SB 223

Department of Legislative Services
Maryland General Assembly
2006 Session

FISCAL AND POLICY NOTE

Senate Bill 223 (The President, *et al.*)
(By Request – Administration)

Budget and Taxation

Maryland Heritage Structure Rehabilitation Tax Credit Program

This Administration bill extends the Maryland Heritage Structure Rehabilitation Tax Credit Program, eliminates the geographic restriction on the awarding of commercial credits, and makes several other changes to the program.

The bill takes effect July 1, 2006 and terminates July 1, 2012.

Fiscal Summary

State Effect: State revenues would decrease by $5.1 million in FY 2009 and 2010 and by $5.0 million in FY 2011. State expenditures would increase by $30.2 million annually in FY 2009 through 2011.

($ in millions)	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
GF Revenue	$0	$0	($3.1)	($3.1)	($3.1)
SF Revenue	0	0	(2.0)	(2.0)	(1.9)
GF Expenditure	0	0	30.0	30.0	30.0
SF Expenditure	0	0	.2	.2	.2
Net Effect	$0	$0	($35.3)	($35.3)	($35.3)

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

Local Effect: Local revenues would decrease as a result of tax credits being claimed against the corporate income tax. Local revenues would decrease by approximately $648,000 annually in FY 2009 through 2011.

Small Business Effect: A small business impact statement was not provided by the Administration in time for inclusion in this fiscal note. A revised fiscal note will be issued when the Administration's assessment becomes available.

Analysis

Bill Summary: In addition to extending the program, the bill proposes to make several significant changes to the tax credit program as outlined below.

- ***Extend Program Termination Date and Funding:*** The bill would extend the program's termination date through fiscal 2012 for commercial and owner occupied residential property rehabilitations. The bill requires the Governor to appropriate $30 million annually to the reserve fund for commercial rehabilitation projects in fiscal 2009 through 2012.

- ***Eliminate Cap of Jurisdictions:*** Currently, a maximum of 50% of the total initial credit certificates issued for commercial rehabilitations in a fiscal year may be allocated for projects located in one county or Baltimore City. The bill would eliminate this geographic restriction.

- ***Allow Preliminary Rehabilitation Expenditures:*** The bill allows applications for a commercial rehabilitation to be accepted if the applicant has incurred certain rehabilitation expenditures, including: (1) architectural, engineering, consultants' services, or limited demolition that is necessary to prepare the application; or (2) emergency repairs. Under current law, an application may not be accepted if any part of the proposed rehabilitation work has begun.

- ***Extend Rehabilitation and Credit Deadlines:*** Under current law, property rehabilitations must be completed within 24 months to qualify for the credit. In addition, any initial credit certificate issued for a commercial rehabilitation project expires if the credit is not completed by the end of the fiscal year following the fiscal year in which the certificate was issued. The bill allows rehabilitations conducted by nonprofit organizations and businesses to be completed within 30 months to qualify for the credit. In addition, an initial credit certificate issued for a commercial rehabilitation would not expire until 30 months after the issuance of the certificate. The Maryland Historic Trust (MHT) can extend this deadline as provided under current law.

- ***Eliminate Preferential Ranking for Certain Historic Properties:*** The bill would eliminate the current ranking system that favors the award of commercial tax credits for structures that are: (1) listed on the national register of historic places; (2) designated as an historic property under local law and determined by MHT to be eligible for listing on the national register of historic places; or (3) located in a historic district listed on the national register of historic places.

Current Law: The following is a summary of the 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 allowed the credit to be taken by partners and shareholders of a business entity in any manner that is agreed.

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.

Chapter 541 also stated that it was 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 have resulted in more than $50 million in tax credits, DLS was required to notify the General Assembly and prepare legislation to implement a $50 million overall cap. Lastly, Chapter 541 provided that the program would terminate 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 2004.

Chapter 76 of 2004 substantially altered the credit program by shifting the commercial credit part of the program from a traditional tax credit program to a tax credit program that is subject to an annual appropriation with an aggregate limit. Chapter 76 also extended the termination of the tax credit program for both residential and commercial rehabilitations to July 1, 2008.

Chapter 76 increased the existing total commercial credit cap for the existing tax credit in tax year 2004 to $25 million, of which $10 million was required to be awarded on a competitive basis by MHT. In order to qualify for a tax credit for tax year 2004, a commercial rehabilitation project must have received approval from MHT of its proposed rehabilitation plan by June 30, 2004. Except for minor changes enacted in 2005 as discussed below, the provisions enacted by Chapter 76 reflect current law.

