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STATE OF HAWAII
DEPARTMENT OF LAND AND NATURAL RESOURCES

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Testimony of SUZANNE D. CASE Chairperson

Before the House Committee on FINANCE

Thursday, February 21, 2019
11:00 AM
State Capitol Conference Room 308

In consideration of HOUSE BILL 1533, HOUSE DRAFT 1 RELATING TO HISTORIC PRESERVATION

House Bill1533, House Draft 1proposes to amend Chapter 235 Hawaii Revised Statutes (HRS), creating a tax credit for certified rehabilitation of certified historic buildings. Tax incentives for rehabilitation of historic buildings have been proven to be enormously effective in preserving important buildings, ensuring their continuing economic viability, revitalizing communities, especially historic downtowns, preserving community character, and promoting heritage tourism. **The Department of Land and Natural Resources (Department) supports this measure and recommends amendments.**

In its 2018 report on the federal historic tax credit program, the National Park Service (NPS) prepared in collaboration with Rutgers University (copy attached for your reference), notes that NPS certified 1,035 completed historic rehabilitation projects. The report documents $6.5 billion in rehabilitation investment during federal fiscal year 2017 (the last year for which figures are available), helped create 106,900 jobs, and $6.2 billion of gross domestic product.

If House Bill 1533, House Draft is enacted, Hawaii will join the 38 states that already provide tax credits for the rehabilitation of historic structures. The nature of each state program is different, so it is difficult to extract information from them that could be directly useful in evaluating the effect of the program proposed in this measure. All states report that their programs are successful both in giving new life and continuing utility to significant historic structures, leveraging private investment at between $4 and $5 per tax credit dollar, contributing significant positive economic impact to affected communities. At between 4 and 9 years, depending on the state and the level of the credit, generating revenue to the state exceeding the decrease in revenue due to the tax credit by between $4 and $5 per tax credit dollar. Since the credit is paid out after the project is completed, the revenue payback begins from taxes on wages, goods, and services, before the credit is claimed.

Testimony before the House Committee on Housing suggests that House Bill 1533, House Draft 1 needs to be revised to reflect the amendments recommended by the department of taxation and to make additional clarifying revisions based on other testimony. Accordingly, the Department recommends that this measure be amended by replacing contents in its entirety and replace it with the following:

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

SECTION 1. Chapter 235, Hawaii Revised Statutes, is amended by adding a new section to be appropriately designated and to read as follows:

"§235- Historic preservation income tax credit. (a) Notwithstanding any law to the contrary, there shall be allowed to each taxpayer subject to tax imposed by this chapter an income tax credit for substantial rehabilitation of a certified historic structure that shall be deductible from the taxpayer's net income tax liability, if any, imposed by this chapter for the taxable year in which the tax credit is properly claimed. The amount of the tax credit for substantial rehabilitation of a certified historic structure that is certified by qualified professional staff of the department of land and natural resources' state historic preservation division, shall be:

(1) Twenty-five per cent of the qualified rehabilitation expenditures; or

(2) Thirty per cent of the qualified expenditures in the event that:

(A) At least twenty per cent of the units are affordable rental housing; ~~or~~

(B) At least ten per cent of the units are affordable homeownership units; or;

(C) In structure with mixed residential and non-residential uses, at least thirty per cent of the total square footage of the structure is for affordable rental housing, affordable homeownership units, or both.

(b) The tax credit allowed under this section shall be available in the taxable year in which the substantially rehabilitated certified historic structure is placed into service. In the case of projects completed in phases, the tax credit shall be prorated to the substantially rehabilitated identifiable portion of the certified historic structure placed into service during that taxable year.

(c) In the case of a partnership, S corporation, estate, trust, or any developer of a rehabilitated certified historic structure, the tax credit allowable shall be as provided under subsection (b) for the taxable year. The cost upon which the credit is computed shall be determined at the entity level and the distribution and share of the tax credit shall be determined pursuant to section 704(b) of the Internal Revenue Code.

