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State Tax Credits for Historic Preservation

by Harry K. Schwartz

By 2005 roughly half the states in the country had adopted laws creating credits against state taxes to provide incentives for the appropriate rehabilitation of historic buildings. In most cases these tax credits take the form of the very successful federal income tax credit for historic rehabilitation contained in Section 47 of the Internal Revenue Code.

Although the tax credits vary from state to state, most programs include the following basic elements:

- Criteria establishing what buildings qualify for the credit.
- Standards to ensure that the rehabilitation preserves the historic and architectural character of the building.
- A method for calculating the value of the credit awarded, reflected as a percentage of the amount expended on that portion of the rehabilitation work that is approved as a certified rehabilitation.
- A minimum amount, or threshold, required to be invested in the rehabilitation.
- A mechanism for administering the program, generally involving the state historic preservation office and, in some cases, the state department of revenue.

Scientific Properties, LLC, used state and federal historic rehab tax credits to rehabilitate a former auto garage into state-of-the-art lab space for emerging biotech businesses in Durham, N.C. The Triangle Biotechnology Center also offers hands-on educational opportunities for area disadvantaged youth. Photo by Andrew Rothschild.

Why Some State Credits Work Better Than Others

Not all state tax credit programs are created equal. Some state programs have been extraordinarily productive in stimulating rehabilitation activity. Many others have produced mixed or minimal results. What causes these programs to fall short? In general, two factors greatly influence the effectiveness of the state historic tax credits: a limit or cap on the amount of credit and a lack of transferability.

Annual Aggregate Caps

A well-thought-out and skillfully drafted tax incentive for historic preservation cannot achieve its objectives if the amount of credits that can be awarded annually is subject to a statutory limit, particularly if the limit is fixed at a low figure. For example, Iowa has a 25 percent credit, but only a $2.4 million annual cap. Delaware has a 20 percent credit for commercial buildings and a 30 percent credit for owner-occupied residences, but only a $5 million annual cap. Indiana has annual aggregate caps of just $450,000 for commercial projects and $250,000 for residential projects.

Even if the annual limit is relatively high, the very act of imposing a cap alters the nature of the program and can produce a perverse result, rewarding projects that do not require an incentive while excluding projects that cannot proceed without the state incentive.

Maryland law sets a limit of $30 million in commercial credits per year, subject to annual appropriation. Applicants must compete for available funds, and individual jurisdictions are subject to sub-limits. Consequently, despite the relatively high overall cap, sponsors of smaller and more marginal projects, particularly in Baltimore City, tend to be discouraged from participating in the program because of the lack of certainty of outcome, the cost of preparing a competitive application that may nevertheless be unsuccessful, and the difficulties of keeping financing commitments in place during the evaluation process, among others.

Individual Project Capping

Although limits on the amount of credits that can be awarded to an individual project are common and acceptable when the credit is sought for the rehabilitation of an owner-occupied single family residence, when low limits are fixed on commercial projects, they effectively defeat the desired incentive.

Colorado law, for example, limits the amount of tax credits that may be awarded to a single project to $50,000. While this does not impair the credit's usefulness for homeownership rehabilitation, it is far too low a figure to affect decisions regarding substantial commercial projects.

Transferability

A state tax credit has value only to the extent that the credit holder has sufficient liability for state taxes that the credit can be used to offset. Although state tax rates vary, they are far lower than federal income tax rates. As a consequence, an apparently valuable state tax credit may wind up in the hands of a party unable to use it. There are several remedies to solve this problem, but many state statutes do not provide for them.

