Defending the Historic Preservation Tax Credit

Lauren K. Shores

COMMENT

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LAUREN K. SHORES, C.P.A.*

I. INTRODUCTION

Historic preservation is not merely "sav[ing] old buildings in order to save old buildings."[1] The preservation of historic buildings is not an end in itself, but a means to accomplish so much more.[2] The end result of historic preservation includes "downtown revitalization, neighborhood stabilization, affordable housing, luxury housing, heritage tourism, education, and . . . economic development."[3] Missouri has been a beneficiary of historic preservation, as investors have spent billions of dollars redeveloping many of Missouri's historic buildings.[4] But this investment did not appear out of nowhere; Missouri's historic preservation tax credit stimulated much of this private investment.[5]

An historic preservation tax credit is a tax incentive used to encourage the redevelopment of historic buildings.[6] This income tax credit is calculated as a certain percentage of redevelopment expenses.[7] Most historic preservation statutes require that the property being rehabilitated be an historic building.[8]

Although this Comment promotes state historic preservation tax credits based on their ability to stimulate redevelopment, the preservation of historic buildings impacts society in many other ways.[9] In the long run, preservation has an "educational, environmental, cultural, aesthetic, historical, and social

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1. Donovan D. Rypkema, Principal, PlaceEconomics, Keynote Speech at the Missouri Statewide Preservation Conference in St. Charles: The Economics of Historic Preservation 8 (Sept. 11, 2008) (transcript available at http://www.preservemo.org/downloadables/2008ConfMats/RypkemaDKeynoteMissouri2008withgraphs%5B1%5D.pdf).
2. *Id.*
3. *Id.*
4. *Id.* at 7.
5. *See id.*
6. *See infra* Part II.A.
7. *See infra* Part III.A.2.
8. *See infra* Part II.
9. Rypkema, *supra* note 1, at 7.

impact."[10] In the short run, the people who are going to make historic preservation happen[11] are much more interested in the economic value of historic buildings.[12] By using the platform of economic impact, advocates of historic preservation are able to make a more persuasive argument for an historic preservation tax credit.[13]

An historic preservation tax credit is effective only if it gives people enough of an incentive to pursue redevelopment. It is important to structure an historic preservation tax credit to maximize its effectiveness as an incentive. One of the main reasons that Missouri's historic preservation tax credit has been so successful is its structure.[14] Yet, there are many who argue that Missouri's historic preservation tax credit program should be significantly reduced in size because of the increasing cost of the credit and the need to balance Missouri's budget.[15] If the General Assembly votes to reduce or even eliminate the historic preservation tax credit program, there will be a significant decrease in the amount of private investment in historic buildings. Additionally, there will be lost tax revenue, less redevelopment, and more deteriorating old buildings.

Part II of this Comment discusses Missouri's historic preservation tax credit, and supplementing the discussion is some background on the federal rehabilitation tax credit. Part III explains how an historic preservation tax credit statute can be structured and outlines the advantages and disadvantages of these structural aspects. In addition, it discusses how historic preservation tax credits can be used as a redevelopment tool and the economic impact that these credits have had in Missouri. Part III of this Comment will review the recommendations made by the Tax Credit Commission appointed by Missouri Governor Jay Nixon. Finally, in Part IV, this Comment proposes changes to Missouri's historic preservation tax credit providing supporting arguments and debunking potential criticisms. The Comment concludes that reinvigorating Missouri's historic preservation tax credit will provide economic benefits to the state for years to come.

10. *Id.*

11. Including "property owners, mayors and legislators and city managers, bankers, developers, investors." *Id.*

12. *Id.*

13. *Id.*

14. *Id.* at 1.

15. *See infra* Part IV.B.

II. LEGAL BACKGROUND

A. The Initial Use of Tax Incentives to Encourage Preservation of Historic Structures

The use of tax incentives to preserve historical buildings and discourage the demolition of older buildings began at the federal level in 1976.[16] Congress eliminated provisions of the tax code that "favored new construction over rehabilitation" and created new tax incentives that encouraged the redevelopment of older buildings.[17] In the early 1980s, Congress passed an incentive that created a 25% investment tax credit for the taxpayers who rehabilitated historic buildings.[18] This program allowed developers to recoup 25% of the redevelopment costs of historic buildings in the form of a federal tax credit.[19] This federal tax credit spurred redevelopment in Missouri.[20] From 1982 to 1988, more than $745 million was invested in Missouri historic preservation projects.[21] The amount of this investment made Missouri "one of the leading states in the nation using the rehabilitation credits."[22] Rehabilitation projects that made use of the new federal credit include the Coates House Hotel, Quality Hill and the Garment District in Kansas City, as well as Union Station and the Fox Theater in St. Louis.[23]

When Congress substantially overhauled the federal tax code in 1986, the federal preservation credit lost some of its usefulness.[24] First, Congress reduced the amount of the allowable federal rehabilitation tax credit from 25 to 20%.[25] Additionally, changes to the passive loss rules[26] in the tax code

16. Mark Miles, *Investing in the Past*, MO. RESOURCES MAGAZINE, Spring 2000, at 11, *available at* http://www.dnr.mo.gov/magazine/2000-spring.pdf.

17. *Id.* at 12.

18. *Id.* Requirements to receive the credit were similar to those today: the building must be historic; the rehabilitation must follow the standards specifically set by the Secretary of the Interior; and the rehabilitation must be substantial. *See id.* at 13.

19. *Id.* at 12. This is an income tax credit that is applied to reduce directly (i.e. dollar-for-dollar) tax liability on future income. For example, if a developer incurred $100,000 in rehabilitation expenses, the allowable tax credit would be $25,000. If then the developer had a tax liability of $30,000, he could use the $25,000 tax credit to reduce his tax liability to $5,000.

20. *Id.*

21. *Id.*

22. *Id.*

23. *Id.*

24. *See id.*

25. *Id.*

26. The federal rehabilitation tax credit is subject to the passive loss limitations. I.R.C. § 469 (2006); 2A NICHOLS CYCLOPEDIA OF LEGAL FORMS ANNOTATED § 35:27 (Westlaw 2011) [hereinafter NICHOLS CYCLOPEDIA]. Passive investors, defined as those who invest in a business in which they do not materially participate, can deduct

made it difficult to put together viable redevelopment projects with the necessary financing.[27] With the reduced ability of developers to use the preservation credit, private investment in historic preservation dropped sharply in Missouri, from a high of $188 million in 1982 to a mere $3.4 million in 1995.[28] A group of Missouri citizens, calling themselves "preservationists," began lobbying for a state rehabilitation credit because they were concerned with the deteriorating state of many historic buildings and the "lack of private investment to preserve them."[29] Legislation calling for an historic preservation tax credit was introduced into the Missouri General Assembly in 1996.[30] The legislation was passed in 1997 and took effect January 1, 1998.[31]

When the Missouri General Assembly first passed the historic tax credit legislation, preservationists organized one-day briefing sessions on the tax credit in both St. Louis and Kansas City.[32] The target audience of these tax credit information sessions included developers, tax attorneys, accountants, and bankers.[33] "[O]utreach to those who had capital to invest or access to investors" was an important step in encouraging the use of the credit and the credit's ultimate success.[34]

Missouri was not the only state to enact its own historic preservation tax credit program. A study conducted in 2010 found that thirty-one state legislatures had enacted laws allowing for a credit against state income taxes to provide incentives for the redevelopment of historic buildings.[35] Most of these credits are modeled after the federal rehabilitation tax credit.[36] Many of these state tax credit programs share several of the same basic characteristics: criteria establishing qualifying historic buildings; rehabilitation standards to en-

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losses from that particular passive investment only to the extent he or she has income from another passive investment. I.R.C. § 469.

