Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Atkins	Analyst:	Jessica Deitchman	Bill Number:	AB 771
Related Bills:	See Legislative History	Telephone:	845-6310	Introduced Date:	February 25, 2015
		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 Tax Law (CTL), allow a tax credit for a portion of the costs paid or incurred to rehabilitate certain historic structures.

This analysis only addresses the provisions of the bill that impact the department’s programs and operations.

RECOMMENDATION

No position.

Summary of Suggested Amendments

Technical amendments are provided for clarity.

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, 2016, and before January 1, 2024.

FEDERAL/STATE LAW

Federal law, section 47 of the Internal Revenue Code (IRC), 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 of 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 Historic District).

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The federal credit is not currently allocated or capped.

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.

Current state law allows corporations that are members of the same unitary combined reporting group to assign "eligible" credits to other members of the group. An "eligible" credit is any credit earned by the taxpayer in a taxable year beginning on or after July 1, 2008, or any credit earned in any taxable year beginning before July 1, 2008, that was eligible to be carried forward to the first taxable year beginning on or after July 1, 2008. The credit assignment is made by an irrevocable election. The assignor and assignee taxpayers must be members of the same combined reporting for the taxable year in which the credit is earned and the taxable year the credit is assigned.

THIS BILL

For taxable years beginning on or after January 1, 2016, and before January 1, 2024, this bill would create a tax credit for the rehabilitation expenses of certain homes and historic buildings determined in accordance with federal law (section 47 of the IRC) except as follows:

- A general 20 percent credit would be allowed for the qualified rehabilitation expenses of a certified historic structure (other than expenses that qualify for the 25 percent credit), and
- A 25 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 rehabilitated structure is located on certain federal surplus property, surplus state real property, or on surplus land.
    - The rehabilitated structure includes affordable housing for lower-income households.[1]
    - The structure is located in a designated census tract.[2]
    - The structure is part of a military base reuse authority.[3]
    - The structure is a transit-oriented development that is a higher-density, mixed-use development within a walking distance of one-half mile of a transit station.

[1] As defined in Section 50079.5 of the Health and Safety Code.
[2] As defined in paragraph (7) of subdivision (b) of Section 17053.73.
[3] Established pursuant to Title 7.86 (commencing with Section 67800 of the Government Code).

Unlike the federal credit;

- A state credit would be unavailable for expenditures with respect to a qualified building unless it is a certified historic structure, and
- A state credit would be allowed for those qualified rehabilitation expenditure amounts for an owner-occupied residence if:
    - The expenses are determined to have a public benefit in the year of completion, and
    - The amounts are equal to or more than $5,000 but do not exceed $25,000.

The California Tax Credit Allocation Committee (Allocation Committee), with assistance from the Office of Historic Preservation, would be responsible for the following:

- Reserve, allocate, and certify tax credits.
- Establish application procedures.
- Establish criteria consistent with the requirements of this bill.
- Determine and designate applicants that meet the requirements of this bill.
- Process and approve, or reject, all applications.
- Allocate an aggregate amount of credits, subject to the annual cap, equal to the sum of all of the following:
    - $50,000,000 in tax credits for the 2016 calendar year and each calendar year thereafter, through and including the 2023 calendar year.
    - The unused allocation tax credit amount, if any, for the preceding calendar year.
- Set aside $10,000,000 of tax credits each calendar year for taxpayers with qualified rehabilitation expenditures of less than $1,000,000. To the extent that this amount is not fully reserved in any calendar year, the unused portion would become available for reservation to other taxpayers.
- Allocate credits awarded to a partnership to the partners of that partnership in accordance with the partnership agreement, and credits awarded to an “S” corporation would be allocated among the shareholders of that “S” corporation in accordance with their respective pro rata shares, independent of how the allocation was done for federal purposes.
- Provide the Franchise Tax Board an annual list of the taxpayers that were allocated a credit, including each taxpayer’s taxpayer identification number, and the amount allocated to each taxpayer.
- Adopt a reasonable fee in an amount sufficient to cover expenses.

In addition, this bill would specify the following:

- No deduction 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.
- The credit could reduce the regular tax plus the tax relating to the separate tax on lump-sum distributions, below tentative minimum tax for taxpayers subject to the CTL and the PITL.
- Section 183 of the IRC[4] would not apply with respect to the credit.
- Section 47(c)(1)(C)(ii) of the IRC, relating to special rules for rehabilitation that may be expected to be completed in phases would not apply.
- The recapture provisions described in subsection (a) of section 50 of the IRC would apply when the property (or interest in the property) is sold within the recapture period.[5]
- The credit provisions would remain in effect regardless of the expiration or repeal of Section 47 of the IRC, relating to the federal rehabilitation credit.