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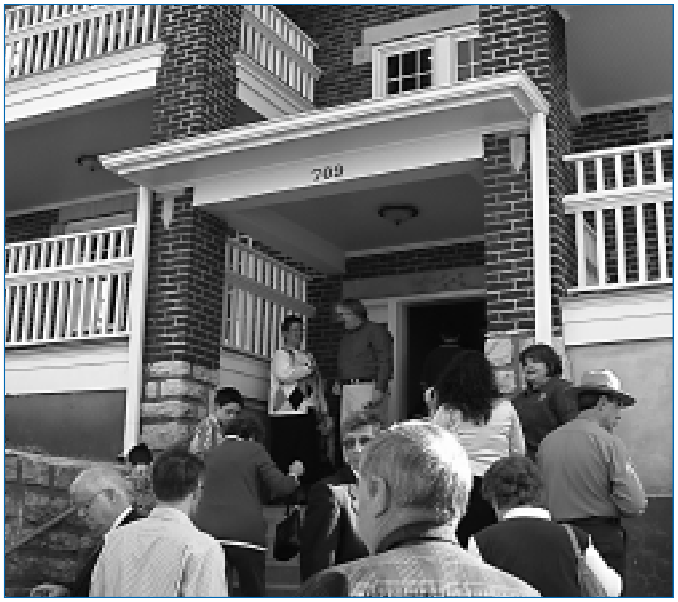

Patriot Place Apartments, LLC, used state and federal historic rehab tax credits and funding from the National Trust Loan Funds to rehabilitate a fire-ravaged apartment building in the Harry S. Truman National Historic Landmark district in Independence, Mo. The project produced 17 apartment units, including 10 reserved for low- to moderate-income renters. Photo by Lisa Weissman.

What Makes a State Tax Credit "Good?"

A successful state tax credit program will contain the following components:

Eligible Buildings

The scope of eligible buildings should include:

1. buildings individually listed in the National Register of Historic Places,

2. buildings located in historic districts listed in the National Register that contribute to the historic character of the district,

3. individual buildings that have been locally designated as landmarks, and

4. buildings located in local historic districts that contribute to the historic character of the district.

Standards for Rehabilitation

The state should adopt the Secretary of the Interior's Standards for Rehabilitation, as interpreted by the state historic preservation officer.

Availability for Homeowners

The credit should be available for owner-occupied residences as well as commercial property. This is particularly important because there is no federal credit for owner-occupied residences.

Appropriate Rates

The percentage rate of the credit should be fixed at a level high enough to constitute a meaningful incentive, typically in the range of 20 percent to 30 percent of qualified rehabilitation expenditures. Rates that are significantly lower don't provide enough incentive to make a difference in a developer's decision to undertake a historic preservation project.

As a negative example, Michigan provides a 25 percent tax credit for the rehabilitation of commercial structures, but reduces its credit to 5 percent when the federal 20 percent credit is used. Since the federal credit is almost universally used in commercial projects, the effective rate in Michigan is 5 percent.

Transferability

As mentioned earlier, there needs to be a workable mechanism to put the credit in the hands of the party that can use it. States have solved this problem in one or more ways:

1. The tax code may permit the party that earns the credit to sell it outright to a third party with adequate tax liability to use it. For example, Rhode Island and Missouri permit the taxpayer to sell or convey the tax credits.

2. The code may permit a partnership that owns the property to make a disproportionate distribution of the credit, so that a local taxpayer can acquire the state tax credit while a national corporation not doing business in the state acquires the federal tax credit. Virginia, Kansas, and Delaware, for example, allow the credit to be passed through or allocated to partners or shareholders.

3. The code may allow a tax credit not fully usable in the current year to be carried back to offset taxes previously paid for prior tax years. This provision appears to be unique among the states to Missouri, although it is a feature of the federal program.

4. The tax credit may be refundable, so that any amount not used to offset current-year taxes is paid in cash to the holder of the credit. Since homeowners earning credits are effectively precluded from using the more complex techniques for transferring credits, the most practical solutions for them are to allow the unused credit to be either refunded or sold outright. Only Maryland provides for a fully refundable tax credit, which is of particular value to lower-income homeowners. The Iowa statute provides for partial refundability.

Annual Aggregate Caps

Although state legislatures and their fiscal analysts prefer to keep a tight grip on the award of tax credits, those states that have resisted capping have had an economic advantage in attracting capital for historic preservation.

For more information about state tax credits for historic preservation and a list of useful state contacts, visit www.nationaltrust.org/help/taxincentives.pdf.

Harry K. Schwartz is a consultant to the National Trust on state tax incentives.

Property owners in Virginia can take advantage of a 25 percent state tax credit for rehabbing a National or state register property. Pictured above is 2114 East Main Street in the Shockoe Valley and Tobacco Row Historic District located in Richmond, Va. Photo courtesy of the Virginia Department of Historic Resources.