27. Miles, *supra* note 16, at 12. The passive loss rules essentially made redevelopment projects a less attractive investment for many investors. *See id.* Thus, there were fewer investors willing to finance historic preservation projects. *See id.*

28. *Id.*

29. *See id.*

30. *Id.*

31. S.B. 1, 89th Gen. Assemb., 2nd Extraordinary Sess. (Mo. 1997). The legislation is outlined in greater detail *infra* Part II.B.

32. Rypkema, *supra* note 1, at 1.

33. *Id.*

34. *Id.*

35. HARRY K. SCHWARTZ, NATIONAL TR. FOR HIST. PRESERVATION, STATE TAX CREDITS FOR HISTORIC PRESERVATION: A PUBLIC POLICY REPORT PRODUCED BY THE NATIONAL TRUST FOR HISTORIC PRESERVATION'S CENTER FOR STATE AND LOCAL POLICY 1 (2010), *available at* http://www.preservationnation.org/issues/rehabilitation-tax-credits/additional-resources/nthp_state_tax_credits_model_policy.pdf [hereinafter NATIONAL TRUST REPORT].

36. Harry K. Schwartz, *State Tax Credits for Historic Preservation*, 2 A.L.I. – A.B.A. COURSE OF STUDY HIST. PRESERVATION L. 1035, 1037 (2007), *available at* WL SM056 ALI-ABA 1035.

sure the preservation of the building's "historic and architectural character"; a method for calculating the allowable tax credit based on a percentage of expenditures; a minimum required investment in the rehabilitation; and a system for administering the program.[37] This article will later discuss the attributes of a successful historic preservation tax credit program.[38]

B. Missouri's Historic Preservation Tax Credit

In September 1997, the Missouri General Assembly passed the Missouri Historic Tax Credit Program.[39] The law became effective January 1, 1998.[40] The law's purpose was to promote "redevelopment of historic structures in the [S]tate of Missouri"[41] by "[p]rovid[ing] an incentive for the redevelopment of commercial and residential . . . structures."[42] The Missouri Department of Economic Development (DED) administers the program and issues all tax credits after final certification of the rehabilitation project by the Missouri Department of Natural Resources, State Historic Preservation Office.[43]

The historic preservation tax credit allows for a state income tax credit equal to 25% of expenses associated with the rehabilitation of historic structures.[44] To receive this historic preservation tax credit, a taxpayer must incur eligible costs and expenses for the rehabilitation of either a "certified historic structure" or a "structure in a certified historic district."[45] A certified historic structure is a building located in Missouri that is listed individually on the National Register of Historic Places.[46] A structure in a certified historic district is a structure that has been "certified by the [Missouri] [D]epartment of [N]atural [R]esources as contributing to the historic significance of a certified historic district listed on the National Register of Historic Places, or a local

37. *Id.*

38. *See infra* Part III.A.

39. 1997 Mo. Laws 1478; MO. DEP'T ECON. DEV., MISSOURI HISTORIC PRESERVATION TAX CREDIT PROGRAM FINAL APPLICATION AND GUIDELINES 1 (2009), *available at* http://ded.mo.gov/upload/final_guidelines_02_09.pdf [hereinafter FINAL APPLICATION AND GUIDELINES].

40. FINAL APPLICATION AND GUIDELINES, *supra* note 39, at 1; *see* 1997 Mo. Laws 1478.

41. FINAL APPLICATION AND GUIDELINES, *supra* note 39, at 1.

42. *Research Toolbox – Historic Preservation*, MISSOURIDEVELOPMENT.ORG, http://www.missouridevelopment.org/topnavpages/Research%20Toolbox/BCS%20Programs/Historic%20Preservation.html (last visited Nov. 26, 2011).

43. MO. TAX CREDIT REV. COMM'N, FINAL REPORT OF THE HISTORIC PRESERVATION SUBCOMMITTEE OF THE MISSOURI TAX CREDIT REVIEW COMMISSION 2-3 (2010), *available at:* http://tcrc.mo.gov/pdf/hispresComreport.pdf [hereinafter SUBCOMMITTEE REPORT].

44. MO. REV. STAT. § 253.550.1 (Supp. 2010).

45. *Id.*

46. *Id.* § 253.545(1); FINAL APPLICATION AND GUIDELINES, *supra* note 39, at 7.

district that has been certified by the United States Department of the Interior."[47] Additionally, the property must be used for either residential or business purposes.[48]

The costs incurred must be associated with rehabilitation and include, but are not limited to, qualified rehabilitation expenditures as defined under the federal rehabilitation tax credit program.[49] Generally, permanent improvements made within the footprint of a building are considered eligible costs.[50] Other eligible costs include soft costs, such as architect's fees, that are directly related to the rehabilitation.[51]

A certain investment threshold is required to qualify for the credit. The qualified rehabilitation expenditures must exceed 50% of the building's basis.[52] Missouri, unlike the federal program, defines basis as the property's acquisition cost.[53]

The historic preservation tax credit can reduce both state income taxes[54] and other taxes, including the bank tax, the insurance premium tax, and the

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47. MO. REV. STAT. § 253.545(6); FINAL APPLICATION AND GUIDELINES, *supra* note 39, at 8.

48. MO. REV. STAT. § 253.545(3).

49. *Id.* § 253.550.1. Specifically, the federal rehabilitation tax credit program defines qualified rehabilitation expenditures in section 47(c)(2)(A) of the Internal Revenue Code of 1986. *Id.* For a list of expense categories, including non-qualified expenses, see FINAL APPLICATION AND GUIDELINES, *supra* note 39, at 24-25.

50. FINAL APPLICATION AND GUIDELINES, *supra* note 39, at 6.

51. *Id.*; MO. TAX CREDIT REV. COMM'N, REPORT OF THE MISSOURI TAX CREDIT REVIEW COMMISSION, 33 (2010), *available at:* http://tcrc.mo.gov/pdf/TCRC FinalReport113010.pdf [hereinafter TAX CREDIT COMMISSION REPORT].

52. MO. REV. STAT. § 253.550.1.

53. TAX CREDIT COMMISSION REPORT, *supra* note 51, at 33. This is a very relevant distinction because a project that qualifies for the Missouri credit might not qualify for the federal credit, and vice versa. *See also Federal and State Tax Credits, Grants & Other Funding Sources*, MO. DEP'T NAT. RESOURCES, Jan. 18, 2011, http://www.dnr.mo.gov/shpo/TaxCrdts.htm [hereinafter *Federal and State Tax Credits*]. "Basis" is defined in the *Final Application and Guidelines* as:

> The cost, or fair market value, of the property at the time of acquisition, or as otherwise defined in the United States Internal Revenue Code. Cost includes the cash paid, the fair market value of services rendered, and the fair market value of property traded in exchange for the property. Also, certain closing costs can be added to the basis of property. Such closing costs include commissions paid by the purchaser, legal fees, recording fees, and state transfer taxes on real estate.