Chapter 76 established the value of the credit equal to 20% of the qualified rehabilitation expenditures expended in the rehabilitation of a certified historic structure. The maximum amount of credits earned for an individual rehabilitation project cannot exceed (1) $50,000 for noncommercial projects; and (2) the lesser of $3 million or the maximum amount stated on an initial credit certificate for commercial projects.

Taxpayers seeking the tax credit in each year for the rehabilitation of a commercial property beginning after June 1, 2005 must submit an application to MHT between January 1 and March 31. MHT awards an initial credit certificate to each approved commercial rehabilitation plan based on the amount of estimated rehabilitation expenditures.

Chapter 76 created a reserve fund that is designed to offset credits claimed in the future for the rehabilitation of commercial properties. The total amount of initial credit certificates issued by MHT in each fiscal year cannot exceed the amount appropriated to the reserve fund in the State budget. There is no aggregate cap or reserve fund for residential tax credits. Chapter 76 required the Governor to appropriate to the reserve fund at least $20 million in fiscal 2006 and $30 million annually in fiscal 2007 and 2008. The Governor may not reduce an appropriation to the reserve fund that is approved by the General Assembly. For each fiscal year, if funds are transferred from the reserve fund as a result of any law, the amount of total credits that can be approved by MHT is reduced by the amount of money transferred.

A maximum of 50% of the total initial credit certificates issued in a fiscal year can be allocated for projects located in one county or Baltimore City. At least 10% of the total initial credit certificates issued are required to be allocated to commercial rehabilitations proposed by nonprofit organizations.

Within 15 days of each calendar quarter, MHT is required to notify the Comptroller of the total number of commercial rehabilitations that were certified as being completed during the quarter and the total amounts of the maximum credit amount stated in the initial credit certificates and the total amounts of the final certified credit amount for these completed projects. Upon this notification from MHT, the Comptroller is required to transfer from the reserve fund to the general fund the total amounts stated in initial credit certificates for each rehabilitation project completed during that quarter.

Initial credit certificates expire and the credit may not be claimed if a commercial rehabilitation is not completed by the end of the fiscal year following the fiscal year in which the certificate was issued. MHT may postpone the expiration date of a certificate indefinitely for “reasonable cause.” By October 1 of each year, MHT must notify the Comptroller the maximum amounts stated on the initial credit certificate for each commercial rehabilitation project for which the certificate has expired as of the prior fiscal year. Upon this notification, the Comptroller is required to transfer from the reserve fund to the general fund the amount of expired initial certificate credit amounts.

The qualified rehabilitation expenditures expended in the rehabilitation of a certified historic structure qualify for the tax credit provided by the bill. Certified historic structures must meet one of the following requirements: (1) is listed on the national register of historic places; (2) is designated as a historic property under local law and determined by MHT to be eligible for listing on the national register of historic places; (3) is located in a historic district listed on the national register of historic places or in a local historic district that MHT determines is eligible for listing on the national historic register of historic places and is certified by MHT as contributing to the significance of the district; or (4) is located in a certified heritage area and is certified by Maryland Heritage Areas Authority as contributing to the significance of the certified heritage area. Structures owned by a unit of federal, State, or local government are not eligible for the tax credit.

Chapter 76 required MHT to adopt regulations to establish (1) the procedures and standards for certifying heritage structures and rehabilitations; and (2) a competitive award process for the award of initial credit certificates for heritage structure rehabilitation tax credits. The competitive process must ensure that credits are awarded in a manner that reflects the geographic diversity of the State and favors the award of tax credits: (1) that are consistent with current State development and growth programs; and (2) for the rehabilitation of structures that meet one of the following requirements: (1) are either listed on the national register of historic places or designated as historic property under local law and determined by MHT to be eligible for listing in the national register of historic places; or (2) is a building with historic significance that is located in a historic district listed in the national registry of historic places. Rehabilitation expenditures may not be certified unless the entity seeking the tax credit states under oath the amount of qualified rehabilitation expenditures. By December 15 of each fiscal year, MHT is required to report to the Governor and the General Assembly information about the credit including: (1) the amount of initial credit certificates awarded in the fiscal year; (2) the tax credits awarded for rehabilitations completed in the prior fiscal year; and (3) certain information about the rehabilitations for which credits were claimed.

