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October 15, 2013

TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Special Session Assembly Bill LRB-3423/1: Individual Income and Corporate Income and Franchise Taxes -- Historic Rehabilitation Tax Credits

Special Session Assembly Bill LRB-3423/1 (and LRB-3424/1, which are identical bills), would increase the current supplement to the federal historic rehabilitation tax credit and create a new credit for rehabilitation expenses.

CURRENT LAW

An individual or corporation may claim a credit against state individual income or corporate income/franchise taxes for up to 10% of qualified rehabilitation expenditures for certified historic structures. (The credit was increased from 5% to 10% under provisions included in 2013 Wisconsin Act 20.) A certified historic structure is defined as a building that is listed in the National Register of Historic Places, or that is determined to be historic and will be listed in the National Register. The building must be used for the production of income, such as commercial, industrial, or residential rental purposes. "Qualified rehabilitation expenditures" are amounts incurred that must be capitalized and added to the basis of the building rather than being deducted. Qualified expenditures do not include any amount being depreciated under an accelerated method, the cost of acquiring the building itself, or any expense for enlargement of an existing building. Expenses capitalized or properly chargeable to a capital account are those that are properly includable in calculating the basis of real property, such as architectural, engineering, and site survey fees, and construction period interest and taxes that are treated by the taxpayer as chargeable to a capital account. Also included are legal and development fees, insurance premiums, and construction costs.

Qualified rehabilitation expenditures are eligible for the credit only if incurred in connection with substantial rehabilitation of property located in the state, if the physical work of construction or destruction in preparation for construction begins after December 31, 1988, and the rehabilitated property is placed in service after June 30, 1989. The test of substantial rehabilitation generally is met if the qualified expenditures during a two-year period (60 months for phased rehabilitation) exceed the greater of $5,000, or the adjusted basis of the building. Unused credit amounts can be carried forward up to 15 years to offset future tax liabilities.

For shareholders of a tax-option corporation, the credit may be allocated in proportion to the ownership interest of each shareholder. Credits computed by a partnership or limited liability company (LLC) may be claimed in proportion to the ownership interests of the partners or members, or allocated to partners or members as provided in a written agreement among the partners or members that was entered into no later than the last day of the tax year of the partnership or LLC, for which the credit was claimed. Any partner or member who claims the credit under these provisions is required to attach a copy of the agreement, if applicable, to the tax return on which the credit is claimed. A person claiming the credit as provided under these provisions is solely responsible for any tax liability arising from a dispute with the Department of Revenue (DOR) related to claiming the credit.

In order to claim the tax credit, a claimant must include, with the return, evidence that the rehabilitation was recommended by the state historic preservation officer for approval by the U.S. Secretary of the Interior before the physical work of construction, or destruction in preparation for construction, began, and that the Secretary of the Interior approved the rehabilitation. The credit must be claimed at the same time as the federal credit is claimed.

A person who elects to base the credit on amounts claimed for expenditures as the expenditures are paid, rather than when the rehabilitation work is completed, is required to file an election form with DOR. DOR may adjust or disallow the credit amount claimed within four years after the date that the State Historical Society notifies the Department that the expenditures for which the credit was claimed do not comply with the standards for certification promulgated by the Historical Society.

Department of Revenue aggregate data for tax year 2010 indicates that the total amount of tax credit claims under the state corporate income and franchise tax was $11,500 and the credit was not used to offset any tax liabilities. The total amount of tax year 2010 credit claims under the individual income tax was about $300,000 by 70 claimants, and approximately $200,000 was used to offset tax liabilities by 60 claimants.

The state credit is a supplement to the 20% federal credit for qualified rehabilitation expenses for certified historic structures. Federal law also provides a 10% credit for qualified rehabilitation expenditures for "qualified rehabilitated buildings" which is currently not available at the state level.

SUMMARY OF BILLS

Special Session LRB-3423/1 and LRB-3424/1 would make numerous changes to the current state supplement to the federal historic rehabilitation tax credit under the state individual income and corporate income and franchise taxes.

The current supplement to the federal historic rehabilitation tax credit would be increased from 10% to 20%, for tax years beginning after December 31, 2012, if the cost of the qualified rehabilitation expenditures was at least $50,000, and the rehabilitated property was placed in service after December 31, 2012.