State Tax Incentives Are a Proven Economic Development Tool

Rhode Island enacted a state historic preservation tax credit in 2002. Owners of historic commercial properties can earn state income tax credits equal to 30 percent of qualified rehabilitation expenditures. A recent study, commissioned by Grow Smart Rhode Island, has shown that the state tax incentive is returning historic properties to municipal tax rolls, generating employment and housing where they are most needed, and leveraging substantial private investment. The study concludes that the state multi-year investment in the tax credit, estimated at $145 million, is generating a total of $795 million in economic activity. The program is estimated to add $242 million to the tax base of local communities and to generate on a present value basis $179 million in additional property tax revenue and $42 million in sales and income tax revenue.

The State Penalty

Unlike the federal tax credit, which is not taxed by the federal government, the state tax credit is always worth less than its face value after federal law is taken into account.

These hidden costs occur for one of two reasons:

1. State tax credit certificates, when transferred upon completion of the project, trigger a short-term capital gain to the seller, typically taxed at a 35 percent rate.

2. A party that uses a state tax credit to reduce its state tax liability normally loses the ability to take a deduction for the state tax paid with the use of the state historic tax credit. Depending on the tax bracket of the party, the loss of the deduction can reduce the value of the state tax credit by up to 35 percent.

This means that $100 worth of federal historic tax credits is worth $100. Yet $100 worth of state tax credits would normally not be worth more than $65. In practice, when credits are sold, federal credits may bring as much as $.95 on the dollar, while the after-tax value of the state tax credits tends to be in the range of $.55 on the dollar.

State	State Income Tax Credit	Contact
Colorado	20% of rehab expenses up to $50,000 in credits for eligible properties designated by national, state, or local government and contributing buildings in historic districts. 20% state credit taken with 20% federal tax credit for commercial property. Minimum investment: $5,000. Cap: $50,000 for any tax year. Carry forward: 10 years. DOI standards apply and work must be completed within 2 years of inception date of project. CLG can review and approve project. Sunset date for credit is 2009.	Colorado Historical Society 303-866-3395 www.coloradohistory-oahp.org
Connecticut	30% credit for eligible rehab of owner-occupied residential, including apartments up to 4 units. Cap: $30,000/dwelling, $3 million statewide/year. Minimum expenditure: $25,000. Recapture period: 5 years. Eligible properties: National and/or State Register of Historic Places, must be located in area targeted as distressed. Carry forward: 4 years.	Connecticut Historical Commission 860-566-3005 www.chc.state.ct.us
Delaware	20% credit for income-producing properties and a 30% homeowner credit. A 10% bonus credit applies for both rental and owner-occupied projects that qualify as low-income housing. Carry forward: 10 years. Homeowner credit cannot exceed $20,000. Credits are transferable. The credit to be claimed in annual progress-based installments with phased projects. Changes in 2005 increased the maximum amount of credits in any fiscal year to $5 million.	Delaware State Historic Preservation Office 302-739-5685 www.state.de.us/shpo/default.shtml
Georgia	20% credit for eligible income-producing properties;10% for owner-occupied properties in non-target area and 15% for owner-occupied properties in target area. Project limit of $5,000 in credits over 10 years.	Georgia Historic Preservation Division 404-656-2840 www.dnr.state.ga.us/dnr/histpres
Indiana	20% of rehab costs up to $100,000. Commercial, rental housing, barns and farm buildings qualify. Minimum investment: $5,000 over 2 years. Per-project cap: $20,000. Statewide cap on total amount of commercial credits permitted annually: $450,000. State register properties qualify. Carry forward: 15 years. Pre-approval of work required. No fees. DOI standards apply. Owner-occupied residential: 20% of rehab costs. Costs must exceed $10,000. Annual statewide cap on credits for owner-occupied residential: $250,000.	Indiana Department of Natural Resources 317-232-1646 www.state.in.us/dnr/historic/index.html
Iowa	25% credit for eligible commercial, income-producing and non-income-producing residential properties, including barns. Statewide cap of $2.4 million annually. DOI standards apply. A provision permits taxpayers whose credit exceeds their tax liability to receive a refund. The amount refunded may not exceed 75% of the excess credit.	State Historical Society of Iowa • Property Tax Exemption Program 515-281-8637 • State Tax Credit Program 515-281-4137 www.iowahistory.org/preservation/index.html
Kansas	25% income tax credit for commercial and residential properties. Carry forward: 10 years. $5,000 minimum on qualified expenditures necessary. Credit is freely transferable. No annual program cap, and no per project cap.	Dept. of Housing and Commerce 785-296-3481 www.kshs.org/resource/shpohome.htm
Kentucky	30% income tax credit for owner-occupied residential properties. A minimum investment of $20,000 is required, with the total credit not to exceed $60,000. 20% income tax credit for all other properties, requiring a minimum investment of $20,000 or the adjusted basis, whichever is greater. Credit is freely transferable. $3 million total program cap annually. Effective January 2006.	Kentucky Heritage Council 502-564-7005 www.state.ky.us/agencies/khc/khchome.htm
Louisiana	25% credit for income-producing properties in “downtown development districts.” $250,000 cap per structure that can be carried forward 5 years. Maximum 25% credit for owner-occupied residential and owner-occupied mixed-use qualified property, capped at $25,000 per project. Requires a minimum investment of $20,000. The rate of credit is graduated on the income of the owner-occupant. $1 million annually for the program. Effective December 31, 2005.	Louisiana Department of Culture, Recreation & Tourism 225-342-8200 www.crt.state.la.us/crt/ocd/hp/ocdhp.htm