A qualified expenditure is an amount that is expended by the end of the calendar year in which the rehabilitation is certified as being completed and in compliance with a plan of proposed expenditures that has been approved by the director of MHT 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;

- other financial assistance from the State or a political subdivision except for 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; or

- any other State tax credit.

A commercial rehabilitation is the rehabilitation of a structure other than a single-family, owner-occupied residence. Business entities, individuals, and nonprofit organizations are eligible to claim the credit. Commercial applications cannot be accepted if: (1) any part of the proposed rehabilitation work has begun; or (2) the applicant has previously submitted three or more applications in that year and the proposed commercial rehabilitations exceed \$500,000. In order to qualify, within a two-year period the rehabilitation expenditures must exceed: (1) \$5,000 for owner-occupied residential property; or (2) the greater of \$5,000 or the adjusted basis of the structure for commercial property. The following rehabilitations qualify as a single commercial rehabilitation: (1) the phased rehabilitation of the same structure; (2) the separate rehabilitation of different components of the same structure; or (3) the rehabilitation of multiple structures that are functionally related.

The tax credit can be recaptured by the State if the rehabilitator performs disqualifying work within four years of the close of the tax year when the grant was approved. The State can recapture: (1) 100% in the same year; (2) 80% one year after; (3) 60% two years after; (4) 40% three years after; and (5) 20% four years after.

The Comptroller's Office can 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. The Comptroller may adopt regulations to require that taxpayers other than corporations claim the credit on the tax return filed by the entity or individual.

The Budget Reconciliation and Financing Act of 2005, Chapter 444 of 2005, required MHT to adopt regulations to charge a fee of up to 1% to certify commercial heritage structures and rehabilitations. Also, certain taxpayers were allowed to claim the credit on the actual rehabilitation expenditures, and not the amount approved in an initial credit certificate, for a limited number of projects. The maximum additional amount approved for any project is limited to $250,000. The fee imposed by MHT is intended to offset the costs of administering the State and federal tax credits. MHT advises that it will charge a fee of 1% in fiscal 2007.

Background:

Additional Federal and Local Tax Incentives

Federal law allows a taxpayer to claim a credit for the rehabilitation of qualified historic buildings. For certified historic structures, the credit is equal to 20% of qualified rehabilitation expenditures. Nonresidential buildings that are not certified historic structures but were placed in service before 1936 qualify for a 10% credit. For both credits, the rehabilitation must be substantial (exceed the greater of $5,000 or the adjusted basis of the building) and the building must be depreciable. A depreciable building is one that is used in a trade or business or held for the production of income. Buildings that serve exclusively as the owner's primary residence do not qualify. The Joint Committee on Taxation estimates that the historic tax credit will reduce federal government revenues by approximately $400 million in federal fiscal 2006.

In addition to federal and State tax credits, rehabilitated properties often qualify for local property tax incentives. These credits include a freeze on the increased property tax assessment due to a rehabilitation project, a property tax credit, or combination of both. According to MHT, one municipality offers an assessment freeze, seven counties and four municipalities offer a property tax credit, and two counties and two municipalities offer a combination of both.

Fiscal Impact of Program

The impact of the program has changed over time as interest in the program increased and legislation altered the program. Through the end of 2005, approximately $149.2 million in total credits have been claimed under the program. An additional $22.2 million has not been claimed, but the projects have been completed. Including incomplete projects and additional credits that will be awarded under the current termination date of the program, an estimated additional $192.4 million in credits will be claimed. Of this amount, $80 million is to be covered by appropriations to the reserve fund ($20 million was appropriated in fiscal 2006, $30 million is to be appropriated in fiscal 2007 and 2008). Assuming full funding of the program in fiscal 2007 and 2008, the total amount of credits that will be claimed through the current termination date of the program is estimated to be approximately $341.6 million.

Commercial credits comprise the vast majority of the total credits that have been approved and claimed. **Exhibit 1** lists the estimated amount of commercial credits earned by county prior to the restriction on the percentage of commercial credits that can be awarded to one county as enacted by Chapter 76 of 2004. Baltimore City had the highest estimated amount of commercial rehabilitation tax credits approved, approximately $105.4 million or 92% of the total amount approved. The amount shown in Exhibit 1 does not include credits awarded in late 2003 and 2004.

