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SFA**BILL ANALYSIS**

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Senate Bill 105 (Substitute S-3 as reported)
Senate Bill 106 (Substitute S-2 as reported)
Sponsor: Senator John J.H. Schwarz, M.D.
Committee: Finance

Date Completed: 4-22-98

RATIONALE

According to the Michigan Historic Preservation Network, there are 54 local units of government in Michigan that have designated portions of their jurisdictions as historic districts, under the Local Historic Districts Act. Under the Act a local unit of government may, by ordinance, establish a historic district, in which the local unit can regulate the construction, alteration, repair, and moving of resources; that is, public or private historic or nonhistoric buildings, structures, sites, open spaces, etc. within the district. The purpose of the ordinance must be to safeguard local heritage, stabilize and improve property values, foster civic beauty, strengthen the local economy, or promote the use of historic districts for the education, pleasure, and welfare of local and State residents. Reportedly, within those 54 communities there are 19,870 resources that have been designated by local ordinances. There also are approximately 900 resources in Michigan that are listed on the State Register of Historic Sites, and/or on the National Register of Historic Places. The owners of historic resources are encourage to maintain and rehabilitate those properties, in order to preserve the properties' historical significance, and to help preserve neighborhood character. The Federal government offers tax credits for the restoration of historic sites that are income producing. In addition, approximately 40 states reportedly offer some form of tax incentives, such as credits, abatements, or reduced property assessments, to the owners of historic resources for rehabilitation expenses. It has been suggested that Michigan also provide a tax credit to taxpayers who rehabilitate historic resources.

CONTENT

Senate Bill 105 (S-3) would amend the Single Business Tax Act, and Senate Bill 106 (S-2)

would amend the Income Tax Act, to allow a "qualified taxpayer" to claim a credit against either or both taxes for "qualified expenditures" made for the rehabilitation of a "historic resource", that is, a publicly or privately owned historic building, structure, site, object, feature, or open space located within a historic district as designated by the National Register of Historic Places, the State Register of Historic Sites, or a local unit that established a historic district under the Local Historic Districts Act; or, a historic building, structure, etc., that was listed individually on the National or State Register. The credit would be equal to 25% of the "qualified expenditures", and could be claimed for the 1998 tax year and thereafter.

"Qualified expenditures" would be capital expenditures that qualify for the Federal rehabilitation credit; that were paid within five years after initial certification of a "rehabilitation plan" was approved by the Michigan Historical Center, and that were paid after December 31, 1997, for the rehabilitation of a historic resource. Qualified expenditures would not include capital expenditures for nonhistoric additions to a resource, except an addition that was required by State or Federal regulations related to historic preservation, safety, or accessibility. "Qualified taxpayer" would mean a person that owned the resource to be rehabilitated or that had a long-term lease agreement (a lease term of at least 27.5 years for a residential site or at least 31.5 years for a nonresidential site) with the owner of the resource and that had qualified expenditures for the rehabilitation of the resource equal to or greater than 10% of the State equalized valuation (SEV) of the property. If the historic resource were a portion of a historic or nonhistoric resource, the assessor for the appropriate local tax assessing unit would have to determine the SEV of

only that portion. If the SEV of that portion could not be determined, qualified expenditures would have to be equal to or greater than 5% of the appraised value as determined by a certified appraiser. "Rehabilitation plan" would mean a plan for the rehabilitation of a historic resource that meets the Federal Secretary of the Interior's standards for rehabilitation and guidelines for rehabilitation of historic buildings under Federal law (36 CFR 60).

The Credit

A taxpayer with expenditures that were eligible for the Federal rehabilitation credit could not claim the credits proposed in the bills for qualified expenditures, unless the taxpayer had claimed and received the Federal credit. Further, a credit taken under the bills would have to be reduced by the amount of credit the taxpayer received for the Federal credit, for the same qualified expenditures in the same tax year. (Under Section 47 of the Internal Revenue Code, a taxpayer may claim a rehabilitation credit for 20% of the qualified expenditures made for a certified historic structure. The rehabilitation credit, along with the energy credit and the reforestation credit, comprise the Federal investment tax credit, as prescribed in the Code.)

