NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

BILL NUMBER: Senate Bill 119 (Third Edition - REVISED)

SHORT TITLE: Expand Historic Preservation Credit

SPONSOR(S): Senator Horton

FISCAL IMPACT

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

	FY 2003-04	FY 2004-05	FY 2005-06	FY 2006-07	FY 2007-08
REVENUES					
General Fund	No estimate available				
EXPENDITURES					
General Fund	$14,000				

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: Department of Cultural Resources – State Historic Preservation Office; Department of Revenue

EFFECTIVE DATE: Section 1 (extend sunset), 3 (tax form), and 4 are effective when the bill becomes law. Section 2 (credit allocation) is effective for taxable years beginning on or after January 1, 2003.

BILL SUMMARY: The bill extends the sunset on the pass-through provision for the tax credit for rehabilitating income-producing historic structures from January 1, 2004, to January 1, 2008. The bill allows a pass-through entity that qualifies for the historic rehab credit to allocate the credit among its owners in its discretion as long as an owner's adjusted basis is at least 40% of the amount of the credit allocated to that owner. The bill also directs the Department of Revenue to modify the income tax forms to provide separate lines for each tax credit claimed by a taxpayer.

BACKGROUND: The National Park Service of the U.S. Department of the Interior administers 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 of Historic Places administered by the National Park Service, or located in a registered historic district and be certified as being of historic significance. All rehabilitation work must meet The Secretary of the Interior's Standards for Rehabilitation and must be approved by the State Historic Preservation Office (SHPO).

From 1993 to 1997, North Carolina investors eligible for the Federal Rehabilitation Investment Tax Credit were 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 claimed 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:
<u>No estimate can be made of the actual revenue impact of this bill</u>. In theory, the bill was introduced to increase the likelihood that the historic rehab tax credits will be fully utilized by taxpayers. However, the General Assembly's Fiscal Research Division has assumed from 1997 (the year the credit increased to 20%), that 100% of the tax credits have been used and have built 100% utilization of the historic credit into the General Fund availability forecast. All efforts to determine the actual cost of the credit program failed for reasons explained below.

From 1989 to 1997, the Journal of Multistate Taxation and Incentives reported North Carolina had 268 federally certified historic rehab projects valued at $125.3 million. The average project size in this period was $468,000 and the average number of projects each year was 30. The increase in the state credit in 1998 saw a significant increase in projects and in the size of projects. From 1998 through March 2003, $178.7 million was spent on rehabbing 199 historic structures. On average in the 1998-2003 period, 38 projects were completed each year at cost of $900,000 per project.

Income Producing Projects - Completed

Tax Year	# Of Projects	Rehab Expenses	Avg. Proj. Cost
1998	27	$6,748,550	$249,946
1999	36	$25,187,152	$699,643
2000	44	$39,385,678	$895,129
2001	50	$74,117,018	$1,482,340
2002	30	$27,229,772	$907,659
J - M 2003	12	$6,035,293	$502,941
	199	$178,703,463	$898,007

As shown in the following chart, the General Fund impact of these credits is lessened by the requirement that the tax credit be taken over five years. In FY 02-03, the actual credit earned is $6,906,727, an amount slightly lower than the original projection of $7.2 million made in 1997.

I. Income Producing Projects - Completed

Tax Year	Credit Amount	FY 98-99	FY 99-00	FY 00-01	FY 01-02	FY 02-03
1998	$1,349,710	$269,942	$269,942	$269,942	$269,942	$269,942
1999	$5,037,430		$1,007,486	$1,007,486	$1,007,486	$1,007,486
2000	$7,877,136			$1,575,427	$1,575,427	$1,575,427
2001	$14,823,404				$2,964,681	$2,964,681
2002	$5,445,954					$1,089,191
J - M 2003	$1,207,059					
General Fund Revenue Loss		**$269,942**	**$1,277,428**	**$2,852,855**	**$5,817,536**	**$6,906,727**
Original 1997 Estimate		**$1,050,000**	**$2,250,000**	**$3,750,000**	**$5,400,000**	**$7,200,000**

While the data above shows the amount of tax credits taxpayers are eligible for each year, it does not reveal the percentage of tax credits claimed each year. The Department of Revenue was asked to report on the amount of income-producing historic rehab credits taken in tax years 2000 and 2001. The Department's Tax Research Division responded that it could only determine the number of corporate taxpayers that claimed the historic rehab credit, because the agency's ITAS computer system does not contain information on the individuals that claim the credit. ITAS does not capture data on individual historic rehab tax credits, because the credit is one of a number of credits filed on Form D-400TC as a miscellaneous credit. The only way for the Department to determine the number of individual tax credits taken would be to manually search through 28,000 tax returns each year that claim a miscellaneous credit.

The Tax Research Division data on corporate historic rehab credits shows $893,265 was claimed in tax year 2000. Since these credits would probably have been claimed in the FY 2001-02 period, the reported $893,265 is only 15% of the $5.8 million in available credits that year. For the 2001 tax year, $725,703 in corporate credits were claimed out of $6.9 million credits available in FY 2002-03 (10.5%). Without the individual tax credit information, the corporate data is meaningless. No conclusion on credit utilization can be drawn from existing Department of Revenue or Department of Cultural Resources data.

Section 3 of the bill directs the Department of Revenue to change the income tax forms to provide separate lines for each tax credit claimed by a taxpayer. This change will remedy the data problems described above and provide valuable information to legislative and executive branch analysts tasked with evaluating and estimating the General Fund revenue loss of each tax credit. The Department of Revenue estimates that it will take its IT Division 200 hours to do system design, programming, testing, and implementation. This programming time will cost the Department $14,000 and will be absorbed by the agency if no appropriation is provided.

SOURCES OF DATA: National Park Service; Journal of Multistate Taxation and Incentives (Nov/Dec 2000); Department of Revenue - Tax Research Division

FISCAL RESEARCH DIVISION: (919) 733-4910
PREPARED BY: Richard Bostic

APPROVED BY: James D. Johnson, Director, Fiscal Research Division

DATE: June 17, 2003

Official Fiscal Research Division Publication

Signed Copy Located in the NCGA Principal Clerk's Offices