SB 496

Department of Legislative Services

Maryland General Assembly
2002 Session

FISCAL NOTE
Revised

Senate Bill 496 (Senators Hoffman and Middleton)
Budget and Taxation Ways and Means

Maryland Heritage Structure Rehabilitation Tax Credit

This bill makes changes to the State's Heritage Structure Rehabilitation Tax Credit.

The bill takes effect June 1, 2002 and applies to all taxable years beginning December 31, 2001. For commercial rehabilitation projects that received the approval of the Director of the Maryland Historical Trust on or before February 1, 2001 for the proposed rehabilitations are not affected by the changes made by the bill.

Fiscal Summary

State Effect: Revenue increase (general fund and Transportation Trust Fund) of up to $33 million annually. Under current law, it is projected that Heritage Rehabilitation Tax Credits will reduce State revenues by $50 million to $84 million annually.

Local Effect: Local government revenues would increase due to the cap put in place by the bill. Approximately 75% of corporate tax revenues are distributed to the general fund and 25% is distributed to the Transportation Trust Fund (TTF). Of the 25% distributed to the TTF, approximately 30% is distributed to local jurisdictions.

Small Business Effect: Potential meaningful.

Analysis

Bill Summary: The bill limits the Maryland Heritage Structure Rehabilitation Tax Credit by reducing the credit percentage from 25% to 20% of qualified expenditures and also provides that a State tax credit under the program may not exceed $3 million.

Under current law, the heritage rehabilitation tax credit is allowable for both residential and commercial projects. The provisions of the bill affect only commercial rehabilitations. The bill defines a commercial rehabilitation as a rehabilitation of a structure other than a single-family, owner-occupied residence.

A qualified expenditure is also an amount expended in compliance with a plan of proposed expenditures that has been approved by the Director of the Maryland Historic Trust and does not exceed the amount of proposed rehabilitation expenditures approved by the director; and is not funded, financed, or otherwise reimbursed by any:

- State or local grant;
- grant made from proceeds of tax-exempt bonds issued by the State, a political subdivision of the State, or an instrumentality of the State or of a political subdivision of the State;
- State or local tax credit other than the Heritage Rehabilitation Tax Credit; or
- other financial assistance from the State or a political subdivision of the State other than a loan must be repaid at an interest rate that is greater than the interest rate on general obligation bonds issued by the State at the most recent bond sale prior to the time the loan is made.

The bill also states that it is the intent of the General Assembly that Heritage Tax Credits for commercial rehabilitations not exceed $50 million annually and requires the Department of Legislative Services (DLS) to monitor approval of commercial rehabilitations eligible for the credit. If the approval of commercial rehabilitations under the credit in a calendar year would result in more than $50 million in tax credits, DLS is required to notify the General Assembly and prepare legislation to implement a $50 million overall cap.

Lastly, the bill provides a two-year sunset on the Heritage Credit that will allow the General Assembly to evaluate the usage of the credit over the next two years and make a determination as to continuation of the tax credit program.

Current Law: A person may claim a tax credit in an amount equal to 25% of the taxpayer's qualified rehabilitation expenditures for the rehabilitation of a certified heritage structure, for the taxable year in which a certified rehabilitation is completed.

Chapter 160 of 2001 provided that any excess amounts of the existing credit in a taxable year that exceed an individual's or a business entity's tax liability may be claimed in refund. Chapter 160 added nonprofit entities to the definition of business entity for the purposes of the credit and also allows the credit to be taken by partners and shareholders of a business entity in any manner that is agreed.

Chapter 160 also provided for the recapture of credits claimed within four years after the credit is claimed if work is performed on a certified heritage structure that, if performed as a part of the historic rehabilitation, would have made the rehabilitation ineligible for the credit. Finally, it required the Director of the Maryland Historic Trust to report to the Governor and the General Assembly each January on use of the heritage structure rehabilitation credits.

Background: Applying for the Maryland Heritage Structure Rehabilitation Tax Credit is a three-part process that is administered by the Maryland Historic Trust within the Department of Housing and Community Development (DHCD).

Part 1 approval is required only for structures that are not designated historic properties that are requesting certification as "contributing" to the historic district or State certified heritage area. All proposed rehabilitations must apply for *Part 2* approval which requires that the plans for the proposed rehabilitation be submitted and found to be consistent with the standards for certified heritage structure rehabilitation. After the rehabilitation is completed, *Part 3* approval is granted upon determination by the Director of the Maryland Historic Trust that the rehabilitation has met the standards for a certified heritage structure rehabilitation.