Exhibit 1
Estimated Commercial Credits Approved
Prior to Chapter 76 of 2004
As of September 2003

County	Credits	Percent of 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	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)

Exhibit 2 lists the credits that were awarded in fiscal 2006. No more than 50% of the total amount of money allocated to the reserve fund for commercial credits could be allocated to any one county. MHT did not allocate the entire $20 million that was appropriated for commercial rehabilitations. The unallocated amount of $328,744 in commercial credits will be added to the amount of credits that can be awarded in fiscal 2007. A total of approximately $24.8 million in residential and commercial credits were awarded fiscal 2006.

Exhibit 2
Residential and Commercial Credits Awarded by County
Fiscal 2006

	Commercial			Residential		
County	**Projects**	**Total Credits**	**Percent of Total**	**Projects**	**Total Credits**	**Percent of Total**
Allegany	2	$166,970	0.8%	0	$0	0.0%
Anne Arundel	2	180,000	0.9%	11	158,166	3.1%
Baltimore City	8	10,000,000	50.8%	251	4,024,905	77.9%
Baltimore	3	1,018,600	5.2%	14	132,675	2.6%
Caroline	1	26,000	0.1%	0	0	0.0%
Carroll	2	671,686	3.4%	2	28,557	0.6%
Cecil	0	0	0.0%	2	19,625	0.4%
Dorchester	2	260,000	1.3%	2	8,521	0.2%
Frederick	3	280,000	1.4%	7	133,600	2.6%
Harford	0	0	0.0%	2	19,547	0.4%
Howard	1	70,000	0.4%	4	41,709	0.8%
Kent	3	1,010,000	5.1%	1	1,281	0.0%
Montgomery	2	3,950,000	20.1%	22	247,248	4.8%
Prince George’s	1	330,000	1.7%	20	165,575	3.2%
Queen Anne’s	0	0	0.0%	1	15,000	0.3%
Somerset	1	400,000	2.0%	1	50,000	1.0%
Talbot	3	656,000	3.3%	4	67,100	1.3%
Washington	2	652,000	3.3%	4	36,771	0.7%
Wicomico	0	0	0.0%	3	14,207	0.3%
Total	**36**	**$19,671,256**		**351**	**$5,164,488**	
Unallocated		$328,744				

State Fiscal Effect: The bill provides that the reserve fund will receive $30 million annually in fiscal 2009 through 2012 and provides that residential credits can be awarded in fiscal 2009 through 2012. As a result, the net effect on State finances would be a decrease of approximately $35.3 million annually in fiscal 2009 through 2012. The following is a detailed description of the bill’s fiscal impact in fiscal 2009 through 2011.

General fund expenditure increase of $30 million annually in fiscal 2009 through 2011 due to appropriations to the reserve fund to offset losses to the general fund resulting from commercial tax credits. General fund revenue increase and Transportation Trust Fund (TTF) decrease of approximately $2.2 million annually in fiscal 2009 through 2011 due to money being transferred back to the general fund for tax credits claimed against the corporate tax income. General fund revenue decrease of approximately $5.3 million annually in fiscal 2009 through 2011 due to credits earned for residential rehabilitations. Special fund revenue and expenditure increases of approximately $193,000 beginning in fiscal 2009 due to fees charged to commercial credit applications to pay for administrative costs at the Maryland Historical Trust. **Exhibit 3** details the fiscal impact of the bill in fiscal 2009 through fiscal 2011.

Exhibit 3
Impact on State Finances, SB 223

Expenditure Effects:	FY 2009	FY 2010	FY 2011
General Fund Expenditures:			
Reserve Fund Appropriation	$30,000,000	$30,000,000	$30,000,000
Special Fund Expenditures:			
MHT Administrative Expenses	193,057	204,412	216,567
Total Expenditures	**$30,193,057**	**$30,204,412**	**$30,216,567**
Revenue Effects:			
General Fund Revenues:			
Reserve Fund Transfers	$2,160,000	$2,160,000	$2,160,000
Residential Credits Claimed	(5,300,000)	(5,300,000)	(5,300,000)
Net General Fund Revenue	(3,140,000)	(3,140,000)	(3,140,000)
Special Fund Revenues:			
Commercial Credits Claimed Against the Corporate Income Tax	(2,160,000)	(2,160,000)	(2,160,000)
MHT Certification Fee	193,057	204,412	216,567
Net Special Fund Revenue	($1,966,943)	($1,955,588)	($1,943,433)
Total Revenues	**($5,106,943)**	**($5,095,588)**	**($5,083,433)**
Net Effect	($35,300,000)	($35,300,000)	($35,300,000)

