Department of Legislative Services

Maryland General Assembly
2004 Session

FISCAL AND POLICY NOTE

House Bill 289 (The Speaker and The Minority Leader, *et al.*)
(By Request – Administration)

Ways and Means

Maryland Historical Trust - Heritage Structure Rehabilitation Tax Credit Program

This Administration bill extends the sunset date for the Maryland Heritage Structure Rehabilitation Tax Credit from June 1, 2004 to January 1, 2010. The total amount of commercial credits approved in a calendar year cannot exceed $30 million. The maximum amount of credits earned for an individual rehabilitation project cannot exceed (1) $50,000 for noncommercial projects; and (2) $3 million for commercial projects. The bill also makes changes to the certification and application processes and authorizes the Department of Housing and Community Development (DHCD) to charge fees to cover administrative costs. The Comptroller's Office is authorized to examine and audit returns claiming the credit.

The bill takes effect June 1, 2004.

Fiscal Summary

State Effect: General fund revenue decrease of approximately $8.4 million in FY 2005 due to credits being claimed against the personal and corporate income tax. Transportation Trust Fund (TTF) decrease of $2.6 million in FY 2005 due to credits being claimed against the corporate income tax. Future year decreases reflect annualization, inflation, and a 20% annual increase in residential projects.

(in dollars)	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
GF Revenue	($8,400,000)	($26,100,000)	($31,500,000)	($33,600,000)	($35,900,000)
SF Revenue	(2,600,000)	(6,100,000)	(7,100,000)	(7,200,000)	(7,200,000)
Expenditure	$0	$0	$0	$0	$0
Net Effect	($11,000,000)	($32,200,000)	($38,600,000)	($40,800,000)	($43,100,000)

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

Local Effect: Local revenues would decline as a result of tax credits claimed against the corporate income tax. Seventy-six percent 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. Revenues would decrease by approximately $780,000 in FY 2005, increasing to a maximum of $2.1 million in FY 2007 and beyond.

Small Business Effect: The Administration has determined that this bill has minimal or no impact on small business (attached). Legislative Services concurs with this assessment.

Analysis

Bill Summary: The bill maintains the existing $3 million cap on individual commercial projects and imposes a new $50,000 cap on individual noncommercial projects. A noncommercial project is defined as a single-family, owner-occupied residence. The bill increases the existing total commercial credit cap in 2004 from $15 million to $30 million. In 2005 and beyond, the commercial cap is $30 million annually. There is no limit on the total of residential credits that can be claimed in a year.

The bill provides for changes in the administration process of the tax credit. In order to qualify for the credit, an applicant must receive approval of the rehabilitation plan from DHCD before substantial rehabilitation occurs. DHCD is authorized to charge fees to certify a structure and the rehabilitation work performed. Applications for certification of rehabilitation work performed must be submitted within 30 months of when DHCD approved the rehabilitation plan. No more than one application for certification of completed rehabilitations for the same project can be submitted within two years.

The bill authorizes the Comptroller's Office to examine and audit returns claiming the tax credit to verify: (1) the amount of rehabilitation expenditures; (2) whether the rehabilitations qualify; and (3) whether the credit is allowable as claimed.

Current Law: The tax credit program terminates June 1, 2004. Under the current 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. A certified heritage structure is defined as a structure that is either listed on the National Register of Historic Places, designated as a historic property under local law, or a nonhistoric building that is located in a historic district or a State certified heritage area and is certified to be "contributing" to the district or area.

Background:

Evolution of the Heritage Tax Credit

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. However, if the entity who performed the rehabilitation and claimed the credit sells the building, the credit may not be captured if the new owner(s) perform work that 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. Commercial rehabilitation is defined as a rehabilitation of a structure other than a single-family, owner-occupied residence. No single-project limit applies to noncommercial projects.

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 certain State or local funds.

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 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.

Chapter 203 of 2003 limited the amount of proposed credits that could be approved from February 1, 2003 until the end of that calendar year by commercial properties to $23 million and $15 million in calendar year 2004.

Application and Certification Processes

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.

Additional Federal and Local Tax Incentives

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. For qualified buildings that are not certified historic structures, the federal credit is equal to 10% of qualified rehabilitation expenses.

In addition to federal and State tax credits, rehabilitated properties often qualify for local property tax incentives. Baltimore County and the City of Frederick institute a tax assessment freeze, whereby any increased assessed value due to rehabilitation is not taxed for up to 10 years. In addition to several municipalities, Baltimore City, Calvert, Frederick, Montgomery, Prince George's, and Washington counties offer a local property tax credit based on a percentage of the increased assessed value due to the rehabilitation work performed. Howard County and the cities of Cumberland and Mount Rainier offer both a tax assessment freeze and property tax credit.

Exhibit 1 lists the total tax benefits that would be received by the hypothetical rehabilitation of a commercial property in Baltimore City in tax year 2003. This analysis assumes that the building is a certified historic structure and the increase in assessment reflects 100% of the rehabilitation costs.

