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JOINT COMMITTEE ON FINANCE

MEMORANDUM

To: Members
Joint Committee on Finance

From: Senator Alberta Darling
Representative John Nygren

Date: July 5, 2017

Re: DOR Report to JFC

Attached is a report on the economic impact of the supplement to the federal historic rehabilitation tax credit from the Department of Revenue, pursuant to 2013 Wisconsin Act 62 Sec. 27.

This report is being provided for your information only. No action by the Committee is required. Please feel free to contact us if you have any questions.

Attachments

AD:JN:jm



State of Wisconsin • DEPARTMENT OF REVENUE

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Scott Walker
Governor

Richard G. Chandler
Secretary of Revenue

MEMORANDUM

June 30, 2017

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St. Finance

TO: Sen. Alberta Darling, Senate Chair, Joint Committee on Finance
Rep. John Nygren, Assembly Chair, Joint Committee on Finance

FROM: Richard G. Chandler
Secretary of Revenue

SUBJECT: 2013 Wisconsin Act 62 Sec. 27 requires, in part, submission of a report on the economic impact of the supplement to the federal historic rehabilitation tax credit

No later than June 30, 2017, DOR, in conjunction with the State Historical Society, shall submit to the Joint Committee on Finance a report describing the economic impact of the credit and shall make a recommendation to the Committee as to whether the credit should continue. If DOR, in conjunction with the State Historical Society, determines that the cost of the credit to the state is greater than the investments made in order to claim the credit, DOR shall recommend in the report that the credit be discontinued for taxable years beginning after December 31, 2017. The report shall also specify the number and type of claimants who have claimed the credit and the commercial purposes for which the rehabilitated properties are used.

Background

The federal historic preservation tax incentives program was created in 1976, and a federal 20% tax credit for qualifying expenses related to rehabilitating certified historic structures has been in place since 1986. The federal credit is intended to supplement and encourage private investment in the rehabilitation of certified historic buildings.

The Wisconsin supplement to the federal historic rehabilitation tax credit (HRTC) was created under 1987 Act 395 and first effective at a 5% credit rate in 1989.¹ Under 2013 Act 20, the Wisconsin credit rate was increased to 10%, beginning in tax year 2013. Beginning in tax year 2014, 2013 Act 62 further increased the Wisconsin credit rate to 20%. In combination, the

¹ Under 1993 Act 16, Wisconsin also adopted a state historic rehabilitation credit for owner occupied historic homes, equal to 25% of the qualifying rehabilitation expenses certified by the State Historical Society.

federal and Wisconsin credits currently allow historic building owners to offset 40% of qualifying expenses used to rehabilitate certified historic structures in Wisconsin.

In addition to Wisconsin, thirty three other states have HRTCs.² Most of those states have either statewide caps on annual credit claims, per-project caps on credit claims, or both. Wisconsin and ten other states do not have either cap. The National Trust for Historic Preservation produced the map shown in chart 1, identifying states with and without state historic tax credits.

Chart 1:



Source: National Trust for Historic Preservation
<http://forum.savingplaces.org/learn/fundamentals/economics/tax-credits/state-htc> (accessed June 7, 2017)

States vary greatly in the uptake rate of the federal HRTC partially due to state credit rates and statutory limitations. Moreover, due to the time required to rehabilitate historic properties, changes in credit claims may lag changes in state law by one or more years. As such, states differ with respect to the projects in planning and completion stages.