IRC allows a taxpayer to claim a credit for qualified rehabilitation expenditures made for qualified rehabilitated buildings. For certified historic structures, the credit is equal to 20% of qualified rehabilitation expenditures. This credit is available for both residential and nonresidential buildings that are listed in the National Register or that are located in a registered historic district and certified as being of historic significance to the district.

For buildings first placed in service before 1936, other than certified historic structures, the credit is equal to 10% of qualified rehabilitation expenditures. The credit for nonhistoric structures is generally available only for nonresidential property.

Between 1997 and July 1, 2001, there were 285 single family residential projects (approximately 6% of approved expenditures), and 72 commercial projects (approximately 94% of approved expenditures) that received preliminary approval of rehabilitation expenditures (Part 2 approval).

Exhibit 1 (attached) details heritage structure rehabilitation tax credits in other states.

State Fiscal Effect:

Current Heritage Rehabilitation Credit

Effect on Existing Projects: Maryland's current heritage rehabilitation tax credit has no per project cap, nor does it have an annual aggregate cap. While the actual credit claimed on income tax returns has increased somewhat over the past two years, only about $12 million in credits has actually been claimed. However, while the actual impact to State revenues so far has been limited, the credits that have been earned by taxpayers who have completed projects and the credits in the pipeline for projects that have received preliminary approval have grown tremendously over the past two years. These "earned" and "pipeline" credits are likely to be claimed on income tax returns over the next two years, reducing State revenues by significant amounts. Based on information provided by the Maryland Historic Trust, it is estimated that a total of approximately $42 million of credits for commercial rehabilitations have been "earned" for certified heritage rehabilitations completed through January 31, 2002, and another $84 million in credits are "in the pipeline" for projects not yet completed but for which the trust has provided Part 2 approval for the proposed rehabilitation projects, as shown in **Exhibits 2** and **3**.

Exhibit 2

Projects Completed Through January 31, 2002							
Part 3 Approval Date	1997	1998	1999	2000	2001	2002	Total
Final Rehabilitation Expenditures	$0	$1,285,890	$45,051,567	$13,875,999	$119,760,572	$2,983,470	$182,957,498
Total Credit	$0	$141,284	$7,746,845	$3,373,394	$29,940,143	$745,867	$41,947,534
Total "Earned" Credit							$41,947,534

Exhibit 3

Projects Receiving Part 2 Approval Before February 1, 2002, but Not Completed							
Part 2 Approval Date	1997	1998	1999	2000	2001	2002	Total
Total Estimated Expenditures	$996,147	$15,000	$57,120,000	$55,375,000	$195,606,636	$27,944,000	$337,058,783
Estimated Credit Amount	$249,037	$3,750	$14,280,000	$13,843,750	$48,902,159	$6,986,000	$84,264,696
Total "Pipeline" Credit							$84,264,696

Based on information provided by the Comptroller, just over $12 million in credits have been claimed under the heritage credit for all tax years, including credits claimed for non-commercial projects. Thus, over $114 million in "earned" or "pipeline" credits for commercial projects are outstanding and are likely to be claimed over the next two years, reducing State revenues by that amount. An additional $25 million in credits are outstanding for the projects that had applications in by February 1 but had not yet received Part 2 approval. Therefore, approximately $139 million in credits are outstanding. The heritage rehabilitation tax credit is claimed for the tax year in which the project is certified as complete. Because of variations in taxpayers' taxable years, there may be somewhat of a delay in the credit appearing on income tax returns. While the total of these outstanding and unclaimed "earned" and "pipeline" credits can be estimated, it cannot be estimated when these will appear on income tax returns or which fiscal years will be affected. It is assumed that some of these credits will be claimed and reduce revenues for fiscal years as early as fiscal 2002. However, the amount that will be claimed in any particular year cannot be estimated.

Under current law, the amount of the heritage credit is 25% of the qualifying rehabilitation expenditures and there is no maximum on the amount of the credit for each project. Based on information provided by the trust, a total of 23 commercial rehabilitations for which heritage credits have been earned or are in the pipeline are estimated to be eligible for or be in line for credits exceeding $1 million. These 23 projects account for an estimated $108 million of the total $126 million in credits earned or in the pipeline to date.

