Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536

BILL ANALYSIS

Telephone: (517) 373-5383
Fax: (517) 373-1986

Senate Bill 469 (Substitute S-1 as passed by the Senate)
Sponsor: Senator Wayne Schmidt
Committee: Finance

Date Completed: 1-3-18

RATIONALE

Public Acts 38, 39, and 40 of 2011 amended the Income Tax Act, the Michigan Business Tax Act, and the Multistate Tax Compact, respectively, to eliminate a number of credits, deductions, and exemptions, levy the Corporate Income Tax, and modify future rates, among other things. The State Historic Preservation Tax Credit was one of the credits that was eliminated when those Public Acts took effect. The credit provided a financial incentive for taxpayers to invest in Michigan's historic resources and sites.

Since the State Historic Preservation Tax Credit was removed, some have expressed concern over a reduction in the number of historic restoration projects. These projects are believed to generate positive economic growth in municipalities across the State, as the projects require the employment of workers and, upon completion, expand the local unit's tax base and provide a potential attraction for visitors or a venue for commercial activity. Some people believe that eliminating the credit has discouraged developers from renovating historic buildings or sites that currently have an undesirable impact on the community where they are located. Moreover, other states may offer financial incentives to encourage developers to invest in historic sites located in cities outside of Michigan. To address these concerns, it has been suggested that the State Historic Preservation Tax Credit be reestablished.

CONTENT

The bill would amend the Income Tax Act to restore the State Historic Preservation Tax Credit Program. Specifically, the bill would add Section 266a to Part 1 of the Act and Section 675 to Part 2 to do the following:

- **Allow a qualified taxpayer with a rehabilitation plan certified after December 31, 2017, to credit against the income tax or Corporate Income Tax (CIT) 25% of the qualified expenditures that met eligibility criteria for the historic rehabilitation credit under the Internal Revenue Code for the rehabilitation of a historic resource.**
- **Require a qualified taxpayer to apply to and receive certification from the Michigan State Housing Development Authority (MSHDA) that the historic significance, the rehabilitation plan, and the completed rehabilitation of the historic resource met certain criteria in order to be eligible for the proposed credit.**
- **Require a qualified taxpayer to file for certification with MSHDA to qualify for the historic rehabilitation credit allowed under the Internal Revenue Code if the taxpayer were eligible for it, unless a filing had occurred previously.**
- **Require a historic resource to meet certain criteria.**
- **Specify that the portion of the credit that exceeded the taxpayer's tax liability for the year 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.**

- **-- Allow a qualified taxpayer under Part 1 to elect to forgo the carryover period and receive a refund equal to 90% of the amount of the credit that exceeded the qualified taxpayer's tax liability if the credit amount were less than $250,000.**
- **-- Allow a qualified taxpayer under Part 2 to assign all or a portion of the credit, and allow an assigned credit amount to be claimed under Part 1 or Part 2.**
- **-- Require a percentage of the credit amount previously claimed to be added back to the tax liability of the qualified taxpayer, if the certificate of completed rehabilitation were revoked or if the historic resource were sold or disposed of less than five years after being placed in service.**
- **-- Allow MSHDA to inspect a historic resource at any time during the rehabilitation process and revoke certification of completed rehabilitation under certain circumstances.**
- **-- Specify that the total of the credits claimed under the bill for a rehabilitation project could not exceed 25% of the total qualified expenditures eligible for a credit for that rehabilitation project.**

(Part 1 of the Income Tax Act imposes a tax on the income of individuals and noncorporate entities. Part 2 of the Act imposes the Corporate Income Tax on every taxpayer with business activity within the State or ownership interest or beneficial interest in a flow-through entity that has business activity in the State. Part 2 also imposes a tax on pensions written by financial institutions and a franchise tax on insurance companies.)

Definitions

"Historic resource" would mean a publicly or privately owned historic building, structure, site, object, feature, or open space 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 that is individually listed on the State Register of Historic Sites or National Register of Historic Places. The term would include all of the following:

- -- An owner-occupied personal residence or a historic resource located within the property boundaries of that personal residence.
- -- An income-producing commercial, industrial, or residential resource or a historic resource located within the property boundaries of that 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 tax under Part 1 or Part 2 of the Income Tax Act.
- -- A resource that is 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.
- -- Any other resource that could benefit from rehabilitation.