FINAL APPLICATION AND GUIDELINES, *supra* note 39, at 7. This differs from the federal rehabilitation tax credit investment threshold which uses adjusted basis in the calculation. I.R.C. § 47(c)(1)(C) (2006). For federal purposes, adjusted basis is defined as the cost of the building adjusted for capital expenditures and depreciation taken with respect to the building. *Id.* §§ 1011, 1016.

54. State income taxes are imposed pursuant to Missouri Revised Statutes section 143.011 (2000).

other financial institution tax.[55] However, the credit may not be used to reduce withholding taxes.[56]

The historic preservation tax credit has several other distinct attributes. First, the tax credit has a carryback and carryforward feature.[57] If a taxpayer is unable to use the full tax credit in the year that the rehabilitated property is placed in service because the amount of the tax credit exceeds the taxpayer's total tax liability for the year, the tax credit can be used to reduce tax liability for any of the preceding three years or any of the next ten years.[58]

In addition, credits granted to an entity that is not taxed at the corporate level, such as a partnership or a limited liability company taxed as a partnership, will pass through to the partners or members "respectively pro rata or according to an executed agreement among the partners [or] members."[59] When property is owned by multiple persons, the credit will pass to the individual owners.[60]

Moreover, the taxpayer "may transfer, sell or assign the credits" to another taxpayer so that he may use that tax credit to reduce his tax liability.[61] When the tax credit is sold, the tax years to which the sold credit may be applied[62] are the same as the original tax credit.[63] The proceeds from the sale of a tax credit are usually considered taxable income and may be subject to tax at either the federal or state level.[64] Not-for-profit entities may not be involved in the sale of state historic preservation tax credits.[65]

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55. MO. REV. STAT. § 253.550.1 (Supp. 2010); *see also* MO. REV. STAT. §§ 148.010-.110, .310-.461, .610-.700 (2000 & Supp. 2010) (describing the bank tax, insurance premium tax, and other financial institution tax, respectively).

56. *Id.* § 253.550.1; *see id.* §§ 143.191-.265 (describing the imposition of withholding taxes).

57. *Id.* § 253.557.1 (2000).

58. *Id.* Specifically, the tax credit must first be used in the year the credit is issued. *Id.* Any excess may be carried back three years and forward for the next ten years. *See also* FINAL APPLICATION AND GUIDELINES, *supra* note 39, at 9.

59. FINAL APPLICATION AND GUIDELINES, *supra* note 39, at 9.

60. *Id.* Each person will not be able to claim the entire amount of the credit, but rather it will be shared amongst all the owners. *See id.*

61. *Id.* Historic preservation tax credits received for expenses incurred prior to August 28, 1998, cannot be transferred, sold, or assigned. *Id.* at 23. The taxpayer must notify DED in writing of the transfer and fill out MO-TF (Transfer Form) for each transfer. *Id.* The DED will then reissue a Tax Credit Certificate to the transferee and notify the Department of Revenue of the transaction. *Id.*

62. This includes the current year in which the tax credit was initially authorized, as well as the preceding three years and the following ten years. *See* MO. REV. STAT. § 253.557.1.

63. FINAL APPLICATION AND GUIDELINES, *supra* note 39, at 23.

64. *Id.*; TAX CREDIT COMMISSION REPORT, *supra* note 51, at 51.

65. MO. REV. STAT. § 253.557.1.

Taxpayers who are eligible to use the tax credit include "any person, firm, partnership, trust, estate, limited liability company, or corporation."[66] Not-for-profit and government entities are ineligible for the historic preservation tax credit.[67] This rule applies even when a for-profit entity participates in the project as well. For example, two groups participated in the restoration of the Gillioz Theatre in Springfield: Gillioz Restoration Partnership LP (the Partnership), a for-profit entity that oversaw the restoration work, and Springfield Landmarks Preservation Trust (the Trust), a not-for-profit entity that owned the building.[68] The expenses paid by the Trust did not qualify for Missouri's historic preservation tax credit, while the expenses paid by the Partnership did.[69]

In 2009, the Missouri General Assembly passed House Bill 191,[70] in which the historic preservation tax credit was amended "in an effort to address growing concerns over the fiscal impact of the Program on the state budget."[71] This amendment established several limitations on the historic preservation tax credit.[72] First, the amendment capped the tax credit for large rehabilitation projects.[73] As of July 1, 2010, there is an annual program cap of $140 million for redevelopment projects receiving more than $275,000[74] of historic preservation tax credits.[75] However, projects receiving less than $275,000 in tax credits, other than owner-occupied residential projects, are completely exempt from this annual program cap.[76] Projects involving owner-occupied, non-income producing residential property have a per project cap of $250,000[77] in historic preservation tax credits.[78]

House Bill 191 also established a multi-step application and approval process for potential historic preservation tax credit applicants.[79] The DED

66. *Id.* § 253.545(7) (Supp. 2010).

67. *Id.* § 253.557.1 (2000); FINAL APPLICATION AND GUIDELINES, *supra* note 39, at 9; SUBCOMMITTEE REPORT, *supra* note 43, at 3.

68. Wes Johnson, *Historic Theater Fights Threat of Foreclosure*, SPRINGFIELD NEWS-LEADER, Dec. 15, 2010, at A1.

69. *See id.*

70. *See* H.B. 191, 95th Gen. Assemb., 1st Reg. Sess. (Mo. 2009).

71. TAX CREDIT COMMISSION REPORT, *supra* note 51, at 33.

72. *See* H.B. 191.

73. MO. REV. STAT. § 253.550.2 (Supp. 2010).

74. This would be 25% of $1.1 million of qualified expenditures.

75. MO. REV. STAT. § 253.550.2. The annual cap technically went into effect on January 1, 2010, to be applied to the second half of the fiscal year. *See id.* However, the cap was reduced pro-rata to $70 million for the time period beginning January 1, 2010, and ending June 30, 2010. *Id.*

76. *Id.* § 253.550.2-.3; *see* TAX CREDIT COMMISSION REPORT, *supra* note 51, at 33-34.

77. This would be 25% of $1 million of qualified expenditures.

78. MO. REV. STAT. § 253.550.3.

79. TAX CREDIT COMMISSION REPORT, *supra* note 51, at 34.

prioritizes applications based on the date of application.[80] The DED provides preliminary approval for the tax credit "only to [the] extent that tax credits are still available for authorization[81] under the annual [program] cap."[82] Tax credits are later issued[83] upon final approval.[84] The preliminary approvals, also known as authorizations, not the actual issuances of the tax credits, are used to calculate the annual program cap.[85] After preliminary approval, applicants must begin work on their rehabilitation projects within two years of the date of approval.[86] After the project is complete and expenses are paid, the applicant submits a final application to the DED.[87] Upon approval of the final application, the DED issues the tax credit to the applicant.[88]

In addition to the state historic preservation tax credit, developers can also use the federal rehabilitation credit for some projects.[89] Although Missouri's historic preservation tax credit is similar to the federal credit, there are some important differences.

C. The Federal Rehabilitation Tax Credit

A federal tax credit is allowed for the rehabilitation of historic buildings. However, the amount of the federal rehabilitation tax credit is not as generous as the Missouri historic preservation tax credit. For certified historic struc-

80. *Id.*

81. Authorization typically refers to "[t]he point at which an administering agency determines that a proposed project, or activity is eligible for tax credits under a tax credit program and awards or assigns an amount of credits , [sic] pending performance of the eligible project or activity." *Id.* at 51.

82. *Id.* at 34.