State	State Income Tax Credit	Contact
Maine	20% credit for rehab of income-producing properties for those properties that are eligible for the federal tax credit. Eligible properties: National Register or National Register eligible. Uses DOI standards for rehabilitation and qualified costs. Minimum expenditures: investment in excess of the adjusted basis of the building or $5,000 during taxable year, whichever is greatest. Cap: $100,000/year, per taxpayer. Compliance period: 5 years with pro rata recapture. Useable by owner or lessee.	Maine Historic Preservation Commission 207-287-2132 www.state.me.us/mhpc
Maryland	Annual appropriation required for commercial credit program. Competitive award process administered by SHPO similar to grant program requires preference for geographic distribution of credits. Not more than 50% of funds available in any year may go to Baltimore City or any county. Credit rate is 20% of qualified rehab expenditures. Commercial project cap of $3 million in credits. Governor required to include in budget $20 million for 2006, and $30 million for 2007 and 2008, but legislature not required to appropriate funds for commercial projects. 20% tax credit for owner-occupied residences not subject to annual aggregate cap, but subject to cap of $50,000 in credits per project. Legislative appropriation not required for homeownership program, and no competitive award process. All credits fully refundable.	Maryland Historical Trust 410-514-7600 www.marylandhistoricaltrust.net
Massa-chusetts	20% credit for eligible income-producing properties. $10 million annual cap. DOI standards apply. Carry forward: 5 years. December 2009 sunset for entire program.	Massachusetts Historical Commission 617-727-8470 www.state.ma.us/sec/mhc
Michigan	25% credit for qualified rehab of historic commercial and owner-occupied residential buildings. Reduces to 5% when federal 20% credit is claimed for commercial properties. Eligibility: National, state, or local designated properties. DOI standards apply. Minimum expenditures: 10% of property's value. 5 year recapture period. Carry forward: 10 years.	Michigan Historical Center 517-373-1630 www.michigan.gov/hal/0,1607,7-160 17445 _19273 _19318–,00.html
Missouri	25% rehab credit for commercial or owner-occupied residential properties listed in National Register or in a certified historic district. Costs must exceed 50% of the adjusted basis of the structure and the rehab work must meet DOI standards. Carry back: 3 years. Carry forward: 10 years. No cap.	Missouri Historic Preservation Program 573-751-7858 www.dnr.mo.gov/shpo/homepage.htm
Montana	Income-producing certified historic properties automatically receive 5% state tax credit if the property qualifies for the 20% federal credit. Carry forward: 7 years.	Montana State Historic Office 406-444-7715 www.his.state.mt.us
New Mexico	50% of rehab costs of up to $25,000 per project. Commercial, owner-occupied and rental residential, and archeological qualify. Tenants with 5-year leases may also qualify. Minimum investment: none. State register properties qualify. Carry forward: 4 years. DOI standards apply. Pre-approval required.	New Mexico Historic Preservation Division 505-827-6320 www.museums.state.nm.us/hpd
North Carolina	30% credit for historic homeowners and 20% for income-producing property owners. Minimum investment for 30% credit: $25,000. 20% commercial credit can be piggybacked on federal rehab credit of 20% providing total of 40%. State credit must be taken in equal annual installments over 5 to 10 years.	North Carolina Historic Preservation Office 919-733-4763 www.hpo.dcr.state.nc.us
