JOINT LEGISLATIVE AUDIT AND REVIEW COMMISSION
Fiscal Impact Review
2011 Session

Bill Number: SB 1432
Review Requested By: Senator Colgan

JLARC Staff Fiscal Estimates

JLARC staff estimate that Senate Bill 1432, which would create an Industrial Building Rehabilitation Tax Credit, would reduce General Fund revenue by $170,000 to $460,000 per year, once fully implemented. The amount of future credit claims cannot be predicted with a high degree of precision due to the many requirements that must be met for a taxpayer to qualify for the proposed credit and possible variations in cost associated with the industrial building rehabilitation projects. However, data collected under Virginia's Real Property Investment Grant, the Virginia Economic Development Partnership, and a similar tax incentive administered by another state provide a reasonable basis for estimating the bill's fiscal impact.

The potential revenue impact ranges because it is dependent on the number of qualifying projects that are underway in a given year and their cost. The number of qualifying projects may fluctuate annually, meaning that the number of taxpayers eligible to claim the credit and the total amount that would subsequently be claimed are likely to vary from year-to-year. Based on analysis of the previously identified data sources, the number of qualifying projects is estimated to range from a low of 1.75 to a high of 4.75 per year. The amount claimed by taxpayers may also fluctuate depending on the expenses incurred under each qualifying project. A review of industrial facility rehabilitation projects under the Real Property Investment Grant program indicates that most qualifying projects are likely to incur total project expenses above the $100,000 credit cap, but because a few smaller projects are also likely to qualify the average claim amount is estimated to be $97,000. In developing these estimates, JLARC staff assumed that taxpayers may claim a credit amount up to $100,000 per qualifying project. However, Senate Bill 1432 does not specifically describe how the proposed credit or the cap are to be applied, and their application is therefore open to alternative interpretations. The extent to which taxpayers may elect to claim the Historic Rehabilitation Tax Credit instead of the proposed credit could not be determined but may also affect the proposed credit's utilization.

An explanation of the JLARC staff review is included on the following pages.

Authorized for Release:

Glen S. Tittermary

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Director

JLARC offers Fiscal Impact Reviews in accordance with Item 30D of Chapter 874 (2010 Acts of Assembly). JLARC Fiscal Impact Reviews do not comment on the merits of the bill under review.

Bill Summary: Senate Bill (SB) 1432 would create a corporate income tax credit for any company establishing a new business within a locality in the Commonwealth if the site of that business is an existing industrial building that is a least 25 years old. The credit would be in the amount paid or incurred by the company for the purpose of rehabilitating or retrofitting such existing industrial building, up to a total of $100,000. Taxpayers could claim the proposed credit for qualifying expenses that were paid or incurred beginning on or after January 1, 2012. Any credit that was unusable for the taxable year could be carried over for the next three taxable years. Businesses would not be eligible to claim this credit if they had already claimed a tax credit for the same rehabilitation or retrofitting expenses under the Historic Rehabilitation Tax Credit.

Discussion of Fiscal Implications: The estimated revenue impact of SB 1432 is based on the number of qualifying rehabilitation projects that are projected to occur and the expected average cost of such rehabilitation projects. While the amount of future credit claims cannot be predicted with a high degree of precision due to the many requirements that must be met for a taxpayer to qualify for the credit and possible variations in cost associated with industrial building rehabilitation projects, a review of data collected under Virginia's Real Property Investment Grant (RPIG), the Virginia Economic Development Partnership's (VEDP) industrial properties database, and Michigan's Industrial Facilities Exemption indicate that the proposed credit would likely reduce General Fund revenue by $170,000 to $460,000 per year once fully implemented.

(A) Estimated Fiscal Impact

The proposed Industrial Building Rehabilitation Tax Credit (proposed credit) is expected to reduce General Fund revenue by $170,000 to $460,000 per year once fully implemented, as indicated in the table below. The potential revenue impact ranges because it is dependent on the number of qualifying projects that are underway in a given year, and this number is likely to vary from year to year. The low estimate given in the table assumes that companies that claim the credit are using qualifying buildings only as a factory, warehouse, or another industrial business. A review of Virginia's RPIG program data indicates that such projects regularly occur. The high estimate assumes that companies also claim the credit for qualifying buildings that are used as office, retail, or other commercial space. The precise extent to which industrial facilities are rehabilitated for commercial use could not be determined due to lack of data, but discussion with the Virginia Department of Housing and Community Development, which manages the RPIG program, suggest that such projects may occur to a limited extent.

Estimated Impact of Proposed Credit on General Fund Revenues

State Fiscal Year	Estimated Impact on General Fund*	
	Low	High
2013	$170,000	$460,000
2014	$170,000	$460,000

* Estimates are based on analysis of RPIG industrial rehabilitation projects conducted from 2005-2010, with adjustments made using ratios determined from RPIG data, Michigan's Industrial Facilities Exemption, and the Virginia Economic Development Partnerships' database of available for sale industrial properties. The RPIG provides grant awards to taxpayers who have constructed, expanded, or rehabilitated, industrial, commercial, or mixed-use properties. VEDP's database lists industrial buildings that are currently for sale in Virginia and their age. Michigan's Industrial Facilities Exemption allows new and rehabilitated industrial facilities to be exempt from local real estate and property taxes.