83. Issuance refers to "[t]he process by which the state provides an authorized tax credit to a recipient who has met the program performance benchmarks." *Id.* at 51. Often, the tax credit is issued in the form of a certificate, which the taxpayer will submit along with his or her tax return when the tax credit is redeemed. *Id.* Also, the amount of tax credits issued may differ from the amount of tax credits initially authorized. *Id.*

84. *Id.* at 34.

85. *Id.*

86. *Id.*

87. *Id.*

88. *Id.*

89. *Federal and State Tax Credits*, *supra* note 53. For example, the Virginia building, located on East Broadway in the downtown Columbia Historic District, was rehabilitated using both the Missouri historic preservation credit and the federal rehabilitation credit. *Preservation Matters!*, MO. DEP'T NAT. RESOURCES, http://www.dnr.mo.gov/shpo/ (last visited Nov. 28, 2011). Additionally, the Kiel Opera House in downtown St. Louis was redeveloped using both credits. *Your Tax Dollars at Work: Can St. Louis Compete – the Edifice Complex*, ST. LOUIS POST-DISPATCH, Nov. 15, 2010, at A13.

tures, a tax credit of 20% of qualified expenditures is allowed.[90] To be "certified," a structure must be listed in the National Register or be located in an historic district and be "certified by the Secretary of the Interior to the Secretary as being of historic significance to the district."[91] For other buildings that are not certified but were placed in service before 1936, a tax credit of 10% of qualified expenditures is allowed.[92]

Qualifying expenditures include "[a]rchitect's fees, engineering expenses, surveys, legal expenses, insurance premiums, capitalized construction period interest, and taxes."[93] These qualifying expenditures must be made within a twenty-four month period of rehabilitation and exceed the greater of the adjusted basis[94] of the rehabilitated building or $5000.[95]

For non-certified historic structures, certain requirements must be met with respect to the rehabilitation. At least 50% of the existing external walls must be retained as external walls and at least 75% of the existing external walls must be retained as either internal or external walls.[96] Additionally, at least 75% of the existing internal structural framework of the building is required to be retained.[97]

Several aspects of the federal rehabilitation tax credit differ from Missouri's historic preservation tax credit. First, unlike the Missouri preservation credit, the federal credit cannot be taken for rehabilitation of non-income producing residential properties.[98] In other words, a taxpayer who rehabilitates his personal residence cannot use the federal historic preservation credit.[99] However, the federal credit may be used for either commercial or residential rental property.[100] Second, when the taxpayer receives the federal rehabilitation tax credit, his basis in the rehabilitated property is reduced by the amount of the credit taken.[101] Missouri's historic preservation tax credit

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90. I.R.C. § 47(a)(2) (2006).

91. *Id.* § 47(c)(3)(A).

92. *Id.* § 47(a)(1), (c)(1)(B).

93. 2A NICHOLS CYCLOPEDIA, *supra* note 26, § 35:27. Expenditures "must be capital in nature and must be made on depreciable property." *Id.*

94. Adjusted basis for federal tax purposes is typically the cost of the building increased by capital expenditures made with respect to the property and decreased by depreciation taken with respect to the property. I.R.C. §§ 1011, 1016.

95. *Id.* § 47(c)(1)(C). This twenty-four month period is selected by the taxpayer. *Id.*

96. *Id.* § 47(c)(1)(A)(iii)(I)-(II); 2A NICHOLS CYCLOPEDIA, *supra* note 26, § 35:27.

97. I.R.C. § 47(c)(1)(A)(iii)(III).

98. *See id.* § 47(c)(2)(A)(i). The statute specifically allows the credit for "property for which depreciation is allowable under section 168" and then lists the types of property that qualify. *Id.*

99. *Federal and State Tax Credits*, *supra* note 53.

100. *Id.*

101. I.R.C. § 50(c); 2A NICHOLS CYCLOPEDIA, *supra* note 26, § 35:27.

does not require a basis adjustment.[102] Lastly, unlike the Missouri historic preservation tax credit, the federal rehabilitation tax credit is not transferable.[103]

III. DISCUSSION

A. Structuring an Historic Preservation Tax Credit

The structure of a state historic preservation tax credit can be crucial to its later effectiveness. According to economist Donovan D. Rypkema,[104] one of the reasons that Missouri's historic preservation tax credit has been so successful is its structure.[105] He points out that the Missouri credit can be used in conjunction with the federal credit on commercial projects, that owner-occupied personal residences are eligible for the state credit, and that the credit can be transferred.[106]

Another study on state credits for historic perseveration suggests that good or effective state historic preservation tax credit programs typically have certain components in common.[107] The two factors that have the most significant influence on the success of an historic preservation tax credit program are some kind of "a limit or cap on the amount of credit" and "transferability."[108] However, there are also several other structural features that can be included in an historic preservation tax credit statute that will make the tax credit program more successful.

1. Caps and Transferability

Two types of caps are often seen in state historic preservation tax credit programs. First, a program might include a state-wide annual aggregate cap.[109] A low aggregate program cap will prevent many projects from occur-

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102. MO. REV. STAT. § 253.550.1 (Supp. 2010).

103. I.R.C. § 47 does not have a provision allowing for the transfer of the rehabilitation tax credit. *See* I.R.C. § 47.

104. "Mr. Rypkema is recognized as an industry leader in the economics of preserving historic structures." *Who We Are*, PLACEECONOMICS, http://www.placeeconomics.com/about-us/who-we-are (last visited Nov. 29, 2011). He teaches a preservation economics graduate course at the University of Pennsylvania and is principal of PlaceEconomics, a real estate and economic development-consulting firm that specializes in "downtown and neighborhood commercial district revitalization and the reuse of historic structures." *Id.*

105. Rypkema, *supra* note 1, at 1.

106. *Id.*

107. Schwartz, *supra* note 36, at 1037.

108. *Id.*

109. *Id.* at 1037-38. A state-wide annual aggregate cap is essentially a yearly limit on the total amount of tax credits awarded in a particular program in the state.

ring.[110] An annual cap can distort the purpose of an historic preservation credit by "rewarding projects that do not require an incentive while excluding projects that cannot proceed without the state incentive."[111] Second, many state historic preservation tax credit programs have individual project caps.[112] Low limits on individual commercial projects can also defeat the purpose of state tax credit programs.[113] For example, Colorado imposes a $50,000 limit on tax credits that may be awarded to a single commercial project.[114] One study suggests that this $50,000 limitation is "far too low a figure to affect decisions regarding substantial commercial projects."[115]

Transferability is also a key component to structuring a state historic preservation tax credit.[116] A tax credit is valuable only to the extent that its holder has sufficient state income tax liability to which the tax credit can be applied.[117] Because most state income tax rates are far lower than federal income tax rates, it is likely that someone who qualifies for a state tax credit may not be able to use it.[118] When that is the case, the ability to transfer the tax credit to a party who can use it becomes extremely important.[119]

States have created various mechanisms to allow for transferability.[120] First, some states allow the party who qualified for the preservation credit to sell the credit to a third party who has sufficient tax liability to use it.[121] Missouri permits parties to sell or convey their earned historic preservation tax credits.[122] Often, developers who are issued the tax credit do not actually

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Id. at 1037. Missouri put a $140 million cap on the historic tax credit program in 2010. MO. REV. STAT. § 253.550.2 (Supp. 2010).

110. *See* Schwartz, *supra* note 36, at 1037.