If a deduction is taken under section 179 (with respect to the election to expense depreciable business assets) of the Internal Revenue Code, no tax credit shall be allowed for that portion of qualified expense for which the deduction is taken.

The basis of eligible property for depreciation or accelerated cost recovery system purposes for state income taxes shall be reduced by the amount of the credit allowable and claimed. In the alternative, the taxpayer shall treat the amount of the credit allowable and claimed as a taxable income item for the taxable year in which it is properly recognized under the method of accounting used to compute taxable income.

(d) If the tax credit under this section exceeds the taxpayer's income tax liability, the excess of the credit over the liability may be used as a credit against the taxpayer's income tax liability in subsequent years until either the credit is exhausted, or for a period of ten years, whichever is earlier. All claims—for the tax credit under this section, including any amended claims, shall be filed on or before the end of the twelfth month following the close of the taxable year for which the credit may be claimed. Failure to comply with foregoing provision shall constitute a waiver of the right to claim the credit.

(e) The state historic preservation division shall develop rules pursuant to chapter 91 for the approval of rehabilitation of certified historic structures for which the tax credit under this section is sought. These standards and criteria shall take into account whether the rehabilitation of a certified historic structure will preserve the historic character of the property.

(f) Following the completion of rehabilitation of a certified historic structure, the owner shall notify the state historic preservation division that the rehabilitation has been completed. The owner shall provide the state historic preservation division with documentation of the costs incurred in rehabilitating the historic property and shall submit certification of the costs incurred in rehabilitating the historic property. The state historic preservation division shall review the rehabilitation and verify that the rehabilitation project complied with the rehabilitation plan. The administrator of the state historic preservation division shall certify in writing that the rehabilitation has been completed in accordance with the approved rehabilitation plan, and provide that certification to both the project proponent and the director of taxation.

(g) The director of taxation shall prepare any forms that may be necessary to claim the tax credit under this section. The director may also require the taxpayer to furnish reasonable information to ascertain the validity of the claim for credit made under this section and may adopt rules necessary to effectuate the purposes of this section pursuant to chapter 91.

(h) The aggregate amount of the tax credits claimed for qualified tax credits claimed for qualified rehabilitation projects not exceed:

(1) $ for the 2020 tax year;

(2) $ for the 2021 tax year;

(3) $ for the 2022 tax year;

(4) $ for the 2023 tax year; and

(5) $ for the 2024 tax year and every year thereafter.

(i) On an annual basis, the state historic preservation division, in consultation with the department of taxation, shall determine the information necessary to enable a quantitative and qualitative assessment of the outcomes of the tax credit to be determined. Each taxpayer claiming this credit shall, no later than the last day of the taxable year following the close of the tax year in which qualified costs were expended, submit a written, certified statement to the state historic preservation division containing the qualified rehabilitation expenditures incurred by the taxpayer and any other information the state historic preservation division or department of taxation may require.

Any taxpayer failing to submit information to the state historic preservation division in a manner prescribed by the state historic preservation division prior to the last day of the taxable year following the close of the tax year in which the qualified costs were expended shall not be eligible to receive the tax credit for those expenses, and any credit already claimed for that taxable year shall be recaptured in total. The amount of the recaptured tax credit shall be added to the taxpayer's tax liability for the taxable year in which the recapture occurs.

All information in the statement submitted under this section shall be a public document, except for information that is otherwise exempt from public disclosure in accordance with chapter 92F.

(j) Recapture of a previously claimed tax credit shall be required from any taxpayer who received the credit if any of the following occur:

(1) The projected qualified expenditures do not materialize;

(2) The qualified rehabilitation plans do not proceed in a timely manner and in accordance with the approved plans;

(3) In the case of the thirty per cent tax credit, less than twenty per cent of the units qualify as affordable rental housing; or

(4) In the case of the thirty per cent tax credit, less than ten per cent of the units qualify as affordable homeownership units.