"Qualified taxpayer" would mean a person that is an assignee under proposed Section 675 or either owns the resource to be rehabilitated or has a long-term lease agreement with the owner of the historic resource and that has qualified expenditures for the rehabilitation of the historic resource equal to or greater than 10% of the State equalized valuation (SEV) of the property. If the historic resource to be rehabilitated were a portion of a historic or nonhistoric resource, the SEV of only that portion of the property would have to be used. If the assessor for the local tax collecting unit in which the historic resource was located determined the SEV of that portion, that assessor's determination would have to be used for the purposes of the definition. If the assessor did not determine the SEV of that portion, qualified expenditures, for the purposes of the definition, would have to be equal to or greater than 5% of the appraised value as determined by a certified appraiser. If the historic resource to be rehabilitated did not have a State equalized valuation, qualified expenditures would have to be equal to or greater than 5% of the appraised value of the resource as determined by a certified appraiser.

"Qualified expenditures" would mean capital expenditures that qualify, or would qualify except that the taxpayer elected to transfer the credit, or entered into a written agreement, for a rehabilitation credit under Section 47(A)(2) of the Internal Revenue Code if the taxpayer is eligible for the credit under that section or, if the taxpayer is not eligible, the qualified expenditures that would qualify under Section 47(A)(2) of the Code except that the expenditures are made to a historic resource that is not eligible for the credit under that section, that were paid. Qualified expenditures would not include capital expenditures for nonhistoric additions to a historic resource except an addition that was required by State or Federal regulations that related to historic preservation, safety, or accessibility.

(Section 47 of the Internal Revenue Code provides for a rehabilitation tax credit. Section 47(A)(2) specifies that the rehabilitation credit for any taxable year is the sum of 20% of the qualified rehabilitation expenditures with respect to any certified historic structure.)

"Rehabilitation plan" would mean a plan for the rehabilitation of a historic resource that meets the U.S. Secretary of the Interior's standards for rehabilitation and guidelines for rehabilitation of historic buildings under 36 CFR Part 67.

<u>Credit Eligibility</u>

Under each proposed section, a qualified taxpayer with a rehabilitation plan certified after December 31, 2017, could credit against the tax imposed under Part 1 or Part 2, as applicable, the amount determined under the bill for the qualified expenditures for the rehabilitation of a historic resource under the rehabilitation plan in the year in which the certification of completed rehabilitation of the historic resource was issued. Only those expenditures that were paid or incurred during the time periods prescribed for the credit under Section 47(A)(2) of the Internal Revenue Code and any related Treasury regulations would be considered qualified expenditures. (The credit under Section 47(A)(2) of the Internal Revenue Code is referred to below as the Federal credit.)

The credit allowed under the bill would be 25% of the qualified expenditures that were eligible for the Federal credit (or would have been eligible except that the taxpayer elected to transfer the credit under Part 1, or entered into an agreement with MSHDA to sell or transfer the historic resource under Part 2), if the taxpayer were eligible for the Federal credit. If the taxpayer were not eligible for the Federal credit, the credit allowed under the bill would be 25% of the qualified expenditures that would qualify under the Federal credit except that they were made to a historic resource that was not eligible for that credit. These provisions would be subject to both of the following:

-- A taxpayer with qualified expenditures that were eligible for the Federal credit could not claim a credit under the bill for those expenditures unless the taxpayer had claimed and received a credit for the qualified expenditures under the Internal Revenue Code or the taxpayer had elected to transfer the credit.
-- A credit under the bill would have to be reduced by the amount of a credit received by the taxpayer for the same qualified expenditures under the Internal Revenue Code.

To be eligible for the credit under bill, the taxpayer would have to apply to and receive certification from the Michigan State Housing Development Authority that the historic significance, the rehabilitation plan, and the completed rehabilitation of the historic resource met the criteria under the bill and either of the following:

-- 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 U.S. Secretary of the Interior's standards for rehabilitation and guidelines for rehabilitating historic buildings; and all rehabilitation work had been done to or within the walls, boundaries, or structures of the historic resource or to historic resources located within the property boundaries of the resource.

-- 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 credit.

If a qualified taxpayer were eligible for the Federal credit, the qualified taxpayer would have to file for certification with MSHDA to qualify for that credit. If the qualified taxpayer had previously filed for certification with MSHDA to qualify for the Federal credit, additional filing for a credit allowed under the bill would not be required.

Historic Resource Criteria

Qualified expenditures for the rehabilitation of a historic resource could be used to calculate the credit under the bill if the historic resource met one of the criteria in two sets of criteria. First, the resource would have to be one of the following during the tax year in which a credit under the bill was claimed for those qualified expenditures:

-- Individually listed on the National Register of Historic Places or the State Register of Historic Sites.
-- A contributing resource located within a historic district listed on the National Register of Historic Places or the State Register of Historic Sites.
-- A contributing resource located within a historic district designated by a local unit under an ordinance adopted under the Local Historic Districts Act.

