single Business Tax Act as proposed in a companion bill, Senate Bill 105, for one taxpayer could not exceed the total qualified expenditures of the taxpayer for the tax year. If the state credit allowed for the tax year and any unused carryforward of the credit exceeded the taxpayer's tax liability for the tax year, the excess amount would not be refunded but could be carried forward to offset tax liability in subsequent tax years for 10 years or until used up, whichever occurred first.

If the taxpayer sold the historic property less than five years after the credit was claimed, a percentage of the tax credit would be added back to the tax base of the taxpayer in the year of the sale. The applicable percentage would be 100 percent for a sale less than one year after the year in which the credit was claimed; 80 percent for a sale at least one year but less than two years after; 60 percent for a sale at least two years but less than three years after; 40 percent for three to four years; and 20 percent for four to five years.

A credit claimed under the bill could not be claimed by the taxpayer on his or her annual state income tax return; instead, the credit would be claimed on a separate form that would be prescribed by the department. The taxpayer would have to attach the certificate of completion and the certificate of designated status related to the qualified expenditures used to claim the credit. The credit could be claimed for either 1) the year in which the historic resource was placed in service; or 2) the year or years in which a final payment of qualified expenditures was made if the project was a phased project and construction was planned for two to five years.

Historic resources criteria. Qualified expenditures could be used to calculate the credit under the bill if, during the tax year for which the credit was claimed, the historic resource was: individually listed on the national register of historic places or the state register of historic sites, a contributing resource (a historic resource that contributed to the significance of the historic resource in which it was located) located within a state or national registered district, or a contributing resource located within a historic district designated by a local unit. In addition, the historic resource would have to be located in one of the following: a locally designated historic district in a local unit of government that had an existing ordinance under the local historic districts act, an incorporated local unit with a population of less than 5,000 that did not have a local historic districts ordinance, or an unincorporated local unit without a local historic districts ordinance.

Certification. In order to be eligible for the credit, a taxpayer would be required to file for certification with the Michigan Historical Center to qualify for the federal rehabilitation credit. If the taxpayer had already filed for certification with the center to qualify for the federal tax credit, additional filings would not be required.

In addition, a taxpayer would have to receive certification from the Michigan Historical Center that the historic significance, the rehabilitation plan, and the completed rehabilitation met the historic resources criteria. Further, unless the taxpayer had received certification from the National Park Service that the property's significance, plan, and completed rehabilitation qualified for the federal rehabilitation credit, a taxpayer would have to have certification that the historic resource contributed to the significance of the historic district in which it was located, the rehabilitation plan and completed rehabilitation meet the federal Secretary of the Interior's rehabilitation standards and guidelines, and all of the rehabilitation work was done within the walls, boundaries, or structures of the historic resource or to historic resources located within the property boundaries of the resource.

The historical center would have authority to inspect a historic resource at any time during the rehabilitation process and could revoke the certification if the rehabilitation was not being undertaken as represented in the plan or if unapproved alterations to the completed rehabilitation were made during the five years after the tax year in which the credit was claimed. The historical center would be required to promptly notify the Department of Treasury of a revocation.

Fees/report/rules. The Department of State could impose a fee to cover the cost of implementing the program and would be required to submit rules to implement the program before January 1, 1999. The department would also be required to report to the legislature annually on its fee schedule and the amount of fees collected; a description of each project certified; and the location of each new and ongoing project.

Tie-bar. The bill would not take effect unless Senate Bill 105, which would amend the Single Business Tax Act to provide for a similar credit under that act, was also enacted.

FISCAL IMPLICATIONS:

According to a Senate Fiscal Agency analysis of Senate Bill 106 (a nearly identical bill to House Bill 4670), the changes proposed would reduce income tax revenue by an estimated $500,000. (4-22-98)

ARGUMENTS:

For:

Supporters of tax credits for historic preservation and restoration say that they represent a small, low-risk investment -- a small, strategic incentive for property owners to engage in revitalizing old properties, whether income-producing buildings or owner-occupied residences. The key features of this bill are: that eligibility is broad, with many kinds of historic properties eligible; rehabilitation work will have to meet ten well-known federal standards; the benefits flow to owners or long-term leasers, not developers who rehabilitate for a quick sale; property owners can claim a credit with expenditures as little as ten percent of SEV, which allows lower and moderate income property owners and owners of modest properties to participate; and the properties will mostly be those that are protected by local historic district ordinances, to ensure that the eligible properties are those important to a community. This credit (and a related single business tax credit found in other legislation) is not a grant or an appropriation; a credit will only be available to those who are investing their own money in the rehabilitation or restoration of older properties. Furthermore, the credit will only be available to those doing the work in accordance with stiff standards and will require the prior certification of state history officials.

Supporters say that, based on their experience with the existing federal tax credit, the tax consequences will be modest. They expect a one percent annual rate of participation with a tax consequence of under $1 million. Furthermore, when the economic benefits are factored in, from such things as increased sales, income, and real estate taxes, the loss of revenue to the state will likely be about one-half million dollars. It should be noted that anyone eligible for the existing federal tax credit must first claim that credit and the amount of any federal credit would be deducted from the state credit.

Against:

This is an immensely complicated tax credit. The form to apply for the credit involves the treasury department, the federal Internal Revenue Service, the Department of State's history center, and local historic district ordinances. It allows for a phased-in credit, which is difficult to understand. It requires the re-payment of a credit if a property is sold within five years, which will require additional investigation. There is no cap on the total amount of the credit. The bill allows the Department of State to establish fees for its participation in the credit process and sets no limits on the fees. If this kind of assistance is really needed, there ought to be an easier way to provide it.

Against:

The credit offered by this bill and its counterpart, Senate Bill 105, could result in substantial revenue loss for the state. Local units could expand the areas, and thereby the properties, to which the bills' provisions could apply. While this expansion could help to encourage local development, the cost to the state would increase as the number of claims for the credit increase.

POSITIONS:

There are no positions on the bill.

Analyst: W. Flory

■This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.