Any credit under this section shall be recaptured following the close of the taxable year for which the credit is claimed if the department of land and natural resources notifies the department that the taxpayer has failed to comply with the requirements of this section or its related rules promulgated by the state historic preservation division.

(k) On an annual basis, the state historic preservation division, in consultation with the department of taxation, shall submit a report to the legislature at least twenty days prior to the convening of each regular legislative session evaluating the effectiveness of the tax credit. The report shall include findings and recommendations to improve the effectiveness of the tax credit to further encourage the rehabilitation of historic properties.

(l) For the purposes of this section:

"Affordable homeownership units" means housing that meets the guidelines published by the United States Department of Housing and Urban Development for the year in which the units are initially offered for sale.

"Affordable rental housing" means rental housing that meets the guidelines published by the United States Department of

Housing and Urban Development for the year in which the units are put into service.

"Certified historic structure" means any structure that is:

(1) Individually listed in the Hawaii register of historic places or the national register of historic places;

(2) Located in a historic district listed in the Hawaii register of historic places or the national register of historic places and certified by the state historic preservation division as contributing to the significance of the historic district; or

(3) A structure that the state historic preservation division has determined is eligible for inclusion in the Hawaii register of historic places, and which is listed in that register by the date of certification by the administrator of the state historic preservation division in accordance with subsection (f).

"Qualified rehabilitation expenditures" means any costs incurred for the physical rehabilitation, renovation or construction of a certified historic structure pursuant to a rehabilitation plan; provided that the term shall not include the owner's personal labor.

"Qualified staff" means a staff person meeting the Secretary of the Interior's Professional Qualification Standards for an architectural historian or historic architect.

"Rehabilitation plan" means any construction plans and specification for the proposed rehabilitation of a historic structure in sufficient detail for evaluation of compliance with the rules adopted by the state historic preservation division.

"Substantial rehabilitation" means that qualified rehabilitation expenditures on a certified historic structure ~~that~~ exceed twenty-five per cent of the assessed value of the structure."

SECTION 2. There is hereby established one temporary position in the state historic preservation division to assist with the establishment and administration of the Hawaii historic preservation income tax credit program. The authorization for this temporary position shall expire at the end of fiscal year ________.

SECTION 3. The department of land and natural resources shall be authorized to collect reasonable fees to defray the expenses incurred as reviewing and certifying plans pursuant to carrying out section 235- , Hawaii Revised Statutes. Fees collected for these purposes shall be deposited into the Hawaii historic preservation special fund established pursuant to section 6E-16, Hawaii Revised Statutes.

SECTION 4. There is appropriated out of the general revenues of the State of Hawaii the sum of $85,000 or so much thereof as may be necessary for fiscal year 2019-2020 and the same sum or so much thereof as may be necessary for fiscal year 2020-2021 for one temporary position in the state historic preservation division to assist with the establishment and administration of the Hawaii historic preservation income tax credit program pursuant to this Act.

The sums appropriated shall be expended by the department of land and natural resources for the purposes of this Act.

SECTION 5. New statutory material is underscored.

SECTION 6. This Act, upon its approval, shall apply to the taxable years beginning after December 31, 2019; provided that sections 2, 3 and 4 shall take effect on July 1, 2019.

The Department believes that tax credit programs such as this can make an important contribution to the comprehensive state historic preservation program established by Chapter 6E HRS.

Thank you for the opportunity to comment of this measure.

DAVID Y. IGE
GOVERNOR

JOSH GREEN M.D.
LIEUTENANT GOVERNOR

LINDA CHU TAKAYAMA
DIRECTOR

DAMIEN A. ELEFANTE
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To: The Honorable Sylvia Luke, Chair
and Members of the House Committee on Finance

Date: Thursday, February 21, 2019
Time: 11:00 A.M.
Place: Conference Room 308, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

Re: H.B. 1533, H.D.1, Relating to Historic Preservation

The Department of Taxation (Department) offers the following comments regarding H.B. 1533, H.D. 1, for the Committee's consideration.