North Dakota	A credit of 25% of an investment is allowed for the preservation and renovation of eligible historic property that is part of a Renaissance Zone Project made between 01/01/00 and 12/31/04. Project cap of $250,000. Carry forward: 5 years.	State Historical Society of North Dakota 701-328-2666 www.state.nd.us/hist
Oklahoma	20% income tax credit for all eligible commercial and residential properties. Carry forward: 10 years. Freely transferable at any time for 5 years following the year of qualification. Effective January 2006.	Oklahoma State Historic Preservation Office 405-522-4484 www.ok-history.mus.ok.us
Rhode Island	30% credit for income-producing projects. Minimum investment must exceed 50% of adjusted basis of structure. No yearly cap, and no project cap. Freely transferable. Carry forward: 10 years. 20% credit for owner-occupied residential. Minimum investment: $2,000. Maximum credit allowable per year: $2,000. Unused credits may be carried forward as long as property maintained. Interior work ineligible. State register properties qualify.	Rhode Island Historic Preservation & Heritage Commission 401-222-2678 www.preservation.ri.gov
South Carolina	Income-producing properties that receive federal credit are eligible for 10% state credit. Changes in 2005 allow banks to be eligible for the credit and allow partnerships to allocate the credits among the partners as they choose. Owner-occupied residential properties that do not receive the federal credit eligible for a 25% state credit. Rehab expenses must exceed $15,000 within a 36-month period. Taxpayer allowed one credit per structure per 10 year period. Credit must be taken in five equal annual installments.	Department of Archives and History 803-896-6100 www.state.sc.us/scdah/histrcpl.htm
Utah	20%. Residential owner-occupied and non-owner-occupied. Cap: none. Minimum investment: $10,000 over 3 years. DOI standards apply. No fees.	Utah State Historical Society 801-533-3500 www.history.utah.gov/historicpreservation/historicpreservation.html
Vermont	10% state credit in designated downtown areas to projects already approved for the 20% federal credit. 25% state credit available for projects that do not qualify for the federal tax credit, up to $25,000/project. This credit can also be used as a mortgage credit certificate. Within “village centers” a 5% credit can be coupled with federal credit. $1,000,000 state cap in 2004 for historic and non-historic projects.	Vermont Division for Historic Preservation 802-828-3211 www.historicvermont.org
Virginia	25% for commercial and owner-occupied residential properties. Reconstruction and improvements must amount to at least 25% of the assessed value for owner-occupied buildings and at least 50% for non-owner-occupied buildings. Carry over: 10 years. National and state register properties eligible. DOI standards apply. No caps. State credit may be split off and sold separately.	Virginia Department of Historic Resources 804-367-2323 www.dhr.state.va.us
West Virginia	20% credit for private residential structures listed in the National Register; 10% credit for rental residential and income-producing structures eligible for the federal credit. Properties must be listed in national, state, or local registers. DOI standards apply. Minimum expenditure is 20% of the property’s basis. Carry forward: 5 years. No caps.	West Virginia Historic Preservation Office 304-558-0220 www.wvculture.org/shpo/index.html
Wisconsin	25% credit for owner-occupied residential properties. Per-project cap: $10,000. Minimum investment: $10,000 over 2 years; extendable to 5 years. Also a 5% credit for commercial properties, not subject to caps. Can be coupled with federal 20% credit. Minimum investment: expenses equal to building's adjusted basis.	State Historical Society of Wisconsin 608-264-6500 www.shsw.wisc.edu/about/index.html