Bill Analysis

Author: Atkins  Bill Number: SB 451

Subject: Rehabilitation of Certified Historic Building 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.

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 specifically operative for taxable years beginning on or after January 1, 2021, and before January 1, 2026, when the credit is included as an appropriation in the budget.

Federal/State Law

Federal law, section 47 of the Internal Revenue Code (IRC), allows a credit for the rehabilitation expenses of older and historic buildings.

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 or after January 1, 2021, and before January 1, 2026, 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 expenditures 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 expenditures 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.

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.
- A state credit would be allowed for qualified rehabilitation expenditure amounts for an owner-occupied residence if the expenses are determined to rehabilitate the historic character and improve the integrity of the residence in the year of completion. The credit would be allowed for amounts equal to or more than $5,000 but does not exceed $25,000.
- The state credit is zero dollars unless appropriations are provided in a bill related to the Budget Act.

\(^1\) 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 of the Revenue and Taxation Code (R&TC).
\(^3\) Established pursuant to Title 7.86 (commencing with Section 67800 of the Government Code).
“Certified historic structure” would have the same meaning as defined in Section 47(c)(3) of the IRC, that is a structure in this state and is listed on the California Register of Historical Resources.

“Qualified rehabilitation expenditure” would have the same meaning as that term is defined in Section 47(c)(2) of the IRC, except that qualified rehabilitation expenditures may include expenditures in connection with the rehabilitation of a building without regard to whether any portion of that building is or is reasonably expected to be a tax-exempt use property.

“Qualified rehabilitation expenditure” has the same meaning as that term is defined in Section 47(c)(2) of the IRC and also means rehabilitation expenditures incurred by the taxpayer with respect to a qualified residence for the rehabilitation of the exterior of the building or rehabilitation necessary for the function of that home, including, but not limited to, rehabilitation of electrical, plumbing, or foundation of the qualified residence.

The Office of Historic Preservation would be required to do the following:

- Establish application procedures with the California Tax Credit Allocation Committee (Allocation Committee).
- Adopt regulations to implement this credit, including regulations regarding the time period that a taxpayer who receives a tax credit allocation must begin rehabilitation after the issuance of the tax credit allocation.
- Establish procedures to determine whether applicants and rehabilitation projects meet the requirements for this credit.
- Establish a process to approve or reject all applications.

The Allocation Committee would be required to do the following:

- Establish a process to jointly administer the credit with the Office of Historic Preservation.
- Allocate and certify tax credits.
- 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 2021 calendar year and each calendar year thereafter, through and including the 2026 calendar year.
  - The unused allocation tax credit amount, if any, for the preceding calendar year.
- Set aside $10,000,000 of tax credits that may be allocated each calendar year as follows:
  - $2,000,000 of tax credits for taxpayers with qualified rehabilitation expenditures for a certified historic structure that is a qualified residence.
To the extent that this amount is not fully allocated in any calendar year, the unused portion shall become available in subsequent calendar years for allocation to other taxpayers with qualified rehabilitation expenditures for a certified historic structure that is a qualified residence.

- $8,000,000 of tax credits for taxpayers with qualified rehabilitation expenditures of less than $1,000,000 for any other certified historic building that is not a qualified residence. To the extent that this amount is not fully allocated in any calendar year, the unused portion shall become available for allocation to other taxpayers, except those that are using the credit to rehabilitate a qualified residence.

- Allocate credits awarded to a partnership to the partners of that partnership in accordance with the partnership agreement, independent of how the allocation was done for federal purposes and without regard to the federal rule requiring substantial economic effect for partnership allocations under Section 704(b) of the IRC.

- 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.

- Establish procedures for the recapture of amounts allocated for a tax credit allowed to a taxpayer for the rehabilitation of a qualified residence if the taxpayer does not use the qualified residence as his or her principal residence within two years after the rehabilitation of the residence.

In addition, this bill would specify the following:

- The Allocation Committee and the Office of Historic Preservation may charge a reasonable fee in an amount sufficient to cover expenses.

- No deduction would be allowed for that expense for which this 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 up to eight years.

- 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 PITL and the CTL.

- Section 47(c)(1)(B)(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.4

• 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 bill specifies that the unlike the federal credit, the entire credit generated shall be claimed the year the building is placed in service.

The tax credit provisions5 would remain in effect until December 1, 2026, and as of that date would be repealed.

**Legislative History**

AB 771 (Atkins, 2015/2016), substantially similar to this bill, would have allowed a tax credit for the costs to rehabilitate a historic building. AB 771 failed to pass by the constitutional deadline.

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.”

**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.

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4 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.

5 R&TC sections 17053.91 and 23691.
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 2021.

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 sunsets on December 31, 2024.

**Fiscal Impact**

This bill would not significantly impact the department’s costs.

**Economic Impact**

This bill would result in the following revenue loss:

Estimated Revenue Impact of SB 451
Assumed Enactment by September 30, 2019

($ in Millions)

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Credits allocated in 2021 cannot be used until after the building has been placed into service. As a result, credit usage would not begin until 2023.

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

**Revenue Discussion**

This bill would authorize the Allocation Committee to allocate $50 million annually for the rehabilitation of certified historic structures in California from January 1, 2021, through January 1, 2026. Based on the federal historic tax credit usage as well as historical data on qualifying rehabilitation expenses, it is assumed that the credit would be fully allocated each year by the Allocation Committee. It is assumed that
five percent, or $2.5 million, of the allocation would ultimately be returned to the Allocation Committee due to unforeseen project issues and added to the allocation amount in the following year. Allocated credits cannot be used until after the building has been placed into service. As a result, credit usage would not begin until 2023. It is estimated that the total credit generated for taxable year 2023 would be $43 million. It is assumed that, 90 percent, including the S corporation adjustment, or $39 million, would be earned by taxpayers who have a tax liability to offset with the credit. Of those, it is estimated that 70 percent, or $27 million, would be claimed in the year generated and the remaining credit would be claimed over the next several years.

To arrive at the offsetting tax effect of the expense deduction that would otherwise be allowed under current law, it is estimated that qualified taxpayers would be unable to deduct approximately $43 million in qualified expenses in taxable year 2023. Applying an average tax rate of 7 percent results in an offsetting revenue gain of $3 million. The resulting net revenue loss, for taxable year 2023, would be $24 million. The amount of the loss would peak at $38 million in taxable year 2027.

The tax year estimates are converted to fiscal year revenue estimates, rounded and reflected in the above table.

**Appointments**

None.

**Votes**

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**Legislative Staff Contact**

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