Credit Reserve Fund

Assuming that the reserve fund appropriations specified in the bill are approved in the State budget in each fiscal year and money is not transferred from the reserve fund as a result of any law, general fund expenditures would increase by $30 million annually in fiscal 2009 through 2012. The money transferred to the reserve fund is to be transferred back to the general fund on a quarterly basis based on the projects that are certified as being completed in that calendar quarter and would act to offset general fund revenue losses resulting from credit being claimed for these completed projects.

Residential Rehabilitation Credits

There is no limitation on the amount of credits that can be earned in a year by residential projects. Based on the average amount of credits claimed for residential rehabilitations in the last four tax years and amount of credits awarded in fiscal 2006, DLS estimates that approximately $5.3 million in credits will be claimed annually in fiscal 2009 through 2011, as shown in Exhibit 3.

Revenue Effects from Reserve Fund Transfers

The bill requires the Comptroller to transfer money from the reserve fund to the general fund in an amount that is anticipated to offset commercial credits that will be claimed during the fiscal year. Based on historical data on the existing tax credit, it is estimated that approximately one-third of credits earned from the rehabilitation of commercial properties will be claimed against the corporate income tax. Twenty-four percent of corporate income tax revenue is distributed to the Transportation Trust Fund (TTF). All of the money transferred from the reserve fund by the Comptroller in anticipation of credits being claimed is to be deposited in the general fund and losses to the TTF will not be offset. As a result, it is estimated that general fund revenues will increase and TTF revenues will decrease by approximately $2.2 million annually in fiscal 2009 through 2011 due to money being transferred back to the general fund for tax credits claimed against the corporate tax income.

It is assumed that the amount of credits claimed in each tax year will be equal to the amount stated in the initial credit certificate so that credits claimed in each tax year will be offset by a transfer from the reserve fund. The final amount of the credit, however, could be less than the amount stated on the initial credit certificate if actual rehabilitation expenses are less than the estimated expenditures stated on the approved application. To the extent final credit amounts for commercial projects are less than the amount stated on the initial credit certificate, revenues could increase in these fiscal years.

It is also assumed that taxpayers claim the credit in the tax year that corresponds to the fiscal year in which the Comptroller transfers funds to the general fund on notification of a commercial project's completion. To the extent that taxpayers claim the credit in a tax year after the fiscal year in which the transfer is made, general fund revenues could increase in earlier fiscal years and potentially decrease by a corresponding amount in later fiscal years. The extent of this lag, if any, cannot be reliably estimated at this time. This timing issue, however, does not alter the total cost of the bill.

Administrative Expenses

MHT advises that three full-time positions are required to administer the program. Expenditures at MHT would increase by approximately $193,100 in fiscal 2009 as a result of administrative expenses. This estimate reflects the employment of three individuals to handle the application and certification processes specified in the bill. Future year expenditures reflect: (1) a full salary with 4.6% annual increases and 3% employee turnover; and (2) 1% annual increases in ongoing operating expenses. These administrative expenses are assumed to be covered by the fee imposed on commercial rehabilitation projects. This fee revenue and expenditure costs incurred by MHT is shown in Exhibit 3.

Changes Enacted to the Program

The bill makes several changes to the program that will take effect fiscal 2007. These changes are not expected to impact the State substantially in fiscal 2007 through 2008. The provisions of the bill altering how commercial credits are awarded will not change the total amount of credits that will be awarded. Extending the deadline to 30 months for completing rehabilitations conducted by nonprofit organizations and businesses could potentially allow credits to be claimed that would not otherwise have been allowed under current law. This impact is not expected to be significant, however. Further, to the extent that credits are claimed that would not have been allowed otherwise, the Board of Revenue Estimates' current forecast of the estimated fiscal impact of the program in fiscal 2007 and 2008 assumes that the maximum amount of credits in each year will be awarded.

Additional Information

Prior Introductions: None.

Cross File: HB 314 (The Speaker, *et al.*) (By Request – Administration) – Ways and Means.

Information Source(s): Maryland Department of Planning, Comptroller's Office, Maryland Historical Trust, Department of Legislative Services

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