Exhibit 4 summarizes, for all projects receiving Part 2 approval before February 1, 2002, the estimated (for incomplete projects) or final (for competed projects) rehabilitation expenditures and tax credits categorized by project size.

Exhibit 4
Rehabilitation Expenditures By Project Size

Project Size Based on Approved Expenditures	Expenditures Less than $4 million	Expenditures $4-10 million	Expenditures $10-$20 million	Expenditures $20-$50 million	Expenditures Greater than $50 million	Total
Number of Projects	89	10	6	5	2	112
Estimated/Final Rehabilitation Costs	$74,195,256	$72,219,847	$81,580,000	$136,081,040	$155,940,138	$520,016,281
Estimated Total Tax Credits	$18,065,077	$18,054,962	$19,595,000	$31,512,156	$38,985,035	$126,212,229
Average Tax Credit	$202,978	$1,805,496	$3,265,833	$6,302,431	$19,492,517	$1,126,895

Effect On Future Projects: Using Part 2 approvals for calendar 2001 and January 2002 as approximations, it is estimated that future year expenditures for Part 2 approvals could likely total between $200 million and $335 million annually, with potential credits totaling between $50 million and $84 million each year. However, as previously discussed, it is difficult to predict when these outstanding credits would be claimed.

Effect of SB 496

Effect on Future Projects: It is estimated that, by reducing the credit percentage to 20%, and by implementing a $3 million maximum credit, revenues would decrease by between $34 million and $51 million annually, as opposed to between $50 million and $84 million under current law. Therefore, the bill will reduce the credit that will be claimed in future years by up to an estimated $33 million annually, increasing State revenues by that amount.

To the extent that: (1) the heritage rehabilitation tax credit generates economic activity that would otherwise have not taken place without the credit; and (2) that additional economic activity generates additional sales tax, income tax, or property tax revenue, then there may be some partial offset of the revenue loss resulting from the credit. Legislative Services advises, however, that it cannot be determined how much of this economic activity would have taken place without the credit, reducing the impact of any indirect tax revenue recoupment.

Local Fiscal Effect: The limits on the credit put in place by the bill will result in fewer credits being claimed against the corporate income tax than could be claimed under current law, which would result in increased local government revenues. Approximately 75% of corporate tax revenues are distributed to the general fund, and 25% is distributed to the TTF. Of the 25% distributed to the TTF, approximately 30% is distributed to local jurisdictions.

Small Business Effect: Small businesses involved in construction or contracting could be impacted if the bill results in fewer commercial rehabilitations being undertaken each year.

Additional Information

Prior Introductions: None.

Cross File: HB 759 (Delegate Hixon, *et al*.) – Ways and Means is listed as a cross file although it is not identical.

Information Source(s): Comptroller's Office (Bureau of Revenue Estimates), Department of Housing and Community Development, Department of Legislative Services

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Exhibit 1
State Historic Rehabilitation Tax Credits as of December 12, 2001

State	Credit Amount- % of Qualified Expenditures	Maximum Project Credit Cap	Annual State Ceiling on Aggregate Credits	Commercial Projects Permitted
Colorado	20%	$50,000	No	Yes
Connecticut	30%	$30,000	$3,000,000	Yes (rental residential only)
Delaware	20% commercial 30% homeowner or low income rental housing 40% low income homeowner	$20,000 for owner-occupied residential property	$3,000,000	Yes
Indiana	20%	$10,000 residential $100,000 commercial	$250,000 $750,000	Yes
Iowa	25%	No	No	Yes
Kansas	25%	No	No	Yes
Maine	20%	$1,000,000 per taxpayer	No	Yes (no residential allowed)
Maryland	25%	No	No	Yes
Michigan	25% residential 5% commercial	No	No	Yes
Missouri	25%	No	No	Yes
Montana	25% commercial	No	No	Yes
New Mexico	50%	$25,000	No	Yes
North Carolina	30% residential 20% commercial	No	No	Yes
North Dakota	25%	$250,000	No	Yes
Rhode Island	20% residential 30% commercial	$2,000 per year No	No	Yes
Utah	20%	No	No	Yes (rental residential only)
Vermont	25% commercial not meeting federal adjusted basis test 5% commercial qualifying for federal credit	$25,000	$300,000	Yes
Virginia	25%	No	No	Yes
West Virginia	20% residential 10% commercial	No	No	Yes
Wisconsin	25% residential 5% commercial	$10,000 for residential only but multiple phases allowed	No	Yes