111. *Id.* In other words, some projects that have secured the necessary financing to make the project viable and do not need the credit to make the project financially possible are able to receive the credit, while projects that need the credit to make the project financially viable do not receive the credit. *Id.*

112. *Id.* at 1038.

113. *Id.*

114. *Id.*

115. *Id.*

116. *Id.* at 1037.

117. *Id.* at 1038.

118. *Id.*

119. *Id.*

120. *Id.* at 1038-39.

121. *Id.* at 1038.

122. MO. REV. STAT. § 253.557.1 (2000). Several other states allow taxpayers to transfer their historic preservation credits, including Delaware, Kansas, and Rhode Island. DEL. CODE ANN. tit. 30 § 1814 (2009); KAN. STAT. ANN. § 79-32,211 (Supp. 2010); R.I. GEN. LAWS § 44-33.2-3 (Lexis through the Jan. 2010 Sess.); 34-1 R.I. CODE R. § 6:VIII (West, Westlaw through Apr. 30, 2011).

redeem the credit to reduce their tax liability.[123] Developers usually sell the tax credit for slightly less than face value to raise cash to finance their projects.[124] Banks and brokers are typically the initial purchasers of these tax credits, and they subsequently sell the tax credits to other taxpayers looking to reduce their tax liability.[125] In St. Louis, Ameren Corporation has been the biggest end buyer of historic preservation tax credits, with a total purchase amounting to $18.2 million from 2006 to 2009.[126] In addition to corporations, wealthy individuals are also large buyers of these tax credits.[127] These end buyers typically pay about ninety-two cents for a one-dollar Missouri income tax credit.[128] Although one might argue that historic preservation tax credits really only end up benefiting wealthy individuals or corporations, these end buyers of the tax credits are necessary to the success of the tax credit program.[129] If an end buyer corporation does not commit to purchasing the credits in advance, the developer might have more difficulty in obtaining the cash financing for his or her project, holding a tax credit that cannot be used until the project generates taxable income.[130]

Second, some state statutes allow a disproportionate distribution of the tax credit to partners in a partnership.[131] For example, a national partnership doing business in Kansas that qualifies for the Kansas historic preservation credit can allocate the tax credit so that it is to be passed through only to its partners in Kansas.[132] The ability to allocate the tax credit is valuable because a national partnership likely has partners that do not reside in Kansas and thus do not have Kansas income tax liability.[133] If the tax credit could not be allocated, a non-Kansas partner would have a worthless income tax credit.[134]

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123. Tim Logan, *Want to Buy a Dollar for 92 Cents?*, ST. LOUIS POST-DISPATCH, Nov. 16, 2010, http://www.stltoday.com/business/article_eeec1a65-2d2b-53d8-b2f7-970462445926.html.

124. *Id.*

125. *Id.*

126. *Id.*

127. *Id.* The article lists various wealthy individuals in St. Louis who have bought historic preservation credits in the last several years. *Id.* These were often people with a high tax bill, or executives or entrepreneurs who retired and sold a business and bought a tax credit to apply against the tax liability they were going to have for the gain on the sale of their business. *Id.*

128. *Id.*

129. *Id.*

130. *Id.*

131. Schwartz, *supra* note 36, at 1038.

132. *See id.*

133. *Id.*

134. *Id.*

Third, a state statute may allow the credit to be applied against tax liability in previous years.[135] As of 2007, Missouri appears to be the only state to have this carryback provision in its state historic preservation tax credit statute.[136]

Fourth, the tax credit might be structured so that it is refundable.[137] This situation is ideal for homeowners, particularly those with lower incomes, who may not be able to transfer the credit[138] or may not have sufficient income to use the tax credit.[139] Maryland, Ohio, Iowa, and Louisiana currently have a refundable historic preservation tax credit.[140]

2. Other Structural Features

As discussed earlier, the amount of an allowable historic preservation tax credit can be limited by a per project cap. Another limitation on the credit is that the amount of the credit is determined by multiplying a statutorily set percentage by the total qualified rehabilitation expenditures.[141] An American Bar Association study suggests that the credit should be in the range of 20 to 30% of qualified rehabilitation expenditures.[142] A rate at this level is "high enough to constitute a meaningful incentive."[143] Missouri currently allows a tax credit of 25% of qualified rehabilitation expenditures.[144]

Another consideration in structuring a state historic preservation tax credit is whether the state credit can be used in combination with the federal rehabilitation tax credit.[145] A developer has more incentive to take on an historic preservation project when the state credit can be used in conjunction with the federal credit because he is able to increase significantly the amount

135. *Id.* at 1039.

136. *Id.* The federal program also allows the tax credit to be carried back to offset taxes paid in prior years. *Id.*

137. *Id.* If a refundable tax credit exceeds the amount of taxes owed by the taxpayer in the current year, the credit is considered an overpayment of the tax owed and will be refunded to the taxpayer. *Id.* The Missouri Property Tax Credit is an example of a refundable credit. MO. REV. STAT. § 135.020 (2000). This statute gives a credit to elderly taxpayers for a portion of their real estate taxes or rent paid for the year. *Id.* § 135.010 (Supp. 2010); Mary McCormick, *Missouri Elder Law*, 41 MO. PRAC. § 14:11 (2011).

138. A homeowner may be unable to transfer the credit when the state statute allowing for a preservation credit does not allow the credit to be transferred.

139. Schwartz, *supra* note 36, at 1039.

140. NATIONAL TRUST REPORT, *supra* note 35, at 3.

141. Schwartz, *supra* note 36, at 1038-41.

142. *See id.*

143. *Id.* at 1038.

144. MO. REV. STAT. § 253.550.1 (Supp. 2010).

145. *See* Schwartz, *supra* note 36, at 1038.

of financing for his project.[146] The DED noted that Missouri's historic preservation tax credit "is a great complement to the federal program [because] developers are using the credit for gap financing to make projects happen that otherwise would not have happened with the federal credits alone."[147] However, some state programs reduce the allowable state historic preservation tax credit when the federal tax credit is also used.[148] For example, Michigan allows a 25% credit for commercial rehabilitation, but when a developer uses the federal credit as well, the state credit is reduced to 5%.[149] When a state structures its historic preservation tax credit so that it cannot be stacked with the federal tax credit, the effectiveness of its state tax credit is severely reduced.[150]

In addition, a state historic preservation tax credit will encourage more redevelopment when the credit is allowed for the rehabilitation of personal residences.[151] Because the federal rehabilitation tax credit program does not allow a credit for the rehabilitation of non-income producing properties, it is important that a state provide this credit to encourage the improvement of historic owner-occupied residences.[152] Missouri's historic preservation tax credit may be used for rehabilitating personal residences.[153]

The final reason why it is important that a state structures its historic preservation tax credit so that it effectively creates incentives for redevelopment is that the state tax credit will always be worth less than its face value after federal income taxes are considered.[154] There are two situations in which federal income tax liability needs to be considered. First, when a taxpayer receives the tax credit from the state and subsequently sells the tax credit, under federal income tax laws, the taxpayer realizes and recognizes a short-term capital gain, taxed at ordinary income levels.[155] Second, a party that uses the state tax credit to reduce its state income tax liability can no longer deduct that amount of income tax liability from the amount of federal income tax owed.[156] Thus, the taxpayer may pay more in federal income taxes even though he has reduced his state income tax liability.[157] The in-

146. *See id.*

147. Miles, *supra* note 16, at 13 (internal quotation marks omitted).

148. *See* Schwartz, *supra* note 36, at 1038.

