

DEPARTMENT OF TAXATION

2012 Fiscal Impact Statement

1. **Patron** Jill Holtzman Vogel

3. **Committee** House Finance

4. **Title** Income Tax: Historic Rehabilitation Tax Credit

2. **Bill Number** SB 444

House of Origin:

☐ Introduced

☐ Substitute

☐ Engrossed

Second House:

☒ In Committee

☐ Substitute

☐ Enrolled

5. **Summary/Purpose:**

This bill would allow any amount of gain or income recognized by a taxpayer in connection with the Historic Rehabilitation Tax Credit that is treated as taxable income for federal tax purposes to be subtracted from individual income, corporate income and estate and trust taxes. The bill contains an enactment clause stating that the provisions of this bill are declarative of existing law.

The effective date of this bill is not specified.

This is a Department of Historic Resources bill.

6. **Budget amendment necessary:** No.

7. **Fiscal Impact Estimates are:** Preliminary. (See Line 8.)

8. **Fiscal implications:**

Administrative Costs

The Department of Taxation (the "Department") considers implementation of this bill as "routine," and does not require additional funding.

Revenue Impact

This bill would have no negative impact on the Commonwealth's current revenue forecast because it did not incorporate any additional revenue arising from the U.S. Court of Appeals for the Fourth Circuit ("Fourth Circuit") decision in *Virginia Historic Tax Credit Fund 2001 v. Commissioner*. On March 29, 2011, the Fourth Circuit held that investors, who contributed funds to three investment partnerships, were deemed to have purchased tax credits instead of investing in the partnerships. Thus, the investors would be required to report taxable income arising from the deemed purchase and redemption of credits, and the partnerships would be required to report taxable income arising from the deemed sale of credits.

9. Specific agency or political subdivisions affected:

Department of Taxation
Department of Historic Resources

10. Technical amendment necessary: No.

11. Other comments:

Federal Historic Preservation Tax Credit

Under federal law, an investment tax credit is allowed to taxpayers for the rehabilitation of historic income-producing properties. The federal credit is equal to 20 percent of the cost of rehabilitating or preserving commercial, agricultural, industrial, or rental residential buildings that are certified as historic.

The Historic Preservation Tax Credit is intended to reward private investors for investing in rehabilitating historic properties, such as abandoned or under-used schools, warehouses, factories, churches, retail stores, apartments, hotels, houses, and offices.

Virginia Historic Rehabilitation Tax Credit

Under Virginia law, an individual, estate, trust, or corporation with eligible expenses in the rehabilitation of a certified historic structure is entitled to claim a tax credit. The credit is equal to 25 percent of rehabilitation expenses for projects completed in 2000 and thereafter.

To qualify for the tax credit, the cost of the rehabilitation must equal to at least 50 percent (or 25 percent if the building is owner occupied) of the assessed value of the building for local real estate tax purposes prior to the rehabilitation. The rehabilitation work must be certified by the Department of Historic Resources ("DHR") and be consistent with the Secretary of the Interior's standards for rehabilitation.

The allowable tax credit may not exceed a taxpayer's tax liability. Any unused credits may be carried forward for up to ten years.

Virginia law allows tax credits awarded to partnerships to be allocated among the partners in a manner agreed upon by the partners. As a general practice, partnerships solicit investors to join the partnership and receive allocations of the tax credit in exchange for their cash investments. The investors, however, would not receive any material distributions of cash or an allocation of the partnership's income, gain, loss or deductions.

The transactions are typically structured so that investors would receive an allocation of the tax credits immediately following their cash contribution to the partnership. After holding interest in the partnership for a certain amount of time, the investors would then sell their interests back to the partnership for a small fraction of the cash they originally paid.

Fourth Circuit Court of Appeals Decision

On March 29, 2011, the U.S. Court of Appeals for the Fourth Circuit overturned the U.S. Tax Court decision in *Virginia Historic Tax Credit Fund 2001 v. Commissioner*. The lower court had determined that three investment funds – the Virginia Historic Tax Credit Fund 2001, Virginia Historic Tax Credit Fund 2001 SCP, LLC and the Virginia Historic Tax Credit Fund 2001 SCP, LP (“Tax Credit Funds”) – had been formed for a legitimate business purpose, were valid partnerships and were correctly not assessed income tax related to the investors’ capital contributions. In overturning the lower court, the Fourth Circuit Court determined that investors in historic development projects through the Tax Credit Funds were not partners for federal income tax purposes and that the receipt of federal historic tax credits in exchange for their investment should be treated as a sale. Consequently, both the Tax Credit Funds and investors will realize taxable income arising from the deemed sale of the historic tax credits. The Fourth Circuit decision, however, did not directly affect the Virginia Historic Rehabilitation Tax Credit.

Although the court addressed the manner in which credits were delivered in that case, neither the court nor the Department of the Treasury have provided definitions or safe harbor guidance for partnerships. Therefore, investors and the banking community are without the proper guidance regarding which partnership structures will be negatively impacted. According to DHR, some financial institutions are requiring that portions of investments be set aside to pay federal and state taxes based on the assumption that such taxes will be owed, which diverts funds away from a project.

According to DHR, the ruling could potentially have a significant impact and threaten the economic viability of historic rehabilitation projects in Virginia that rely on the allocation of tax credits through a partnership and bank financing as part of a complex financing arrangement to fund the rehabilitation project.

Proposal

This bill would allow any amount of gain or income recognized by a taxpayer in connection with the Historic Rehabilitation Tax Credit that is treated as taxable income for federal tax purposes to be subtracted from individual income, corporate income and estate and trust taxes. The bill contains an enactment clause stating that the provisions of this bill are declarative of existing law.

The effective date of this bill is not specified.

Similar Bills

House Bill 531 is identical to this bill.

cc : Secretary of Finance

Date: 2/16/2012 tlg
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