The total credit allowed under both bills together could not exceed the total qualified expenditures of the taxpayer for a tax year. If the credit allowed for the tax year, and any unused carryforward of the credit, exceeded the taxpayer's tax liability for the tax year, the portion that exceeded the tax liability could 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 resource for which a credit had been taken, less than five years after the year in which the credit was claimed, the following percentage of the credit amount previously claimed relative to that resource would have to be added back to the tax liability of the taxpayer in the year of the sale: If the sale were less than one year after the year in which the credit was claimed, 100%; if the sale were at least one year but less than two years after the year in which the credit was claimed, 80%; at least two years but less than three years after the year in which the credit was claimed, 60%; at least three years but less than four years after the year in which the credit was claimed, 40%; and at least four years but less than five years, 20%.

The credit could be claimed in the year in which a rehabilitated historic resource was placed in service; or the year in which a final payment of qualified expenditures was made if the project were a phased project and construction were planned for two to five years.

A person who claimed a credit under the bills could not report the credit amount on the income tax or SBT return, but would have to use a separate form prescribed by the Department of Treasury. The taxpayer would have to attach to the form the certificate of completion and the certificate of designation status, related to the qualified expenditures used to claim a credit.

Certification

To be eligible for the credit, a taxpayer would have to apply to and receive from the Michigan Historical Center (within the Department of State) certification that the historical significance, a rehabilitation plan, and the completed rehabilitation of the historic resource met either of the following criteria and the historic resources criteria (described below):

- The historic resource contributed to the significance of the historic district in which it was located; both the rehabilitation plan and completed rehabilitation of the historic resource met the Secretary of the Interior's standards for rehabilitation and guidelines for rehabilitating historic buildings in the Code of Federal Regulations (36 CFR 60); and all rehabilitation work had been done to or within the walls, boundaries, and structures of the historic resource or to historic resources located within the property boundaries of the property.
- The taxpayer had received certification from the National Park Service that the historic resource's significance, the rehabilitation plan, and the completed rehabilitation qualified for the Federal rehabilitation tax credit.

To be eligible for the State credit, a qualified taxpayer would have to file for certification with the Center to qualify for the Federal credit. If a qualified taxpayer had previously filed for certification with the Center to qualify for the Federal tax credit, additional filing for the credit under the bill would not be required.

The Center could inspect a historic resource at any time during the rehabilitation process and revoke certification if the rehabilitation were not undertaken as represented in the rehabilitation 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 Center would promptly have to notify the Department of Treasury of a revocation.

Historic Resources Criteria

A taxpayer's qualified expenditures could be used to calculate the credit if, during the tax year in which a credit was claimed, the historic resource were one of the following: individually listed on the National Register of Historic Places or State Register of Historic Sites; a contributing resource located within a historic district listed on the National or State Register; or a contributing resource located within a historic district designated by a local unit pursuant to an ordinance adopted under the Local Historic Districts Act. In addition, the historic resource would have to be located in one of the following: a designated historic district in a local unit of government with an existing ordinance under the Local Historic Districts Act; an incorporated local unit of government that did not have an ordinance under that Act and had a population of less than 5,000; or an unincorporated local unit. ("Contributing resource" would mean a historic resource that contributed to the significance of the historic district in which it was located.)

Fee/Report/Rules

The bills would allow the Department of State, through the Michigan Historical Center, to impose a fee to cover the cost of implementing the bills. Before January 1, 1999, the Department would have to submit proposed rules to implement the bills. Further, the Department (through the Center) would have to report to the Legislature each year, for the immediately preceding State fiscal year, the fee schedule used and the total fees collected; a description of each project certified; and the location of each new and ongoing project.