149. *Id.*

150. *See id.*

151. *See id.*

152. *See id.*

153. *See* MO. REV. STAT. § 253.550.1 (Supp. 2010).

154. Schwartz, *supra* note 36, at 1039.

155. *Id. See also* I.R.C. §§ 1001, 1222 (2006) (defining short term capital gain and long term capital gain).

156. Schwartz, *supra* note 36, at 1039. Section 164 of the Internal Revenue Code allows the deduction of state and local income taxes from gross income. I.R.C. § 164 (2006).

157. Schwartz, *supra* note 36, at 1039.

crease in the amount of federal income taxes owed will depend upon the taxpayer's federal income tax rate but could amount to 35% of the amount of the tax credit that was applied against state income tax liability.[158] Because of these two hidden costs of federal income taxation, a $100 state tax credit is typically not worth more than $65 after tax, while a federal tax credit is worth its full face value of $100.[159]

Program caps and transferability are two of the most important components to consider when structuring a state historic preservation tax credit program. However, as previously discussed, there are several other features of a tax credit program that should be considered when structuring an historic preservation tax credit statute.

B. Tax Credits as a Redevelopment Tool

1. Economic Development in General

States should use historic preservation tax credits to encourage historic preservation. In addition to preserving history, preservation has significant economic benefits for the state.

When discussing economic development, policymakers often look at two particular economic development measurements: "jobs created and increased . . . household income."[160] Historic preservation increases both of these measurements.[161] Compared with new construction that typically consists of half materials and half labor, historic rehabilitation consists of 60 to 70% labor.[162] Higher labor requirements mean increased jobs; but the increased labor required for rehabilitation actually affects the economy on two levels.[163] First, a developer buys the services of a local carpenter.[164] Second, after the carpenter gets paid, he spends his paycheck in the local economy buying food, clothing, and other consumer goods.[165]

Economic development can also be thought of in terms of manufacturing.[166] In Missouri, for every one million dollars of manufacturing production, an estimated 13.9 jobs are created and approximately $470,000 is added to local household incomes from the salaries associated with these newly created jobs.[167] In comparison, for every one million dollars invested in rehabilitating an historic building, an estimated 20.2 jobs are created and ap-

158. *Id.*
159. *Id.*
160. Rypkema, *supra* note 1, at 8.
161. *Id.*
162. *Id.*
163. *Id.*
164. *Id.*
165. *Id.*
166. *Id.*
167. *Id.*

proximately $704,000 is added to local household incomes.[168] On a per job basis, the average salary of the rehabilitation job is $34,851; more than one thousand dollars more than the average $33,813 salary of a manufacturing job.[169]

Jobs and local household income are popular economic measurements, but there are other, less obvious economic benefits from historic rehabilitation. First, historic preservation encourages heritage tourism.[170] Heritage tourists typically stay longer and spend more money on a trip than other visitors.[171] This impacts a large portion of the local economy because heritage tourists spend money at hotels, gift shops, restaurants, and gas stations.[172] Second, historic preservation has a positive effect on property values.[173] Properties located within historic districts tend to appreciate in value at a greater rate than the local real estate market overall.[174] Additionally, these historic properties are not affected as much by the volatility in the real estate market.[175] Third, historic preservation facilitates small business.[176] This is because the occupancy costs of an historic building are typically less than a new office building or space in an office park.[177] By providing affordable work space to small business, historic preservation enables those businesses to grow and create new jobs.[178] And it is small businesses, not *Fortune 500* companies, that are creating new jobs in America.[179]

2. The Impact in Missouri

Missouri's historic preservation tax credit has significantly impacted Missouri's economy. Over the first ten years of its use, Missouri's historic preservation tax credit created more than 40,000 jobs.[180] Additionally, the

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168. *Id.*

169. To calculate the average salary per job, divide the dollar amount added to household income by the number of jobs.

170. *See* Rypkema, *supra* note 1, at 9. The study mentioned in the speech defines heritage tourists as tourists visiting one more of the following places: a museum, a Civil War battlefield, or an historic site. *Id.* at 10.

171. *Id.* at 10.

172. *Id.*

173. *See id.*

174. *Id.*

175. *Id.*

176. *Id.* at 11.

177. *Id.*

178. *See id.*

179. *Id.*

180. *Id.* at 8. A "job" under Rypkema's economic analysis is defined as a "full time equivalent job for one year." *Id.* For a more recent study discussing Missouri's historic preservation tax credit on job creation, see SARAH L. COFFIN, ROB RYAN & BEN MCCALL, AN EVALUATION OF THE MISSOURI HISTORIC PRESERVATION TAX

credit attracted private investment in Missouri's historic buildings.[181] In the ten years since the creation of Missouri's historic preservation tax credit, more than $2 billion was invested in Missouri's historic buildings.[182]

During the first two years of Missouri's historic preservation tax credit, the Missouri DED issued $11.5 million in state income tax credits to support the completion of twenty-eight rehabilitation projects.[183] These projects represented an "investment in local Missouri communities of approximately $46.3 million," and produced an estimated 1,325 new jobs and 552 new housing units.[184] Yet Missouri's historic preservation tax credit has not just benefited large development projects. Of all the projects taking advantage of the credit from the beginning of 1998 to the end of 2007, only 11% were large development projects consisting of over $5 million in rehabilitation expenditures.[185] Essentially, two-thirds of the rehabilitation projects were for projects with less than $500,000 in rehabilitation expenditures.[186]

In a speech given in late 2008, Donovan D. Rypkema discussed the economics of historic preservation and what has happened in Missouri since the General Assembly created the state historic preservation tax credit.[187] He made calculations of different economic indicators, including gross domestic product for the United States, gross state product for Missouri, the construction segment of the U.S. economy, and projects using the federal rehabilitation tax credit as well as projects using the Missouri historic preservation tax credit.[188] He compared the activity in each of these areas from the beginning of 1998, the year in which Missouri enacted its state credit, until the end of 2007.[189]

Rypkema found that the activity of Missouri projects using the Missouri historic preservation tax credit outpaced all of the other economic indicators over the ten year period.[190] One could argue that the overall growth over the ten year period was disproportionately large because the first few years of growth were relatively small because the Missouri historic preservation tax

CREDIT PROGRAM'S IMPACT ON JOB CREATION AND ECONOMIC ACTIVITY ACROSS THE STATE (2010) [hereinafter EVALUATION OF THE TAX CREDIT]. This study can be found attached to the SUBCOMMITTEE REPORT, *supra* note 43.

181. Rypkema, *supra* note 1, at 7.

182. *Id.* at 1.

183. Miles, *supra* note 16, at 13.

184. *Id.* For data on the economic impact of specific projects, such as The Lofts @ 415 (formerly Noyes Norman Shoe Company Building) in St. Joseph and the Western Union Building (formerly Western Union Telegraph Building) in Kansas City, see EVALUATION OF THE TAX CREDIT, *supra* note 180, at 15-16.

185. Rypkema, *supra* note 1, at 6.

186. *Id.*

187. *Id.* at 1.

188. *Id.* at 1-6.

189. *Id.* at 1.