The tax credit provisions[6] would remain in effect until December 1, 2024, and as of that date would be repealed.

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.

The bill would allow a credit for those taxpayers that receive a tax credit "reservation" from the Committee. To avoid confusion between taxpayers and the department on the timing and amount of the credit, it is recommended the bill be amended to specify that a taxpayer must receive an "allocation" from the Committee to receive the credit.

The language would allow a taxpayer a credit for rehabilitation of a "qualified residence" as long as the taxpayer will make the residence their principal residence within two years after the rehabilitation of the residence. However, the bill lacks recapture language that would require the credit to be recaptured if the taxpayer fails to make the rehabilitated residence their principal

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[4] IRC section 183 provides that in the case of an activity engaged in by an individual or an S corporation, if such activity is not engaged in for profit, no deduction attributable to such activity shall be allowed.

[5] The compliance and recapture period for the federal historic credits is five years from the date the property is placed in service. Twenty percent of the recapture risk decreases each year.

[6] Revenue and Taxation Code sections 17053.91 and 23691.

residence. If this is contrary to the author's intent, the bill should be amended to specify a recapture period and mechanism.

TECHNICAL CONSIDERATIONS

To clarify the definition of "certified historic structure," the following three amendments are recommended.

1. On page 4, line 24 after "code," strike "and" and insert "that is"
2. On page 4, line 25, strike "additionally means"
3. On page 4, line 25, strike "that" and insert "and"

The bill contains two definitions of the phrase "qualified rehabilitation expenditure" that are inconsistent. For consistency, the following amendment is recommended.

1. On page 5, line 1, after "expenditure" insert "has the same meaning as that term is defined in Section 47(c)(2) of the Internal Revenue Code, and"

To clarify the section of the Internal Revenue Code that is being referenced, the following amendment is recommended.

2. On page 4, line 36, after "(c)" insert "(2)"

To eliminate duplicated language, the following seven amendments are recommended.

1. On page 7, strike lines 38-40
2. On page 8, strike lines 1-2
3. On page 8, strike lines 3-4
4. On page 11, line 37, after "partnership" strike "or "S" corporation"
5. On page 11. Line 38, strike "(A)"
6. On page 12, line 12, strike "(B)" and insert "(2)"
7. On page 12, strike lines 18-21

LEGISLATIVE HISTORY

AB 1999 (Atkins, 2013/2014) would have allowed a tax credit substantially similar to this bill. AB 1999 was vetoed by the governor, stating in part; "this bill would require a spending commitment that should be weighed against other important priorities in the upcoming budget."

AB 166 (Cedillo, 2001/2002) would have allowed a tax credit in an amount determined in accordance with provisions of the federal tax credit for historic rehabilitation. 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 in 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* lack 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 of the qualified rehabilitation costs for income-producing properties and 25 percent of such costs for projects with affordable housing. 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 Adjusted Gross Income of the homeowner. This credit must be claimed in conjunction with the federal credit and sunset on December 31, 2014.

FISCAL IMPACT

The department's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 771 As Introduced February 25, 2015 Assumed Enactment After June 30, 2015 ($ in Millions)		
2015-16	2016-17	2017-18
- $19	- $41	- $48

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

Revenue Discussion

This bill would authorize the Allocation Committee to allocate $50 million annually for the rehabilitation of certified historic structures or qualified residences in California. Based on the federal historic tax credit usage, it is assumed that after a short phase-in period, the annual amount would be fully allocated each year by the Committee. Any unallocated credit would be carried forward to be allocated in subsequent years. It is assumed that 80 percent of the credit would be used in the year generated and the remaining credit would be used in the subsequent four years. The estimates are converted to fiscal year estimates and then rounded to arrive at the amounts reflected in the table above.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Some may say that California's historic buildings are an important asset to communities throughout the state, and that the preservation and restoration of these buildings is important to enhancing civic pride, increasing tourism, and maintaining vibrant neighborhoods.

Opponents: Some may argue that costs to the state of providing a tax credit for the rehabilitation of historic structures is excessive and those funds could instead be used to benefit other worthy social programs.

POLICY CONCERNS

This bill would provide 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.

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