Exhibit 1
Hypothetical Rehabilitation Project in Baltimore City
Total Tax Benefits Received

Rehabilitation Expenditures	$1,000,000
Federal Tax Credit	200,000
State Tax Credit	200,000
Local Property Tax Credit (Realized over 10 Years)	232,800
Total Tax Benefits	**$632,800**

Estimated Eligible Properties

Exhibit 2 lists the estimated number of properties eligible for the tax credit as of 2003. Baltimore City has the most eligible historic properties, approximately 54% of the State's total. This estimate is based on the number of eligible properties identified by DHCD in 1995 and projected forward by Lipman, Frizzell, and Mitchell, LLC under contract to DHCD.

Exhibit 2
Estimated Eligible Historic Properties By County (2003)

	Properties	**Percent Total**
Baltimore City	34,787	54.3%
Prince George's	4,069	6.4%
Frederick	3,437	5.4%
Washington	3,248	5.1%
Montgomery	2,856	4.5%
Carroll	2,702	4.2%
Baltimore County	2,353	3.7%
Harford	1,630	2.5%
Talbot	1,559	2.4%
Other	7,431	11.6%
Total	**64,072**	**100%**

Source: Department of Housing and Community Development (Maryland Historical Trust)

Credits Claimed to Date

As mentioned previously, the credit can be claimed for commercial and residential rehabilitation projects. Commercial credits comprise the vast majority of the total credits that have been approved and claimed. According to DHCD, from 1997 through 2003 approximately $131.8 million in tax credits were approved. A total of approximately $116.5 million (88% of total) credits were approved for commercial projects and approximately $15.3 million was approved for noncommercial projects. **Exhibit 3** lists the estimated rehabilitation expenditures for residential properties from 1997 through 2002. Detailed data for the amount of credits approved are not available for residential projects. The percent of residential expenditures for each county roughly reflects the percent of total credits claimed.

Exhibit 3
Total Residential Rehabilitation Costs
Qualifying for Tax Credit, by County
1997-2002

County	Rehabilitation Costs	Percent Total
Baltimore City	$32,357,920	40.5%
Baltimore County	11,923,880	14.9%
Montgomery	9,269,088	11.6%
Anne Arundel	5,439,416	6.8%
Kent	4,652,301	5.8%
Frederick	3,340,603	4.2%
Washington	2,968,064	3.7%
Prince George’s	2,416,846	3.0%
Talbot	2,338,506	2.9%
Other	5,184,527	6.5%
Total	**$79,891,156**	**100%**

Source: Governor’s Task Force on Maryland Heritage Structure Rehabilitation Tax Credit Program

Exhibit 4 lists the estimated amount of commercial credits earned by location. Baltimore City has the highest estimated amount of commercial rehabilitation tax credits approved, approximately $105.4 million or 92% of the total amount approved.

Exhibit 4
Estimated Commercial Credits Approved
As of September 2003

County	Credits	Percent Total
Baltimore City	$105,407,754	92.4%
Frederick	4,402,166	3.9%
Allegany	1,399,814	1.2%
Talbot	563,840	0.5%
Baltimore County	496,272	0.4%
Anne Arundel	400,383	0.4%
Howard	323,864	0.3%
Montgomery	223,968	0.2%
Kent	189,814	0.2%
Washington	143,578	0.1%
Carroll	139,243	0.1%
Queen Anne's	130,032	0.1%
Harford	100,000	0.09%
Wicomico	88,348	0.08%
St. Mary's	32,703	0.03%
Cecil	22,520	0.02%
Total	**$114,064,299**	**100%**

Source: Department of Legislative Services, Department of Housing and Community Development (Maryland Historical Trust)

Anticipated Tax Claim Schedule under Current Law

Initially the revenue impact to the State from the tax credit was limited. This impact has changed in the past three years as the number of taxpayers who have completed projects and earned credits has increased. The "pipeline" of projects for which plans of rehabilitation have been approved and rehabilitation is underway has grown dramatically. As a result of these lags, the amount of credits that have been earned but not yet claimed has grown dramatically. **Exhibit 5** lists the anticipated credit claim schedule for tax credits approved under current law as estimated by the Board of Revenue Estimates. Through September 2003 approximately $120 million in credits have been earned or are in the pipeline and have yet to be claimed. This schedule assumes that, under current law, the amount of tax credits claimed in calendar 2004 will be $15.0 million for commercial projects and $6.0 million for residential projects. The estimates are based on the following assumptions: (1) $23.9 million in earned but unclaimed credit will be claimed in fiscal 2004; (2) 90% of credits earned in a calendar year are claimed in the fiscal year that begins in July of that year and 10% the following fiscal year; (3) all projects that began before 2003 will be completed in 2003; and (4) two-thirds of all projects will be completed on time and one-third the following calendar year.