H.B. 1533, H.D. 1, establishes a new nonrefundable tax credit for taxpayers who rehabilitate historic structures to create or rehabilitate affordable housing. A summary of key provisions are as follows:

- Adds a new section to Hawaii Revised Statutes (HRS) chapter 235, creating a nonrefundable tax credit for qualified expenses incurred in the certified rehabilitation of a certified historic structure resulting in the creation or rehabilitation of affordable housing units;
- Sets the amount of the credit at 25% of the qualified expenses or 30% if at least twenty percent of the units are for affordable rental housing or at least ten percent are sold for affordable homeownership under affordable housing guidelines;
- Creates a carryforward where a credit that exceeds the taxpayer's income tax liability may be used as a credit against the taxpayer's income tax liability in subsequent years until exhausted;
- Creates an unspecified aggregate cap on the total amount of credits that may be certified in taxable years and directs the State Historic Preservation Division to discontinue certifying credits if the cap is reached;
- Requires taxpayers to submit a written, certified statement to the State Historic Preservation Division identifying their qualified expenses and the amount of credits claimed in the previous taxable year;
- Requires the State Historic Preservation Division to certify expenses, maintain records of all qualified expenses, and provide taxpayers certifications of credit amounts;

- Authorizes the Director of Taxation to require proof of the claim for the tax credit; and
- Has a defective effective date of January 1, 2050.

The Committee on Housing made several amendments at the Department's request. The Department appreciates the consideration of its testimony and notes that it can administer this measure as drafted, provided a functional effective date is inserted. If a functional effective date is inserted, the Department respectfully requests that it be made no earlier than taxable years beginning after December 31, 2019.

Thank you for the opportunity to provide comments.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304 Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Historic Preservation Tax Credit

BILL NUMBER: HB 1533, HD-1

INTRODUCED BY: House Committee on Housing

EXECUTIVE SUMMARY: Establishes a refundable tax credit based on the qualified rehabilitation expenses of a historic structure. The adoption of this credit would provide tax relief to taxpayers regardless of their need for tax relief. It also would shift the burden of paying for government to the rest of us.

SYNOPSIS: Adds a new section to HRS chapter 235 to allow a credit for a rehabilitation plan or a certified historic property that is certified by the historic preservation division of DLNR.

The credit is to be 25% of the qualified rehabilitation expenditures, or 30% if (A) at least 20% of the units are for affordable rental housing, or (B) at least 10% of the units are sold for affordable homeownership under affordable housing guidelines.

Tax credits that exceed the taxpayer's income tax liability is nonrefundable but may be carried forward until exhausted.

For a partnership, S corporation, estate, or trust, the cost upon which the credit is computed shall be determined at the entity level and the distribution and share of the tax credit shall be determined pursuant to section 704(b) of the Internal Revenue Code.

Requires the director of taxation to prepare any forms necessary to claim a credit, may require a taxpayer to furnish reasonable information to validate a claim for the credit, and adopt rules pursuant to HRS chapter 91. Requires claims for the credit, including any amended claims, to be filed on or before the end of the twelfth month following the taxable year for which the credit is claimed. Failure to comply with the foregoing provision shall constitute a waiver of the right to claim the tax credit.

The aggregate amount of tax credits claimed shall not exceed $_____ for the 2020 calendar year, $_____ for the 2021 calendar year, $_____ for the 2022 calendar year, $_____ for the 2023 calendar year, and $_____ thereafter.

Provides for recapture of a previously claimed tax credit if the department of land and natural resources notifies DOTAX that the taxpayer's certification of qualified expenses from which the credit arose has been withdrawn due to failure to comply with the requirements of law.