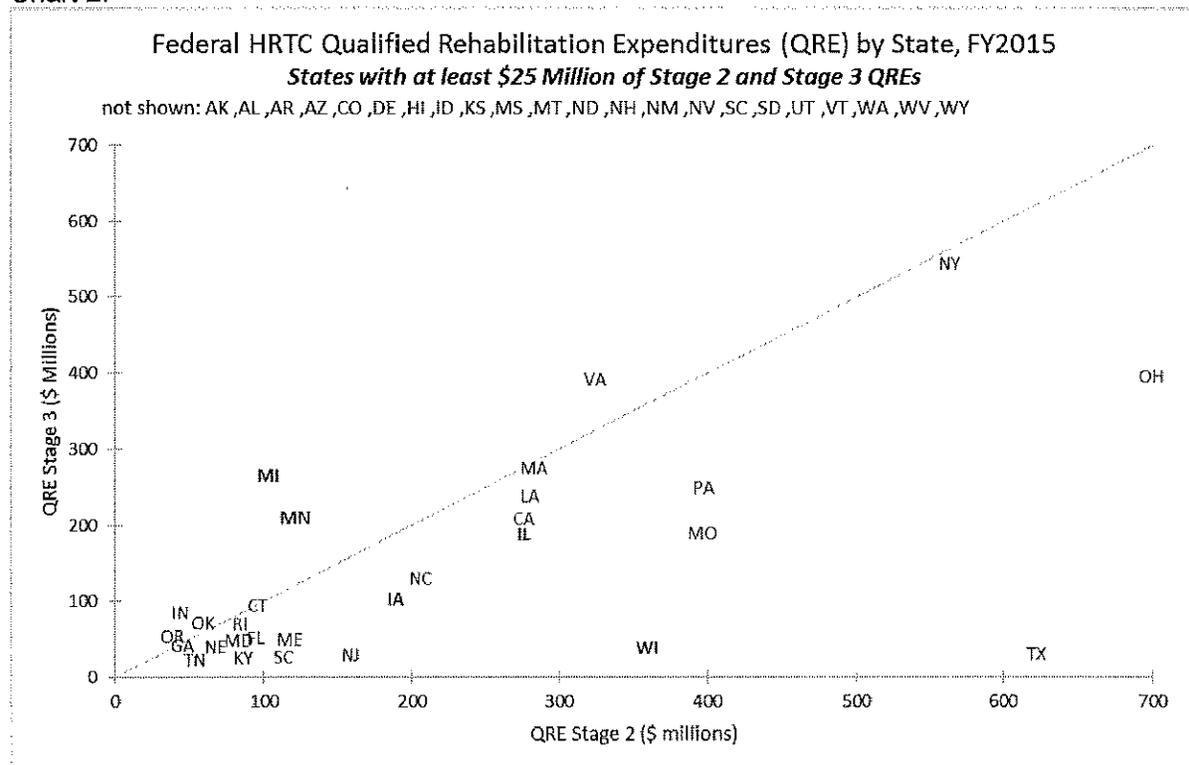
In general, in order to claim the federal and state tax credits, historic building owners must progress through three stages of certification:

² States with HRTCs most commonly have a credit rate of 25% or 20%.

- 1) Certification of historic significance for their properties.
- 2) Approval of the specific rehabilitation project plan.
- 3) Certification of the qualifying rehabilitation expenses (QREs) after the projects have been completed to the standard required under the law.³

Chart 2, below, shows states with at least \$25 million of estimated QREs at stage 2 and at stage 3 during federal fiscal year 2015. The gray diagonal line indicates points at which the value of new project proposals equaled the value of project completions. States below and to the right of the line reflect increasing rehabilitation work (more work starting than finishing). Credits above and to the left of the line reflect decreasing rehabilitation work (more work finishing than starting). For example, the chart indicates that Michigan should expect fewer credit claims in the near future relative to FY15, while Ohio and Wisconsin should expect more credit claims. Wisconsin is near the lower middle of the chart, but because the chart excludes 22 states with less than \$25 million in stage 2 and stage 3 QREs, the state reflects a relatively typical level of stage 3 projects and a relatively high level of stage 2 projects. Wisconsin and neighboring states are highlighted in red.

Chart 2:

