

NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

BILL NUMBER: S.B. 251 (Second Edition) Modify Historic Rehab Credit

SHORT TITLE: Modify Historic Rehab Credit

SPONSOR(S): Senator Hamilton Horton

FISCAL IMPACT

Yes () No () No Estimate Available (X)

FY 1999-00 FY 2000-01 FY 2001-02 FY 2002-03 FY 2003-04

REVENUES

General Fund

* See Assumptions and Methodology *

PRINCIPAL DEPARTMENT(S) &

PROGRAM(S) AFFECTED: Department of Revenue, Department of Cultural Resources.

EFFECTIVE DATE: Effective for taxable years beginning on or after January 1, 1999 and expires effective January 1, 2002 for property placed in service on or after that date.

BILL SUMMARY:

The bill modifies the existing historic rehabilitation income tax credit to allow a pass through organization to allocate the credits among project owners. It requires that the amount of the credit be limited to the owner's adjusted basis in the pass-through entity. It also allows for the recapture of the credit if the taxpayer is required to recapture the credit under the Code or if the taxpayer disposes of his interest in the pass-through entity. It requires the pass through organization and the property owners to include an allocation statement with their annual tax returns. It also recodifies the existing historic rehabilitation credit language in a single Article, and makes conforming changes.

BACKGROUND INFORMATION:

Federal law provides a federal income tax credit equal to 20% of qualified rehabilitation expenditures for certified historic structures that are used in connection with a trade or business or held for the production of income. This credit is available for both residential rental buildings and nonresidential buildings. In order to qualify, the property itself must be either listed in the National Register, or located in a registered historic district and be certified as being of historic significance.

Since 1993, North Carolina investors eligible for the Federal Rehabilitation Investment Tax Credit have been allowed a state income tax credit equal to one-fourth of the federal amount (5%). The 1997 General Assembly expanded the State income tax credit from 5% to 20% for rehabilitating an income-producing historic structure, effective for tax years beginning on or after January 1, 1998. (S.L. 1997-139) The credits may not be taken in one year, but must be spread out in installments over five years after the historic structure is placed in service. Any unused portion of a credit may be carried forward for a five-year period.

ASSUMPTIONS AND METHODOLOGY:

By allowing a pass through entity to reallocate the tax credits, the bill effectively authorizes rehabilitation property owners to transfer all of the North Carolina tax credits to North Carolina residents and businesses with tax liability. Currently, if foreign investors are involved in a qualifying rehabilitation project, their tax credits can not be redistributed. For example, if there are five equal investors, but only four of them are North Carolinians, only 80% of the available North Carolina tax credits are used.

Previous fiscal notes assumed taxpayers would use 100% of their allotted credit taken over a required five-year period. Once the bills enacting the rehab credit were passed (the original enacting legislation and SB 323 which expanded the credit in 1997), the resulting revenue losses were included in future year base budget projections. The fiscal note for SB 323 assumed the number of completed federal projects each year would range from 35 projects valued at \$17,500,000 in 1998 up to 60 projects valued at \$30 million in 2002. However, the program has proven more popular than was originally projected. (see note below)

Under the existing law, the actual experience is that 100% of the rehab credit will probably not be used due to out-of-state investors without North Carolina income tax liability or North Carolina investors without state income tax liability. According to the Department of Cultural Resources, two of the 69 projects reviewed in 1998 had out-of-state investors. Due to the confidentiality of tax information, it is unknown if these out-of-state investors can utilize all of the rehab credits. It is also impossible to determine how many projects had in-state investors with no state tax liability.

In 1998, the Executive Director of the Historic Preservation Foundation of North Carolina, Myrick Howard, saw the pass - through issue as a technical correction. It allows rehab project managers to fully utilize the credits as envisioned in the 1997 legislation and accompanying fiscal note. On the other hand, officials from the Department of Revenue believe the credit could encourage more out of state investment. However, there is no way to quantify what that additional investment might be.

NOTE: January 1999 data from the State Historic Preservation Office (SHPO) indicate that the historic rehabilitation credit has received far more interest than expected. As an example, SHPO and Fiscal Research estimated there would be 35 projects with a total value of \$17.5 million in 1998. This estimate was based on other states' experiences. In reality, the SHPO received 89 applications for rehabilitation work valued at \$106 million. If all the projects are completed and all credits are utilized, project owners will recoup \$21.2 million in income tax credits over five years. This is six times the \$3.5 million originally estimated.

FISCAL RESEARCH DIVISION 733-4910

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DATE: Thursday, July 01, 1999



**Official
Fiscal Research Division
Publication**

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