Although the estimates project that the full revenue impact of SB 1432 will occur in FY 2013, the actual impact may be delayed for several reasons. First, a typical rehabilitation project may last from two to five years and so claims may be delayed until a project is completed or the maximum credit claim amount is reached. Second, the proposed credit may be carried over for up to three taxable years, meaning that credit claims and their accompanying revenue impact may be delayed. Third, corporate income taxes owed for a given tax year are collected over the course of several State fiscal years, resulting in a lagging impact on revenue. This lag occurs largely because of differences between the State's fiscal year and corporate tax years, delays of up to two year in corporate filings due to extensions, and delays of up to a year in payment of tax refunds (which are generally issued in the fiscal year after final tax returns have been filed).

(B) Expected Number of Qualifying Projects

The estimated year-to-year revenue impact of the proposed credit is likely to fluctuate due to the restrictions upon what type of projects qualify for the credit and the accompanying uncertainty in the number of taxpayers who may be eligible to claim the credit. Specifically, in order to qualify, the taxpayer claiming the credit must (a) conduct a project to rehabilitate or retrofit an existing industrial building that is at least 25 years old, and (b) establish a new business within the locality and locate this new business in the rehabilitated building. These restrictions appear to limit the credit to rehabilitation projects that result in the establishment of new industrial or commercial (office, retail) businesseses in former industrial buildings, such as vacant factories and warehouses. Projects that convert former industrial buildings into residential or non-profit community facilities would not appear to qualify, nor would commercial development projects where the developer did not establish a new presence in the locality or take occupancy of the rehabilitated building.

RPIG program data indicate that an average of 15 projects for rehabilitating industrial facilities occurred per year from 2005 to 2010. However, this number includes rehabilitation projects involving buildings under 25 years old and where no new business was established. To account for these factors, two adjustments to the average number of projects were made. First, the average number of projects was adjusted downward using VEDP's industrial properties data, which indicated that 55 percent of industrial buildings for sale were 25 years or older. Second, the average number of projects was further adjusted downward using data on Michigan's Industrial Facilities Exemption, which indicated that only 21 percent of industrial facility rehabilitation projects involve the establishment of a new business. After these adjustments, the number of qualifying projects expected to occur in a given year was 1.75. However, this estimate is likely low as it only includes rehabilitation projects that result in establishment of an industrial business, whereas it appears the proposed credit could also be claimed by taxpayers establishing other types of commercial businesses.

In order to account for projects that result in establishment of a non-industrial commercial business, the ratio of commercial to industrial rehabilitation projects in RPIG data was determined. As no data was available on the extent to which commercial rehabilitation projects involve conversion of an industrial facility, it was assumed that 25 percent of commercial rehabilitation projects would involve rehabilitation of an industrial facility. Based on this ratio and assumptions regarding building age and occupancy, 3 additional projects were expected to qualify, indicating that the propose credit could result in as many as 4.75 qualifying projects per year.

(C) Average Project Cost

As noted in the Fiscal Impact Statement for SB 1432, the cost of a qualifying project is likely to vary based on the extent of the rehabilitation that is conducted, which could range from a deep clean to full reconstruction. A review of industrial facility rehabilitation projects under the RPIG program found that the total cost of a project ranged from $50,000 to several million dollars. However, because the credit is capped, $100,000 per project is the maximum credit that could be claimed. Most projects in the RPIG data had total costs above the $100,000 credit cap, but a few smaller projects did not. Based on analysis of these data, it is expected that credit claims would average $97,000 per project.

In developing the above estimates, it was assumed that the credit amount is determined based on expenses paid or incurred by a taxpayer for total project expenses, and therefore the credit may only be claimed once per project. However, the bill language is somewhat vague and could alternatively be interpreted as allowing taxpayers to claim up to $100,000 per year in which qualifying project expenses are paid or incurred. Under this interpretation, the credit could be claimed multiple times for projects spanning more than a single tax year. However, the estimated revenue impact under this alternative interpretation is not substantially different from what is reported above because many projects span only a single year or may not incur annual expenses above the $100,000 cap.

JLARC staff estimates also assume that the $100,000 cap applies to the amount of credit claimed by each taxpayer for a given project, but the language in the bill is open to other interpretations. The bill states that "the total amount of the credit shall not exceed $100,000", which could alternatively be interpreted as a cap on all claims by a single taxpayer for all projects, a cap on all claims made by all companies in a given tax year, or a cap on all claims made by all companies over the life of the credit. If any of these alternative interpretations of the cap are assumed, the proposed credit would have a lower revenue impact than what is reported in this review.

(D) Other Factors Impacting Credit Use

In addition to placing restrictions on the type of projects that qualify for the credit, SB 1432 stipulates that taxpayers who claim the proposed credit may not claim the Historic Rehabilitation Tax Credit (HRTC), which could have a significant impact on the proposed credit's use. Taxpayers who have a choice between the two credits may be more likely to claim the HRTC because it appears to offer a greater reduction in tax liability. The HRTC offers an uncapped return of 25 percent of the total rehabilitation project value, while the proposed credit only offers taxpayers a liability reduction of up to $100,000 per tax year in which project expenses are paid or incurred. According to JLARC staff calculations, corporate taxpayers receive an average $550,000 reduction in tax liability from the HRTC, compared to an estimated $100,000 reduction that would be received under the proposed credit. The extent to which taxpayers may elect to claim the HRTC instead of the proposed credit is not reflected in JLARC staff estimates of revenue impact because the proportion of projects that would qualifying for both credits is unknown.

Budget Amendment Necessary: Yes. General Fund revenue would need to be adjusted downward beginning with FY 2013.

Agencies Affected: Department of Taxation.

Date Released, Prepared By: 12/02/2011, Mark Gribbin.