190. *Id.* at 1-6.

credit program had not really gotten started.[191] However, Rypkema addressed this possible allegation by changing the scale of the graph to depict growth in only the last eight years of the program, from 2000 until 2007, and then again to depict just the last seven years, from 2001 until 2007. [192] Even when Rypkema changed the time periods, the graphs showed that the "tax credits caused a huge investment attributable to absolutely no other factor."[193] He analogized the significance of this statistic to "running a marathon but you don't start until all the other runners are at the 8 mile marker and when you cross the finish line the fastest other runner is at mile marker 12. Absolutely incredible."[194]

The economic impact of Missouri's historic preservation tax credit can especially be seen in cities like St. Louis. Downtown St. Louis has been called "the biggest turnaround story of American downtowns."[195] It "had experienced decades of decline and departure," but since the enactment of Missouri's preservation credit, "[o]ver $4 billion has been invested, 90 new retail businesses have opened, 2500 new hotel rooms have been created and 5000 new residents now call downtown St. Louis home."[196] Almost half of this investment was put toward the rehabilitation of historic buildings and a majority of the projects were historic rehabilitations.[197] Close to 100 historic buildings have been rehabilitated and more than $1 billion of private investment has gone to the "15 largest historic preservation projects" in St. Louis.[198] But St. Louis has not been the only city to benefit from the Missouri historic preservation tax credit. Small towns throughout Missouri have used the credit and have benefited from its economic impact.[199] Cities like Columbia and West Plains have both used the Missouri historic preservation tax credit to revitalize their downtowns.[200] As the citizens of Missouri analyze the historic preservation tax credit during difficult financial and economic times, they need to consider the impact that this tax credit has had on Missouri's economy and what this tax credit can do to improve Missouri's economy in the future.

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191. *Id.* at 4-5.
192. *Id.*
193. *Id.* at 5.
194. *Id.*
195. *Id.* at 7.
196. *Id.*
197. *Id.*
198. *Id.*
199. *See* EVALUATION OF THE TAX CREDIT, *supra* note 180, at 21-22. This study discusses the economic impact of the redevelopment of the Palace Hotel Office Building (formerly Palace Hotel) in Butler and the Neosho Historic Office Building (formerly Haas Wholesale Grocery) in Neosho. *Id.* at 22.
200. *Historic Preservation Tax Credits in West Plains, Missouri*, MO. DEP'T NAT. RESOURCES, http://www.dnr.mo.gov/shpo/wplains.htm (last visited Nov. 30, 2011); *Preservation Matters!*, *supra* note 89.

C. Missouri Tax Credit Review Commission

Tax credits have been used in Missouri since 1973 as incentives for businesses and individuals to perform specified activities.[201] Missouri's first tax credit, the senior citizen's property tax credit, was adopted by the General Assembly in 1973.[202] As of November 30, 2010, there were sixty-one active tax credit programs in Missouri.[203]

The various Missouri agencies and departments responsible for issuing tax credits have allowed an increasing number of tax credits over the past decade. In 1998, the State authorized a total of $102.7 million of tax credits.[204] In the fiscal year ending July 2010, the State authorized $521.5 million of tax credits.[205] There was an average annual growth of 17.4% of tax credit authorizations over this time period, while state revenue only grew at 1.2% per year.[206] Tax credit redemptions[207] increased from 1.7% of net general revenue in fiscal year 1998 to 7.7% in fiscal year 2010.[208]

Use of the historic preservation tax credit grew along with the other tax credit programs over the past several years. In 2009, the State authorized $211,950,941 in historic preservation tax credits, and $186,426,164 were redeemed.[209] As of 2010, the historic preservation tax credit program was the third largest Missouri tax credit program in tax credit authorizations, with a total of $99,510,174 in tax credits authorized.[210] The program was also the third largest in tax credit redemptions, with a total of $108,064,200 in tax credit redemptions.[211]

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201. TAX CREDIT COMMISSION REPORT, *supra* note 51, at 3.

202. *Id.*

203. *Id.*

204. TAX CREDIT COMMISSION REPORT, *supra* note 51, at 3; Editorial, *Creditworthy: Our View – Commission Takes Valuable Steps Toward Tax Incentive Reform*, ST. LOUIS POST-DISPATCH, Dec. 13, 2010, at A16 [hereinafter *Creditworthy Our View*].

205. *Creditworthy Our View*, *supra* note 204.

206. *Id.*

207. Tax credit redemptions, as opposed to authorizations, are when the tax credit is actually applied to reduce tax liability for a particular year. TAX CREDIT COMMISSION REPORT, *supra* note 51, at 51. Tax credit authorizations occur when the state initially grants the tax credit. *Id.* Thus, the impact on the state's tax revenue cash flow occurs when the tax credits are redeemed, as opposed to authorized. *See id.*

208. *Id.* at 3. For more detailed information on the growth of tax credit redemptions in comparison to Missouri's general revenue, see a chart prepared by Senate Appropriations staff in the Tax Credit Commission Report. *Id.*

209. *Id.* at 33. For a listing of yearly tax credit redemptions for the historic preservation tax credit from 2001 to 2009, see SUSAN MONTEE ET AL., REPORT NO. 2010-47, GENERAL ASSEMBLY AND SUPPORTING FUNCTIONS TAX CREDIT COST CONTROLS 14 (2010), *available at* http://tcrc.mo.gov/pdf/TCCostControls_State Auditor.pdf [hereinafter STATE AUDITOR REPORT].

210. TAX CREDIT COMMISSION REPORT, *supra* note 51, at 4.

211. *Id.*

Missouri's tax credit programs have been reviewed several times in the past. The Missouri State Auditor most recently issued a report in April 2010 that analyzed "the [S]tate's procedures to contain the costs of tax credit programs" during the five years ending June 30, 2009.[212] One of the focuses of the audit was the fact that tax credit redemptions often exceed the projected fiscal impact on the budget.[213] Although there were several factors that appeared to be the cause of inaccurate budget allocations,[214] the State Auditor recommended implementing certain cost controls to project more closely the financial impact of these tax credit programs.[215] First, the State Auditor suggested that the General Assembly add annual and/or cumulative limits to all tax credit programs, based on the State Auditor's finding that the use of annual limits on newer programs has "helped to more closely project the financial impact of those programs."[216] Second, the State Auditor recommended implementing sunset provisions[217] on each of the tax credit programs so that the General Assembly can periodically review the tax credit to see if it is achieving its intended purpose and to consider whether the funding for the tax credit should be altered.[218] Prior to this report, the State Auditor issued an audit report in February 2001, which specifically reviewed tax credits administered by Missouri's DED.[219] In the 2001 report, the State Auditor noted that information for calculating precise cost-benefit analyses of tax credit programs was either not obtained, or there were no procedures in place to verify that the information obtained was accurate.[220] In the 2010 report, the State Auditor

212. STATE AUDITOR REPORT, *supra* note 209, at 2.

213. *Id.* at 8-9.

214. *Id.* The audit report stated,

> Based upon our analysis and discussions with various officials of the agencies administering tax credit programs, there appeared to be several factors that resulted in redemptions exceeding the projected fiscal impact including 1) more businesses and or citizens participated in the tax credit program than predicted, 2) fiscal notes significantly underestimated the impact of legislative changes, 3) the amount of tax credits expected to be authorized was increased by actions of the agency administering the tax credit or state officials having authority to increase limits, 4) some fiscal notes indicated the impact was unknown, and 5) many tax credits have carry forward and carry back provisions making it very difficult to predict the timing of redemption activity.

Id.

215. *Id.*

216. *Id.* at 10-11.