A new state rehabilitation tax credit would be created, for tax years beginning after December 31, 2012, that would equal 20% of the cost of qualified rehabilitation expenditures on property located in the state, as defined under the Internal Revenue Code (IRC), for qualified rehabilitated buildings, as defined under the IRC (generally pre-1936 buildings that are not certified historic structures), if the property was located in the state, the cost of the qualified rehabilitation expenditures was at least $50,000, and the rehabilitated property was placed in service after December 31, 2012. The credit could be claimed regardless of whether the rehabilitated property was used for multiple or revenue-producing purposes. A credit could not be claimed for property listed as a contributing building in the State Register of Historic Places, or in the National Register of Historic Places, or for non-historic, nonresidential property converted into housing, if the property had previously been used for housing. Unused credit amounts could be carried forward up to 15 years to offset future tax liabilities.

The drafts would allow both credits to be claimed against the state individual income minimum tax. Under current law, the supplement to the federal historic rehabilitation tax credit cannot be claimed against the state minimum tax.

A claimant, including a nonprofit entity under the IRC, could sell or otherwise transfer either credit, in whole or part, to another person subject to the state individual income or corporate income and franchise taxes, if the claimant notified DOR, and submitted, with the notification, a copy of the transfer documents, and DOR certified ownership of the credit with each transfer. If DOR adjusted or disallowed, in whole or part, a credit that was transferred, only the person that originally transferred the credit to another person would be liable to repay the adjusted or disallowed amount.

Current law provisions requiring that certain evidence and information be included with a claimant's tax return would be modified and expanded for the supplement to the federal historic preservation credit (not to the new rehabilitation credit) to require evidence that the rehabilitation was recommended by the state historic preservation officer for approval by the Secretary of the Interior before the physical work of construction, or destruction in preparation for construction, began, and that the rehabilitation was approved by the state historic preservation officer (rather than the Secretary of the Interior as required under current law). In addition, the drafts would require evidence be included that the taxpayer had obtained written certification from the state historic preservation officer that:

a. The property was; (1) listed on the National Register of Historic places in Wisconsin, or the State Register of Historic Places; (2) was determined by the State Historical Society to be eligible for listing on the National Register of Historic Places in Wisconsin or the State Register of Historic Places; (3) was located in a historic district that was listed in the National Register of Historic Places in Wisconsin or the State Register of Historic Places and was certified by the state preservation officer as being of historic significance to the district; or (4) was an outbuilding of an otherwise eligible property certified by the state historic preservation officer as contributing to the historic significance of the property.

b. The proposed preservation or rehabilitation plan complied with standards promulgated under state law by the State Historical Society, and the completed preservation or rehabilitation substantially complied with the proposed plan.

c. The costs were not incurred to acquire any building or interest in a building, or to enlarge an existing building.

d. The costs were not incurred before the State Historical Society approved the proposed preservation or rehabilitation plan.

The drafts would require DOR, in conjunction with the State Historical Society, to submit a report, by June 30, 2016, to the Joint Committee on Finance (JFC) that described the economic impact of both tax credits, and that made a recommendation as to whether the credits should continue. If DOR determined, in conjunction with the Historical Society, that the costs of the tax credits to the state was greater than the investments made in order to claim the credits, it would be required to recommend that the credits be discontinued for tax years beginning after December 31, 2016. The report would also be required to specify the number and type of claimants who claimed the credits, and the commercial purposes for which the rehabilitated properties were used. Within 14 working days after the submittal date of the report, the Co-chairs of JFC would be required to notify DOR and the State Historical Society that the Committee had scheduled a meeting for the purpose of reviewing the recommendation. The recommendation could only be implemented by Committee approval.

FISCAL EFFECT

Special Session LRB-3423/1 and LRB-3424/1 would, for tax years beginning after December 31, 2012, increase, from 10% to 20%, the current state supplement to the federal historic rehabilitation tax credit and create new rehabilitation tax credit equal to 20% of the qualified rehabilitation expenditures for qualified rehabilitated buildings, if the cost of the qualified rehabilitation expenditures was $50,000 or greater, and the rehabilitated property was placed in service after December 31, 2012. In addition, the credits could be sold or otherwise transferred to persons subject the state individual income and corporate income and franchise taxes. The credits could also be claimed under the state individual income minimum tax. The drafts would reduce state income and franchise taxes by an estimated $4.8 million in 2013-14, and $3.8 million in 2014-15, and annually thereafter. The 2013-14 estimate includes a one-time revenue decrease of $1.0 million that reflects reconciliation of fiscal year and calendar year tax credit claims.

Prepared by: Ron Shanovich