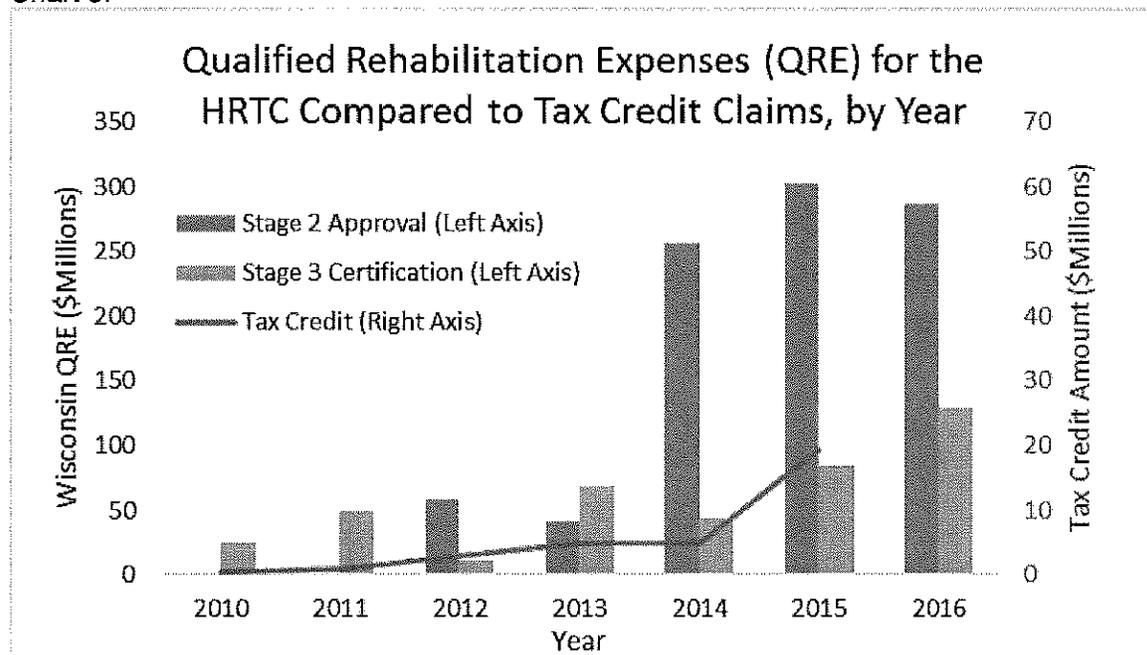


Source: U.S. Department of the Interior, National Park Service, Technical Preservation Services, *Federal Tax Incentives for Rehabilitating Historic Buildings Statistical Report and Analysis for Fiscal Year 2015*

³ The federal standards for rehabilitation required under the law are available in CFR title 36, chapter 1, part 67, section 67.7 (available here: <https://www.law.cornell.edu/cfr/text/36/67.7>).

Chart 3 compares stage 2 QREs, stage 3 QREs, and tax credit claims. Note that after receiving a stage 3 certification for QREs, the tax credit is calculated by multiplying the certified expenses by the credit rate (5% prior to 2013, 10% in 2013, and 20% after 2013). As chart 3 shows, Wisconsin experienced a surge in stage 2 project proposals after the state credit rate was increased. Wisconsin project completions (stage 3) and resulting credit claims have not yet reflected the stage 2 activity level in the chart, though they are increasing. Approximately \$300 million of stage 2 QREs will translate to about \$60 million of credits if all projects are completed at the level at which they were planned. Due to the variation in project completion time, the increased credit claims may be spread over several years.

Chart 3:



Sources: 2014-2016 stage 2 and stage 3 information was provided by the State Historical Society. Prior year stage 2 and stage 3 are estimates based on *Federal Tax Incentives for Rehabilitating Historic Buildings Statistical Reports*. Tax credit amounts are based on DOR data, including carryforwards of unused credits.

Measuring Economic Impact

As chart 3 indicated, there is evidence that Wisconsin experienced an increase in project proposals after the credit rate increase. While this suggests that those credits were not simply a windfall for rehabilitation work that would have happened anyway, it does not distinguish between new investments versus investments that would have occurred on non-historic buildings but are instead shifted to qualifying historic buildings.

A complete accounting of the economic benefit of the HRTCs would require a plausible counterfactual scenario, a concept that would provide for a more in-depth analysis than simply measuring the activity generated by the credit applicants. It is not clear how much of the increase in HRTC projects is the result of new investments and how much is the result of a shift

in investments in order to qualify for the credit. A counterfactual analysis could attempt to broadly measure the economic impact relative to other policy alternatives or could focus on specific indicators.

The Wisconsin Economic Development Corporation (WEDC) tends to focus on the direct creation or retention of ongoing full-time jobs as the measure of success for the tax incentives that they certify. This provides some insight into the relative effectiveness of economic development policies in the context of job creation.⁴

There is currently no requirement that HRTC projects create, retain, or report on jobs, so a measure directly comparable to the WEDC measure is not available. To the extent that the HRTC program is different from other economic development policies, other reporting metrics should also be required to ensure that the program is effectively achieving its goals.⁵

Other states' analyses of HRTCs have tended to provide general economic impact predictions based on regional input-output (I-O) models. I-O models are powerful models based on the relationships between industries in a regional economy, recognizing that producing final goods and services in one industry requires the use of intermediate goods and services from other industries. As a result of these interrelations, the direct effect of spending produces spillover effects in the broader economy in terms of additional jobs and production.

Evaluations of the HRTC using qualified expenses in an I-O model approach will count temporary construction jobs as well as ongoing jobs, will count indirectly-created jobs as well as directly-created jobs, and will count jobs that are reallocated to credit recipients from elsewhere in the state. A general I-O prediction based on 2010 Wisconsin data, suggests that \$100 million per year in construction production would directly correspond to 914 construction jobs and, including indirect and induced effects, would correspond to 1,815 total jobs. To be clear that these effects are not specific to HRTC spending, it should be emphasized that a similar I-O approach applied to manufacturing production or professional, scientific and technical services production would result in similar estimates of job gains.

Assuming the current economy's correspondences can be used to project the effect *new* spending/production will have generating *new* jobs, I-O models can be useful in predicting the total effect new spending will have on a regional economy. However, they must start by identifying *new* spending excluding any shift in *existing* spending patterns.⁶ For example, a state could more realistically identify a federal grant as *new* spending in the state, while a state tax credit would reflect a shift in *existing* state spending patterns. To the extent that a state tax credit incentivizes private investment, it is important to separate *net* new private spending by accounting for qualifying spending that would have occurred anyway and decreases in non-qualifying private spending,

⁴ For example, if one policy yields ten jobs per one million dollars of state funds while another policy yields twenty jobs per one million dollars of state funds, it's possible to compare their relative effectiveness. The comparison would still need to consider metrics such as job quality and be careful to restrict the measure to reflect new economic activity rather than a shift in existing activity.

⁵ This report does not account for any intrinsic values associated with historic preservation.

⁶ Bess and Ambargis (2011) provide additional I-O model assumptions and guidance.

It is also important to note that I-O models produce *predictions* based on the existing economy rather than *measurements* based on the outcome of a change in the economy. An individual project may outperform or underperform the I-O model prediction based on how well it fits the assumption framework of I-O analyses.

Credit Claims

Existing tax credit claims do not provide for a complete assessment of the economic impact of the investments made as a result of Wisconsin 2013 Act 62. The median historic rehabilitation project in Wisconsin takes more than two years to progress from an approved rehabilitation plan to a completed project. Larger projects also tend to take more time to complete than smaller projects. As such, most plans that received approval in 2014 or 2015, after Wisconsin 2013 Act 62 was enacted, will receive credit certification for 2016 tax returns or later. For tax years 2014 and 2015, DOR has received 157 claims to date for the supplement to the federal historic rehabilitation tax credit (HRTC), totaling \$24.0 million.

The overwhelming majority of entities applying for rehabilitation project approval since January 1, 2014 have been partnerships. However, the credit must be claimed by the partners rather than the partnership itself. Partners may be individuals, corporations, or other partnerships that must continue to pass the credit through to their partners. Because the credit is transferrable, it is also possible that credit claimants purchased the credit rather than participating in the rehabilitation work that generated the credit. DOR has certified 67 such credit transfers since January 1, 2015. On average, the transferees purchase credits from transferors for about 90% of their face value. This incurs administrative costs to certify and track transfers. It also incurs costs on credit claimants to find, negotiate, and contract with potential purchasers of the credits that they are unable to use.

Recommendation

At this point in time, DOR does not have the data necessary to provide a complete analysis of the economic impact of the HRTC changes from 2013 Act 62 nor are there any reporting requirements in statute in order to obtain pertinent information.

DOR supports the recommendations included in the Governor's 2017 Budget Bill. DOR recommends that the legislature require clear economic development related metrics that prospective HRTC claimants must provide as part of the project plan for stage two of the certification process. Furthermore, DOR recommends that the legislature establish an annual credit allotment (\$10 million in the budget bill) and award project approvals under a competitive process. These requirements will provide greater certainty for budget planning and ensure funding for the projects with the best potential for economic development. DOR also recommends statutory clawback provisions for projects that fail to deliver contracted benefits.