Defines "qualified expenditures" as any costs incurred for the physical construction involved in the certified rehabilitation of a certified historic structure. "Qualified expenditures" shall not include the owner's personal labor.

EFFECTIVE DATE: January 1, 2050.

STAFF COMMENTS: Lawmakers need to keep in mind two things. First, the tax system is the device that raises the money that they, lawmakers, like to spend. Using the tax system to shape social policy merely throws the revenue raising system out of whack, making the system less than reliable as there is no way to determine how many taxpayers will avail themselves of the credit and in what amount. The second point to remember about tax credits is that they are nothing more than the expenditure of public dollars, but out the back door. If, in fact, these dollars were subject to the appropriation process, would taxpayers be as generous about the expenditure of these funds when our kids are roasting in the public school classrooms, there isn't enough money for social service programs, or our state hospitals are on the verge of collapse?

If lawmakers want to subsidize the rehabilitation of certified historic buildings, then a direct appropriation would be more accountable and transparent.

Furthermore, the additional credit would require changes to tax forms and instructions, reprogramming, staff training, and other costs that could be massive in amount. A direct appropriation may be a far less costly method to accomplish the same thing.

Finally, the credit is directed to persons who might have no need for financial assistance.

Digested 2/17/2019

LAND USE RESEARCH
FOUNDATION OF HAWAII

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February 19, 2019

Representative Sylvia Luke, Chair
Representative Ty J.K. Cullen, Vice Chair
House Committee on Finance

Comments in Strong Support of HB 1533, HD1 Relating to Historic Preservation. (Establishes a historic preservation tax credit for qualified construction expenses incurred in rehabilitation of historic structures that produces affordable housing units.)

<u>FIN Hrg</u>: Thursday, February 21, 2019, at 11:00 a.m. in Conf. Rm. 308

The Land Use Research Foundation of Hawaii (LURF) is a private, non-profit research and trade association whose members include major Hawaii landowners, developers, resort operators and utility companies. LURF's mission is to advocate for reasonable, rational and equitable land use planning, legislation and regulations that encourage well-planned economic growth and development, while safeguarding Hawaii's significant natural and cultural resources, and public health and safety.

LURF appreciates the opportunity to provide comments in **strong support of HB 1533, HD1.**

<u>HB 1533, HD1</u>. This bill establishes a historic preservation tax credit for qualified construction expenses incurred in the rehabilitation of income-producing historic structures, with an enhanced tax credit for income-producing historic structures that provide affordable housing units.

<u>LURF's Position</u>. LURF members maintain and are stewards of historic properties and buildings. LURF and its members believe that preserving and appropriately using historic buildings are ways to maintain, enhance a living display of Hawaii's history and community character, and also, in some cases, encourage heritage tourism.

Also, the lack of affordable housing remains a significant problem affecting Hawaii and finding ways to provide sufficient housing for Hawaii's residents has continued to be a major objective for the Legislature, state and county agencies, and members of the housing industry and business community.

Tax credit programs to encourage historic preservation have proven to be successful incentives for rehabilitating historic structures and returning them to useful life, and affordable housing tax credits have resulted in the construction of sorely needed affordable housing units.

Logical changes to existing laws such as the historic preservation tax credit proposed by this bill are therefore significant and necessary and should be welcomed as a method to assist with addressing the diminished supply of affordable housing in Hawaii. This seemingly small tax credit measure has the potential to result in substantial and positive impacts on the preservation of historic structures and affordable housing, as well as invigorating the local construction industry and advancing the State's economy and general welfare.

For these reasons, LURF **supports HB 1533, HD1** and respectfully urges your favorable consideration.

Thank you for the opportunity to provide comments in strong support of this matter.

HB-1533-HD-1
Submitted on: 2/20/2019 2:36:43 PM
Testimony for FIN on 2/21/2019 11:00:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Melodie Aduja	O`ahu County Committee on Legislative Priorities of the Democratic Party of Hawai`i	Support	No

Comments: