**Franchise Tax Board**

# ANALYSIS OF AMENDED BILL

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| Author: | Atkins | Analyst: | Jessica Deitchman | Bill Number: | AB 1999 |
| Related Bills: | See Legislative History | Telephone: | 845-6310 | Amended Date: | April 1, 2014 |
| | | Attorney: | Bruce Langston | Sponsor: | |

**SUBJECT:** Rehabilitation of Certified Historic Structure Tax Credit

## SUMMARY

This bill would, under the Personal Income Tax Law (PITL) and the Corporation Income Tax Law (CITL), allow a tax credit for a portion of the costs paid or incurred to rehabilitate certain historic structures.

## RECOMMENDATION

No position.

### Summary of Amendments

The April 1, 2014, amendments removed intent language from the bill, and replaced it with the provisions discussed in this analysis. This is the department's first analysis of the bill. This analysis only addresses the provisions of the bill that impact the department's programs and operations

## REASON FOR THE BILL

The reason for the bill is to provide an incentive to taxpayers to rehabilitate historic structures by providing a tax credit to help offset some of the costs associated with the rehabilitation.

## EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and operative for taxable years beginning on or after January 1, 2015, and before January 1, 2026.

## ANALYSIS

FEDERAL/STATE LAW

Federal law, Internal Revenue Code section 47, allows a two-tiered credit for the rehabilitation expenses of older and historic buildings, as follows:

- A 10 percent credit is available for the rehabilitation expenses on non-historic buildings with an additional requirement that the building must have been originally constructed before 1936, and
- A 20 percent credit is available for the rehabilitation expenses of a certified historic structure, (one listed on the National Register of Historic Places or located in a Registered Historic District and determined to be of significance to the Historical District).

| Board Position: | | | Executive Officer | Date |
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Current state and federal laws generally allow taxpayers engaged in a trade or business to deduct all expenses that are considered ordinary and necessary in conducting that trade or business.

Existing state law lacks a tax credit for the rehabilitation of property or historical buildings.

THIS BILL

For taxable years beginning on and after January 1, 2015, and before January 1, 2026, this bill would modify the PITL and the CTL to generally conform to the federal rehabilitation credit, modified to provide that the California credit would be a two-tiered credit for the rehabilitation of a certified historic structure in this state, as follows:

- A general 25 percent credit would be allowed for the qualified rehabilitation expenses of a certified historic structure (other than expenses that qualify for the 30-percent credit), and
- A 30 percent credit would be allowed for the qualified rehabilitation expenses of a certified historic structure if that structure meets any of the following conditions:
  - The structure is located on federal, state, or local surplus property,
  - The rehabilitated structure will contain a majority of low-income housing units,
  - The structure is located in an economically distressed area,
  - The structure is located in a Base Realignment and Closure Zone, or
  - The structure is located in a Transit-Oriented Development Area.

Unlike the federal credit, no state credit would be allowed for expenditures with respect to a qualified building unless it is a certified historic structure.

A “certified historic structure” would mean a structure in this state that appears on either the National Register of Historic Places or the California Register of Historical Resources. Coordinating provisions would provide that no would be allowed for any expense for which a credit is allowed, and if a credit is allowed with respect to property, the basis of that property would be reduced by the amount of the credit.

Any unused credits could be carried over for eight years or until exhausted.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author’s office to resolve these and other concerns that may be identified.

This bill uses phrases that are undefined, i.e., “federal, state or local surplus property,” “economically distressed area,” “Base Realignment and Closure Zone,” and “Transit-Oriented Development Area.” The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this credit.

Additionally, the bill uses the undefined phrase “majority of low-income housing units.” Absent a definition, it is unclear how the “majority” should be measured. For example, does majority mean the amount of space on the land that must be occupied by low-income housing?

Or is it the total number or units that must be a majority? Further, it is unclear how “low-income” would be determined. It is recommended that the author amend the bill to clarify the intention.

**LEGISLATIVE HISTORY**

AB 166 (Cedillo, 2001/2002) would have allowed a tax credit in an amount determined in accordance with provisions of the federal rehabilitation credit. Additionally, the bill would have allowed a 25 percent credit for any certified rehabilitation of a certified historic structure within a redevelopment area. AB 166 failed to pass out of the Assembly Revenue and Taxation Committee.

SB 875 (Marks, 1995/1996) would have allowed a tax credit for an amount equal to 10 percent of the costs for rehabilitating a residential historic building, and 20 percent of the costs for rehabilitating a commercial historic building. SB 875 failed to pass out of the Assembly Revenue and Taxation Committee.

**OTHER STATES’ INFORMATION**

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota,* and *New York.* These states were selected due to their similarities to California's economy, business entity types, and tax laws.

*Florida* and *Michigan* lacks a credit comparable to the one created in this bill.

*Illinois* offers a 25 percent credit for eligible expenditures on the rehabilitation of properties in certain designated zones throughout the state. The minimum investment must be the greater of $5,000 or 50 percent of the purchase price.

*Massachusetts* provides a credit equal to 20 percent for income-producing properties and 25 percent credit for projects with affordable housing of the qualified rehabilitation costs. The program is limited to $50 million, statewide, per year. The minimum investment must be 25 percent of the adjusted basis of the property.

*Minnesota* allows a credit equal to 100 percent of the federal credit allowed for the rehabilitation of certified commercial property, or a grant equal to 90 percent of the federal credit allowed. The credit is fully refundable, but the applicant must register for the credit before beginning the rehabilitation. The credit sunsets in fiscal year 2015.

*New York* provides a credit for the rehabilitation of both commercial and residential properties of 20 percent of the costs. The commercial rehabilitation is limited to $5 million in credits per project. The residential credit is limited to $50,000 per project and may be refundable depending on the AGI[1] of the homeowner. This credit must be claimed in conjunction with the federal credit and will sunset on December 31, 2014.

**FISCAL IMPACT**

The costs to administer this bill have yet to be determined. As the bill continues to move through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

[1] Adjusted Gross Income

## ECONOMIC IMPACT

Revenue Estimate

| Estimated Revenue Impact of AB 1999<br>As Amended April 1, 2014<br>Assumed Enactment After June 30, 2014<br>($ in Millions) | | |
|---|---|---|
| 2014-15 | 2015-16 | 2016-17 |
| - $8.8 | - $25 | - $30 |

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

## SUPPORT/OPPOSITION

Support: California Preservation Foundation and American Institute of Architects (co-sponsor), CA Council (co-sponsor)

Opposition: None provided.

## ARGUMENTS

Proponents: Some may argue that providing a tax incentive would encourage taxpayers to rehabilitate historic structures.

Opponents: Some may argue that providing a tax credit for the rehabilitation of historic structures may be overly narrow and inadvertently exclude other noteworthy buildings in California in need of restoration.

## POLICY CONCERNS

This bill provides a state credit in an amount greater than the federal credit for the rehabilitation expenses for a historic structure. In general, a taxpayer's federal income tax liability is significantly higher than his or her state income tax liability. As a result, a state tax credit equal in amount or exceeding the federal credit could be considered to provide a greater proportionate benefit for state tax purposes than for federal tax purposes.

## LEGISLATIVE STAFF CONTACT

Jessica Deitchman
Legislative Analyst, FTB
(916) 845-6310
jessica.deitchman@ftb.ca.gov

Mandy Hayes
Revenue Manager, FTB
(916) 845-5125
mandy.hayes@ftb.ca.gov

Jahna Carlson
Asst. Legislative Director, FTB
(916) 845-5683
jahna.carlson@ftb.ca.gov