In addition, the historic resource would have to meet one of the following during the tax year in which the credit was claimed for the qualified expenditures:

-- Be located in a designated historic district in a local unit of government with an existing ordinance under the Local Historic Districts Act.
-- Be located in an incorporated local unit of government that did not have an ordinance under the Act, and had a population of less than 5,000.
-- Be located in an unincorporated local unit of government.
-- Be located in an incorporated local unit of government that did not have an ordinance under the Act, and was located within the boundaries of an association that had been chartered under Public Act 39 of 1889 (which authorizes the formation of corporations for the purchase and improvement of grounds to be occupied for summer homes, camp-meetings, or meetings of assemblies or associations and societies).
-- Be subject to a historic preservation easement.

Carryforward, Refund, & Revocation

If a credit allowed under the bill for the tax year, and any unused carryforward of the credit, exceeded the taxpayer's tax liability for the tax year, the excess portion 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 credit amount allowed were less than $250,000, a qualified taxpayer could elect to forgo the carryover period and receive a refund of the amount of the credit that exceeded the taxpayer's tax liability. The amount of the refund would have to be equal to 90% of the amount of the credit that exceeded the tax liability. An election would have to be made in the year that a certificate of completed rehabilitation was issued and would be irrevocable.

If a certificate of completed rehabilitation were revoked or if the historic resource were sold or disposed of less than five years after being placed in service as defined under the Internal Revenue Code and related Treasury regulations, a percentage of the credit amount previously claimed relative to that historic resource would have to be added back to the tax liability of the qualified taxpayer that received the certificate of completed rehabilitation and not the assignee in the year of the revocation, as shown in Table 1.

Table 1

Years after Resource was Placed in Service	**Percentage to be Added Back**
Less than one	100%
One or more but less than two	80%
Two or more but less than three	60%
Three or more but less than four	40%
Four or more but less than five	20%

Under proposed Section 675, if a qualified taxpayer had an unused carryforward of the credit, the amount otherwise added back to the taxpayer's tax liability could instead be used to reduce the taxpayer's carryforward. In addition, the add-back requirement would not apply if the qualified taxpayer entered into a written agreement with MSHDA that would allow for the transfer or sale of the historic resource and provided the following:

-- Reasonable assurance that, after the transfer, the property would remain a historic resource during the five-year period after it was placed in service.
-- A method that the Department of Treasury could use to recover an amount from the taxpayer equal to the appropriate percentage of credit added back.
-- An encumbrance on the title to the historic resource being sold or transferred, stating that the property would have to remain a historic resource throughout the five-year period after it was placed in service.
-- A provision for the payment by the taxpayer of all legal and professional fees associated with the drafting, review, and recording of the written agreement.

Transfer of Credit under Part 1

Under proposed Section 266a, a qualified taxpayer could elect to forgo claiming the credit and transfer the credit along with the ownership of the property for which the credit could be claimed to a new owner. The new owner would have to be treated as the qualified taxpayer having incurred the rehabilitation costs and would be subject to the recapture provisions if the new owner sold or disposed of the property within five years after acquiring the property.

For purposes of these provisions and the credit revocation provisions, the placed in service date for a new owner would be the date the new owner acquired the property for which the credit was claimed.

Assignment of Credit under Part 2

Under proposed Section 675, a qualified taxpayer could assign all or any portion of the credit allowed under that section. The assignment would be irrevocable and would have to be made in the tax year in which a certificate of completed rehabilitation was issued. A qualified taxpayer could claim a portion of a credit and assign the remaining amount. If the qualified taxpayer both claimed and assigned portions of the credit, the taxpayer would have to claim the portion it claimed in the tax year in which a certificate of completed rehabilitation was issued. An assignee could subsequently assign the credit or any portion of it to one or more assignees. An assignment or subsequent reassignment of a credit could be made in the year the certificate of completed rehabilitation was issued. A credit assignment or subsequent reassignment would have to be made on a form prescribed by the Department of Treasury. The Department or its designee would have to review and issue a completed assignment or reassignment certificate to the assignee or reassignee. An assigned credit amount could be claimed against the assignees' tax under Part 1 or Part 2 of the Income Tax Act. An assignee or subsequent reassignee would have to attach a copy of the completed assignment certificate to the annual return required to be filed under Part 2 for the tax year in which the assignment or reassignment was made and the assignee or reassignee first claimed the credit, which would have to be the same tax year.

A credit amount assigned under proposed Section 675 could be claimed against a partner's, member's, or shareholder's tax liability under Part 1.

