Department of Legislative Services
Maryland General Assembly
2003 Session

FISCAL AND POLICY NOTE

House Bill 341 (Delegate Hixson, *et al.*)
Ways and Means

Maryland Heritage Structure Rehabilitation Tax Credit - Termination

This bill changes the termination date of the Maryland Heritage Structure Rehabilitation Tax Credit from June 1, 2004 to June 1, 2003. The bill also provides that the tax credit may not be claimed for a rehabilitation project unless an application for the approval of a plan of proposed rehabilitation was received by the Department of Housing and Community Development (DHCD) by February 1, 2003.

The bill takes effect June 1, 2003.

Fiscal Summary

State Effect: General fund revenue increase of approximately $25.5 million and a Transportation Trust Fund (TTF) revenue increase of approximately $992,000 in FY 2004. Future year increases represent the estimated savings over current law of no more projects being added to the pipeline after February 1, 2003.

($ in millions)	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
GF Revenue	$25.47	$44.41	$11.02	$.72	$0
SF Revenue	.99	1.73	.43	.03	0
Expenditure	$0	$0	$0	$0	$0
Net Effect	$26.47	$46.14	$11.45	$.75	$0

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: Local government revenues would increase as a result of the credit no longer being claimed on corporate tax returns. Based on the above estimate, local government revenues would increase by approximately $297,700 in FY 2004. Potential loss of property tax revenue.

Small Business Effect: Potential meaningful.

Analysis

Current Law: Under the Maryland Heritage Structure Rehabilitation Tax Credit program a person may claim a tax credit in an amount equal to 20% 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 601 of 1996 established the Heritage Structure Rehabilitation Tax Credit. The credit replaced an existing subtraction modification for rehabilitating historic structures. The credit has been altered several times since it was established.

Chapter 160 of 2001 expanded the program by providing 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.

Chapter 541 of 2002 limited the program by reducing the credit percentage from 25% to 20% of qualified expenditures and providing that a State tax credit under the program may not exceed $3 million for any single commercial project. The provisions of Chapter 541 affect only commercial rehabilitations. Under Chapter 541, commercial rehabilitation is defined as a rehabilitation of a structure other than a single-family, owner-occupied residence.

A qualified expenditure is an amount that is expended in compliance with a plan of proposed expenditures that has been approved by the Director of the Maryland Historic Trust 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 other than a loan that 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.

Chapter 541 also stated that it is the intent of the General Assembly that heritage tax credits for commercial rehabilitations not exceed $50 million annually and required 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, Chapter 541 provided that the program would sunset effective June 1, 2004.

Background: Applying for the Maryland Heritage Structure Rehabilitation Tax Credit is a three-part process that is administered by the Maryland Historic Trust within 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.

Federal law 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 residential buildings, which meet specified criteria, 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.

Under the federal credit, buildings first placed in service before 1936, other than certified historic structures, the credit is equal to 10% of qualified rehabilitation expenditures.

State Fiscal Effect: Maryland's heritage rehabilitation tax credit has a $3 million per project cap for commercial projects. However, there is no overall limit on the amount of credits that may be claimed in any year. While initially the revenue impact to the State was limited, this has changed over the past two years as the number of taxpayers who have completed projects and "earned" credits and the "pipeline" of projects for which plans of rehabilitation have been approved and rehabilitation is underway has grown dramatically.

Under the current sunset date of June 1, 2004, an estimated $30 million in credits in calendar 2004, and $50 million in credits in calendar 2005 will be added to the pipeline of commercial projects. The addition of these credits to what is already in the pipeline increases the amount of credits that could be claimed in fiscal 2004 to approximately $56.69 million and approximately $69.8 million in fiscal 2005. Because the bill does not affect projects that are in the pipeline prior to February 1, 2003, only those projects that are estimated to be added to the pipeline after February 1, 2003 and prior to June 1 would in essence be removed from the pipeline. Therefore, as indicated in **Exhibit 1**, the bill is estimated to result in a revenue savings of approximately $22.8 million in fiscal 2004.

Exhibit 1
Heritage Credit – Commercial Properties
Savings Resulting from HB 341 – No New Projects Being Added to the Pipeline After February 1, 2003
($ in Millions)

Fiscal Year	Credits Claimed With 6/1/04 Termination Date	Credits Claimed With 2/1/03 Termination Date	Total Savings
2004	$56,532,291	$33,733,197	$22,799,094
2005	$69,768,374	$24,961,772	$44,806,602
2006	$17,333,135	$5,886,094	$11,447,041
2007	$2,694,426	$1,944,426	$750,000

It is estimated that 85% of the credits are taken on personal income tax returns by individuals or pass-through entities that file personal income tax returns. As a result, general funds decrease by the amount of the credit taken. Conversely, the savings created by the bill result in a general fund increase. Because 76% of all corporate income tax revenues are distributed to the general fund, and 24% are distributed to TTF, the savings associated with credits claimed on corporate returns will increase general fund revenues by 76% of the amount of the credits taken, and TTF revenues will be increased by 25% of the credits taken. In addition, 30% of the 25% of revenue distributed to TTF is distributed to local governments.

The credit may also be claimed for rehabilitation projects completed by individual homeowners. It is estimated that projects that will result in approximately $5.0 million in credits will occur between February 1, 2003 and May 31, 2004. As a result of the bill, these credits would also be removed from the pipeline.

Exhibit 2 indicates the effect on both general fund and TTF revenues resulting from the bill.

Exhibit 2
Total Revenue Savings Resulting from HB 341

Fiscal Year	**Total Savings**	**TTF**	**General Fund**
2004	$26,465,761	$992,466	$25,473,295
2005	$46,139,935	$1,730,248	$44,409,688
2006	$11,447,041	$429,264	$11,017,777
2007	$750,000	$28,125	$721,875

Local Fiscal Effect: Local government revenues would increase as a result of the credit no longer being claimed on corporate tax returns. As mentioned above, 76% of corporate tax revenues are distributed to the general fund, and 24% are distributed to the TTF. Of the 24% distributed to the TTF, approximately 30% are distributed to local jurisdictions. Based on the above estimate, local government revenues would increase by approximately $297,700 in fiscal 2004.

Local governments could also lose property tax revenue to the extent that fewer rehabilitation projects are undertaken and completed. This is due to the fact that rehabilitated properties would be assessed at higher values, which would have the effect of increasing property tax collections.

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: None, although SB 203 is an identical bill.

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

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mdf/jr

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