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SFA BILL ANALYSIS

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Senate Bills 105 and 106 (as enrolled)
Sponsor: Senator John J.H. Schwarz, M.D.
Senate Committee: Finance
House Committee: Tax Policy

PUBLIC ACTS 534 and 535 of 1998

Date Completed: 2-4-99

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 encouraged 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 was suggested that Michigan also provide a tax credit to taxpayers who rehabilitate historic resources.

CONTENT

Senate Bill 105 amended the Single Business Tax Act, and Senate Bill 106 amended 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 is listed individually on the National or State Register. The credit is equal to 25% of the "qualified expenditures", and may be claimed for tax years beginning after 1998 and before 2003.

The bills define "qualified expenditures" as capital expenditures that qualify for the Federal rehabilitation credit under Section 47(a)(2) of the Internal Revenue Code if the taxpayer is eligible for that credit, or the qualified expenditures that are eligible for the credit under the bills if the taxpayer is not eligible for the Federal 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, 1998, for the rehabilitation of a historic resource. Qualified expenditures do not include capital expenditures for nonhistoric additions to a resource, except an addition that is required by State or Federal regulations related to historic preservation, safety, or accessibility. "Qualified taxpayer" means a person that owns the resource to be rehabilitated or that has 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 has 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 is a portion of a historic or nonhistoric resource, the SEV of only that portion of the property may be used. If the assessor for the appropriate local tax assessing unit determines the SEV for that portion, the determination must be used; if the assessor does not determine the SEV, then qualified expenditures must be equal to or greater than 5% of the appraised value as determined by a certified appraiser. "Rehabilitation plan" means 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

The credit allowed under the bills is 25% of the qualified expenditures that are eligible for the Federal rehabilitation credit if the taxpayer is eligible for that credit; or 25% of the qualified expenditures eligible for the credit under the bills if the taxpayer is not eligible for the Federal credit. A taxpayer with expenditures that are eligible for the Federal rehabilitation credit may not claim the credits created by the bills for qualified expenditures, unless the taxpayer has claimed and received the Federal credit. Further, a credit taken under the bills must 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 may not exceed the total eligible qualified expenditures of the taxpayer. If the credit allowed for the tax year, and any unused carryforward of the credit, exceeds the taxpayer's tax liability for the tax year, the portion that exceeds the tax liability may not be refunded but may be carried forward to offset tax liability in subsequent tax years, for 10 years or until used up, whichever occurs first.

If the taxpayer sells the historic resource for which a credit has 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 must be added back to the tax liability of the taxpayer in the year of the sale: If the sale is less than one year after the year in which the credit was claimed, 100%; if the sale is 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 may be claimed in the year in which a rehabilitated historic resource is placed in service; or the year in which a final payment of qualified expenditures is made if the project is a phased project and construction is planned for two to five years.

A person who claims a credit under the bills need not report the credit amount on the income tax or SBT return, but must use a separate form prescribed by the Department of Treasury. The taxpayer must attach to the form the certificate of completed work, the certificate of historic significance related to the historic resource, and the qualified expenditures used to claim the credit.

Certification

To be eligible for the credit, a taxpayer must 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 meet either of the following criteria and the historic resources criteria (described below):

-- The historic resource contributes to the significance of the historic district in which it is located; both the rehabilitation plan and completed rehabilitation of the historic resource meet 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 has 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 has received certification from the National Park Service that the historic resource's significance, the rehabilitation plan, and the completed rehabilitation qualify for the Federal rehabilitation tax credit.

If a taxpayer is eligible for the Federal credit, the taxpayer must file for certification with the Center to

qualify for the Federal credit. If a qualified taxpayer previously filed for certification with the Center to qualify for the Federal tax credit, additional filing for the credit under the bill is not required.

The Center may inspect a historic resource at any time during the rehabilitation process and revoke certification if the rehabilitation is not undertaken as represented in the rehabilitation plan, or if unapproved alterations to the completed rehabilitation are made during the five years after the tax year in which the credit was claimed. The Center must promptly notify the Department of Treasury of a revocation.

Historic Resources Criteria

A taxpayer's qualified expenditures may be used to calculate the credit if, during the tax year in which a credit is claimed, the historic resource is 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 must 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 does not have an ordinance under that Act and has a population of less than 5,000; or an unincorporated local unit. ("Contributing resource" means a historic resource that contributes to the significance of the historic district in which it is located.)

Fee/Report/Rules

The bills allow the Department of State, through the Michigan Historical Center, to impose a fee to cover the administrative cost of implementing the bills. Within six months after their effective date, the Department must submit proposed rules to implement the bills. Further, the Department (through the Center) must 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

"Historic resource" (defined above) includes 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 is used primarily by a taxpayer lessee in a trade or business unrelated to the governmental body, nonprofit organization, or tax-exempt entity, and that is subject to the income tax or the single business tax.
-- A resource that is 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.

MCL 208.39c (S.B. 105)
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 create tax credits for rehabilitation expenses incurred by the owners of historic resources, under strict qualification requirements. This will provide an incentive to the owners to perform work that may 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, will partially offset increased local taxes and reduce rehabilitation costs. This should 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 may result in substantial revenue loss to the State. The bills may encourage local units that now have historic districts to expand those districts into areas that are not necessarily historic, but are simply run down. The bills also may 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 can claim the tax credit for home or business improvements. Further, the bills might result in inequitable tax treatment of neighbors; a taxpayer just outside the boundary of a historic district, who restores his or her home will not be allowed to claim the credit, while a person across the street who performs similar restorative work will be able to claim a credit.

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

Response: The bills provide that the credit may not be claimed after 2002. At that point, if it appears that the bills have caused problems, then those problems can be addressed, or the program simply can be allowed to expire.

Legislative Analyst: G. Towne

FISCAL IMPACT

Senate Bill 105 will reduce single business tax revenue by an estimated $1.5 million and Senate Bill 106 will reduce income tax revenue by an estimated $0.8 million, beginning in FY 1999-2000. These estimates are based on information supplied by the Michigan Historic Preservation Network, and on estimates of the new historic renovation activity that these new tax credits will generate. These bills set no maximum limit on the size of the tax credits, so the fiscal impact in any particular year could be much higher than estimated if one or more large historic renovation projects, with costs much higher than the average costs used in this analysis, qualify for either or both of these credits. The loss in tax revenue that will result from both of these bills will have an impact on the revenue going to the General Fund/General Purpose budget.

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.