Authority Inspection

The bill would allow MSHDA to inspect a historic resource at any time during the rehabilitation process and to revoke certification of completed rehabilitation 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 Authority would have to promptly notify the Department of Treasury of a revocation.

Additional Provisions

The Authority could impose a fee to cover the administrative cost of implementing the program under the bill. The Authority could also promulgate rules to implement the bill's provisions.

A qualified taxpayer would be required to attach all of the following to the qualified taxpayer's annual return:

-- Certification of completed rehabilitation.
-- Certification of historic significance related to the historic resource and the qualified expenditures used to claim a credit under the bill.
-- A completed assignment form if the qualified taxpayer were an assignee of any portion of a credit allowed under that section, or if the qualified taxpayer or assignee had assigned any portion of a credit under Section 675.

The total of the credits claimed under the bill for a rehabilitation project could not exceed 25% of the total qualified expenditures eligible for a credit for that rehabilitation project.

The Authority would have to report all of the following to the State Legislature annually for the immediately preceding State fiscal year:

-- The fee schedule used by MSHDA and the total amount of fees collected.
-- A description of each rehabilitation project certified.
-- The location of each new and ongoing rehabilitation project.

Proposed MCL 206.266a & 206.675

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

Michigan has many historic sites in need of rehabilitation that are located in low-rent areas or have challenging characteristics that make them risky investments for developers. While many of these sites hold tremendous potential to generate economic activity and produce vibrancy in the surrounding area, developers may look elsewhere for properties that are safer to invest in due to the amount of capital needed to rehabilitate historic sites and the uncertainty regarding their outcome.

When active from 1999 to 2011, the State Historic Preservation Tax Credit Program proved to be a successful economic tool across the State. According to Committee testimony, the credit leveraged almost $1.5 billion in direct rehabilitation activity and $251.0 million in Federal historic tax credits, while creating 36,000 jobs. Simply put, each $1 of credit issued leveraged $11.37 in direct economic impact.

Giving developers an incentive to renovate historic buildings that do not presently contribute to the community could unlock money that otherwise would be invested elsewhere. Furthermore, maintained historic buildings preserve diversity throughout the State, which can attract tourists and workers looking to visit or move to a unique location. By promoting historic site rehabilitation, the bill would help create new economic opportunities, improve municipal environments, and attract visitors and skilled workers to municipalities across the State.

Opposing Argument

The State Historic Preservation Tax Credit was eliminated in an effort to build transparency within the economic development process, with an emphasis on promoting economic development through the appropriations process, and to simplify the tax code. Historic restoration projects should not be subsidized through the statute.

Response: While the philosophy that led to eliminating the State Historic Preservation Tax Credit may have been sound at the time, it is appropriate to reconsider the credit's value to the State. Developers who accept the challenge of restoring historic buildings and sites create jobs and usable properties, and otherwise positively affect Michigan communities. Without the credit, the State will continue losing out on investment opportunities.

Opposing Argument

It is not accurate to conclude that the bill generally would have a positive economic impact across the State. Each potential project would be different, and it is not possible to consistently determine whether a project would have proceeded without an economic incentive. Benefits of economic activity are often difficult to quantify. While the costs to the State are easier to estimate, it should not be assumed that the indeterminate benefits of rehabilitation projects will outweigh those costs long-term.

Opposing Argument

The bill would create inequity among taxpayers by creating an incentive only for specific types of development. Developers who engage in projects that do not involve historic sites would not be eligible for the tax relief.

Legislative Analyst: Drew Krogulecki

FISCAL IMPACT

According to the Michigan Department of Treasury, the bill would reduce State revenue by approximately $10.0 million to $12.0 million per year, with the overwhelming majority of the impact reducing General Fund revenue. Most historic preservation credits claimed under the current law are claimed by business filers, and are claimed under the Michigan Business Tax (MBT). The bill would add the credit to the Corporate Income Tax (CIT), which currently does not allow any credits. Taxpayers that presently claim the credit under the MBT would not be affected by the bill until they exhausted all MBT certificated credits and shifted to filing CIT returns, or in the case of pass-through entities such as partnerships and S-corporations, shifted to filing individual income tax returns.

The impact of the credit on the State, either under current law or under the bill, will be affected by changes in Federal law, because the credit is reduced for any credit claimed at the Federal level. The Federal tax changes adopted in December 2017 will have an indeterminate impact on both the credit under current law and the fiscal impact of the bill, to the extent the changes do have an impact, they are likely to lower the impact of the bill.

Fiscal Analyst: David Zin