Historic Resources

A "historic resource" (defined above) would include all of the following:

- An owner-occupied personal residence or a historic resource located within the property boundaries of the personal residence.
- An income-producing commercial, industrial, or residential resource or a historic resource located within the property boundaries of the resource.
- A resource owned by a governmental body, nonprofit organization, or tax-exempt entity,

that was used primarily by a taxpayer lessee in a trade or business unrelated to the governmental body, nonprofit organization, or tax-exempt entity, and that was subject to the income tax or the single business tax.

- A resource that was occupied or used by a governmental body, nonprofit organization, or tax-exempt entity pursuant to a long-term lease or lease with option to buy agreement.
- Any other resource that could benefit from rehabilitation.

Proposed MCL 208.39c (S.B. 105)

Proposed MCL 206.266 (S.B. 106)

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

The bills would create tax credits for rehabilitation expenses incurred by the owners of historic resources, under strict qualification requirements. This would provide an incentive to the owners to perform work that could have numerous positive benefits, not only to the properties themselves, but also to the neighborhoods in which they are located and the communities in general. Many historic buildings, both residential and commercial properties, are located in older urban areas. Such areas often are in great need of economic revitalization. Buildings that are abandoned or left to deteriorate become liabilities for the neighborhoods and communities in which they are located; they generate little if any tax revenue, can become useful for local criminal activity, destroy the attractiveness of the area, and lower property values in the vicinity. Rehabilitation of such properties does just the opposite. It stimulates the local economy, makes once gloomy neighborhoods attractive again, removes the welcome mat for criminals, revitalizes the tax base, preserves historic and cultural landmarks, and restores neighborhood character.

Supporting Argument

Owners of historic properties can invest enormous amounts of money, time, and work in restoring their properties, whether the properties are to be used as a residence or for commercial purposes. Owners who restore these properties are often "rewarded" with increased assessments and higher property taxes. The bills, by offering tax credits for rehabilitation expenses, would partially offset increased local taxes and reduce rehabilitation costs. This could encourage more persons who have lower or moderate incomes to invest in older

neighborhoods, thus increasing home ownership in previously neglected areas.

Supporting Argument

Anything reasonable that can be done to encourage the rehabilitation of existing older structures should be done. Tearing down an existing structure takes up dwindling space in landfill sites, and in effect wastes valuable materials that were contained in the structure. Further, rehabilitation of existing structures preserves green space through reuse; that is, it reduces the need for new construction in undeveloped areas.

Opposing Argument

The credits offered by the bills could result in substantial revenue loss to the State. The bills could encourage local units that now have historic districts to expand those districts into areas that were not necessarily historic, but were simply run down. The bills also could encourage other communities to use the historic designation as a form of local development; that is, declare substantial portions of a local unit to be a historic district simply so persons could claim the tax credit for home or business improvements. Further, the bills could result in inequitable tax treatment of neighbors; a taxpayer just outside the boundary of a historic district, who restored his or her home would not be allowed to claim the credit, while a person across the street who performed similar restorative work would be able to claim a credit.

In addition, the credits as proposed could be extremely complicated for taxpayers to claim, and for the Department of Treasury to administer.

Legislative Analyst: G. Towne

FISCAL IMPACT

Senate Bill 105 (S-3) would reduce single business tax revenue by an estimated \$1.0 million and Senate Bill 106 (S-2) would reduce income tax revenue by an estimated \$0.5 million. These estimates of the full impact of the bills would probably not be felt until two to three years after the bills were enacted into law. These estimates are based on information supplied by the Michigan Historical Preservation Network. This information included data and estimates on the number of historic sites in Michigan that would qualify for, and claim, these investment tax credits, and the average cost of these renovation projects. These bills set no limit on the size of the proposed tax credits, so the fiscal impacts in any particular year could be higher than estimated above if large

historic structures qualified for these tax credits and were renovated at a cost in excess of the average costs used in this analysis. The loss in revenue from both of these bills would have an impact on General Fund/General Purpose revenue.

Fiscal Analyst: J. Wortley

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.