Exhibit 5
Anticipated Credit Claim Schedule
Under Current Law

Credits to be earned and pipeline credits	$119,950,812
Credits claimed to date	105,248,875
Total Credits	$225,199,687

Fiscal Year	**Amount**
2004	$52,909,236
2005	32,715,955
2006	15,455,817
2007	11,343,137
2008	4,185,000
2009	2,141,667
2010	1,100,000
2011	100,000

Source: Board of Revenue Estimates

State Revenues: This bill increases the total commercial credit limitation for 2004 from $15 million to $30 million. From 2005 to 2009, the commercial cap is also $30 million. It is estimated that noncommercial projects, which are not capped, will increase by 20% annually. As a result, revenues will decrease by approximately $11.0 million in fiscal 2005, $32.2 million in fiscal 2006, $38.6 million in fiscal 2007, $40.8 million in fiscal 2008, and $43.1 million in fiscal 2009. **Exhibit 6** lists the breakdown of losses between the TTF and general revenue due to the bill.

Exhibit 6
Estimated Credits Claimed
and Revenue Loss

	2005*	2006	2007	2008	2009
Credits Claimed:					
Commercial	$10.8	$25.5	$29.7	$30.0	$30.0
Residential	0.2	6.8	8.9	10.8	13.1
Revenue Decrease:					
General Fund	$8.4	$26.1	$31.5	$33.6	$35.9
TTF	2.6	6.1	7.1	7.2	7.2
Total	**$11.0**	**$32.2**	**$38.6**	**$40.8**	**$43.1**

***Board of Revenue Estimates fiscal 2005 estimate already reflects $6 million for residential projects and $15 million for commercial projects.

The estimated revenue loss due to commercial rehabilitation projects earning tax credits is based on the following facts and assumptions:

- 80% of projects will be completed on time;
- 90% of credits earned in a calendar year are claimed in the fiscal year that begins in July of that year and 10% of the credits are claimed in the following year; and
- one-third of commercial credits are claimed against the corporate income tax.

There is no limitation on the amount of credits that can be earned in a year by noncommercial projects. The bill does provide for a $50,000 limitation on the maximum amount of credits that can be earned by a single noncommercial project. The estimates for the residential credits are based on the following assumptions and facts:

- the number of noncommercial projects will increase 20% annually;
- according to the Maryland Historical Trust the average residential rehabilitation expenditure was $99,491 from 1997 through 2002;

- it is estimated the cost of rehabilitation will increase by 1% annually due to inflation;

- based on data from 1997-2002 detailing the distribution of individual residential rehabilitation expenditures, the total noncommercial rehabilitation costs decrease by 15% in each year as compared to the average amount from 1997 through 2002 to reflect the $50,000 per project cap;

- credits as a result of noncommercial projects will be claimed against the personal income tax;

- the Board of Revenue Estimates already estimates that $6 million in noncommercial credits will be earned in 2004 under current law; and

- 90% of credits earned in a calendar year are claimed in the fiscal year that begins in July of that year and 10% of the credits are claimed in the following year.

Over the lifetime of the program, the number of noncommercial projects and credits claimed has increased by a rate in excess of 20% annually. To the extent that this trend will continue general revenue decreases will be greater. In addition, the number of properties in Maryland listed on the National Register of Historic Places has increased dramatically from 2001 through 2003, increasing the potential eligible pool of noncommercial properties.

Indirect Revenue Effect

The Governor's Task Force on Maryland Heritage Structure Rehabilitation Tax Credit Program states that any direct revenue loss to the State is more than offset by increases in State taxes due to the economic activity generated by rehabilitation projects. This conclusion is based on an analysis performed by Lipman, Frizzell, and Mitchell, LLC under contract to DHCD that utilizes an input-output model to estimate additional State and local revenues generated by several rehabilitation projects. These additional revenues include sales, real property, transfer, and personal income taxes as well as local permits and fees and recordation fees. Similarly, the Comptroller's Office estimates that the tax revenues generated as a result of the program more than offset the direct revenue loss to the State.

A crucial assumption made in this type of analysis is that all of the economic activity is new to the State. For instance, none of the people who work in a recently rehabilitated commercial property worked in the State previously and generate new income tax to the

State. In addition, it is assumed that in the absence of the tax credit, similar economic activity would not occur. For instance, the entity that rehabilitated the property would not, in the absence of the credit, decide to build a new facility rather than rehabilitating an existing commercial property.

The Department of Legislative Services advises that the tax credit primarily acts to substitute economic activity instead of generating new economic activity. Instead of opting to build a new office building in Harford County, for example, an entity receiving the tax credit opts to rehabilitate a property in Baltimore City. In instances there is likely no net effect to the State. Local tax property assessment increases in Baltimore City are offset by the increase that would have been realized had the new office building been built in Harford County. For instance, in the rehabilitation project of Montgomery Park, the State provided tenants by moving the Maryland Department of the Environment and State Lottery Agency. These jobs existed previously in Maryland and do not generate additional revenues to the State. Local taxes increase in Baltimore City, but are offset by decreases in the counties where the employees previously worked.

Additional Information

Prior Introductions: None.

Cross File: SB 190 (The President, *et al.*) (By Request – Administration) – Budget and Taxation.

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

Fiscal Note History: First Reader - February 19, 2004
ncs/mdr

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