217. These provisions would require the tax credit programs to terminate after a fixed number of years. *See* TAX CREDIT COMMISSION REPORT, *supra* note 51, at 54.

218. STATE AUDITOR REPORT, *supra* note 209, at 11.

219. *Id.* at 12; *see* CLAIRE MCCASKILL ET AL., REPORT NO. 2001-13, REVIEW OF STATE TAX CREDITS ADMINISTERED BY THE DEPARTMENT OF ECONOMIC DEVELOPMENT (2001), *available at* http://www.auditor.mo.gov/press/2001-13.pdf.

220. STATE AUDITOR REPORT, *supra* note 209, at 12.

referenced this 2001 report and pointed out that this problem of estimating the costs and benefits of tax credit programs has been ongoing since 2001.[221]

The tremendous growth of Missouri's tax credit programs and the inaccuracy in forecasting their effects on the state's budget spurred governmental action. In the spring of 2010, Missouri Governor Jay Nixon made an eleventh-hour effort to set a cap of $314 million on the total amount of tax credits that Missouri could authorize a year.[222] This proposition failed in the legislature.[223] As a result, Governor Nixon appointed a commission to deal with the issue of a growing tax credit program.[224]

Governor Nixon announced the creation of a Tax Credit Review Commission (Tax Commission) on July 21, 2010.[225] This Tax Commission, comprised of various business, community, and legislative leaders,[226] had the duty to review Missouri's sixty-one tax credit programs,[227] including the historic preservation tax credit, and to "make recommendations for greater efficacy and enhanced return on investment."[228] The Tax Commission held its first meeting on September 8, 2010.[229] In Governor Nixon's initial remarks to the Tax Commission, he expressed his concern that Missouri would likely have a budget gap for fiscal year 2012 of more than $400 million.[230] Additionally, he noted that government spending on tax credit programs had continued to

221. *Id.*

222. *Creditworthy Our View*, *supra* note 204.

223. *Id.*

224. *Id.*

225. *About the Commission*, MO. TAX CREDIT REV. COMMISSION, http://tcrc.mo.gov/ (last visited Nov. 30, 2011). Governor Nixon stated in the announcement:

> "Missouri must have sharp, effective development tools that will promote growth, create jobs, strengthen our communities and continue to drive our economic recovery forward . . . . This commission will perform a critical analysis to ensure taxpayers receive the greatest possible return on investment from tax credit programs and that those programs are used efficiently and effectively. The work of the commission will play a vital role in reshaping the way the state uses financial incentives to achieve those important goals."

Id.

226. For a list of those serving on the commission, see *Contact Us*, MO. TAX CREDIT REV. COMMISSION, http://tcrc.mo.gov/contactus.htm (last visited Nov. 30, 2011).

227. The three biggest tax credit programs include historic preservation, low-income housing, and senior citizens property tax. *Creditworthy Our View*, *supra* note 204. These three programs accounted for about 65% of the total tax credits redeemed in fiscal year 2010. *Id.*

228. MO. TAX CREDIT REV. COMMISSION, *supra* note 225.

229. TAX CREDIT COMMISSION REPORT, *supra* note 51, at 5.

230. *Id.*

increase in recent years, while state revenues had declined.[231] During this first meeting, the Tax Commission formed a number of subcommittees, including the historic preservation subcommittee, to analyze each of the tax credits and provide specific recommendations on each program.[232]

1. Historic Preservation Subcommittee

As part of its analysis of the historic preservation tax credit, the historic preservation subcommittee (Subcommittee) held several public meetings in which it solicited information related to the historic preservation tax credit program.[233] Sarah Coffin, Ph.D., an Associate Professor of Public Policy at St. Louis University, presented her study entitled, "An Evaluation of Missouri's Historic Preservation Tax Credit Program on Job Creation and Economic Activity," at the October 1, 2010 meeting.[234] Her study found that from 2000 to 2008, Missouri's historic preservation tax credit program generated at least 43,150 jobs, with an average salary of $42,732, and "approximately $670 million in state and local sales and income taxes."[235]

The Subcommittee also heard from two representatives of the Missouri DED: Sallie Hemenway, Director of Business and Community Services, and Alan Spell, Deputy Chief Economist.[236] Ms. Hemenway and Mr. Spell provided an overview of an economic model used by the DED to measure the economic impact of state tax credits.[237] In addition to explaining their model, Ms. Hemenway and Mr. Spell provided one example of a report that quantified "the fiscal return to the state derived from projects receiving [historic

231. *Id.*; Letter from Mo. Tax Credit Rev. Comm'n to Governor Jeremiah "Jay" Nixon (Nov. 30, 2010), *available at* http://tcrc.mo.gov/pdf/GovernorLetter_final report.113010.pdf [hereinafter Tax Commission Letter].

232. TAX CREDIT COMMISSION REPORT, *supra* note 51, at 5. The Historic Preservation Subcommittee was charged with analyzing just the historic preservation credit. *Id.* at 6. The subcommittee was made up of chairs Zach Boyers and Luana Gifford, along with other commission members Tom Reeves, Senator Matt Bartle, Mike Wood, Ray Wagner, and additional non-commission members. *Id.* For a full listing of members, see *Historic Tax Sub-committee Members*, MO. TAX CREDIT REV. COMMISSION, http://tcrc.mo.gov/pdf/HistoricSubCommitteeMembers.pdf (last visited Nov. 30, 2011).

233. SUBCOMMITTEE REPORT, *supra* note 43, at 1.

234. *Id.* Dr. Coffin's report in full can be found at the end of the Subcommittee Report. *Id.* at app. This study was published in March 2010. *Id.*

235. *Id.* at 4-5. These estimates were minimums because Dr. Coffin's economic model did "not accurately reflect the added economic impact on local entrepreneurial enterprises, or the so called 'induced' or 'indirect' economic effect" of the historic preservation credits. *Id.* at 4.

236. *Id.* at 1.

237. *Id.* at 4.

preservation] tax credits."[238] This example showed that the Drury Hotel[239] project in St. Louis provided "a return of $0.35 to state general revenue for every $1 of tax credits issued to the project under the [historic preservation tax credit p]rogram over 11 years."[240] However, Ms. Hemenway and Mr. Spell acknowledged that this report did not present a complete economic picture as it did not measure any other effect of the use of the historic preservation tax credit, such as increases in local tax collections[241] or benefits of increased private investment in the area surrounding the Drury Hotel resulting from the increased attractiveness of the hotel.[242] The Subcommittee found that

> the economic data available to the [S]tate does not satisfactorily measure the total return on investment from the [historic preservation tax credit p]rogram, and when considering the economic and social benefits derived from tax credits, the resulting economic development through rehabilitation of historic buildings provides a more than sufficient return on investment to the [S]tate of Missouri.[243]

Thus, it appears that the Subcommittee rejected the DED's economic analysis and relied more heavily on Dr. Coffin's study.

The Subcommittee also focused on the alleged problems with the current historic preservation tax credit program.[244] First, the Subcommittee analyzed the fiscal impact of the tax credits and discussed the unpredictability of this impact on Missouri's annual budget.[245] Much discussion took place around the current $140 million annual cap.[246] The DED presented data showing that in fiscal years 2007, 2008, 2009, and 2010, there were a total of $128,334,638, $170,058,700, $211,950,941, and $99,510,175 authorized tax credits, respectively.[247] The DED noted that the amount of historic preservation tax credits authorized in 2010 were well below the annual cap, and that

238. *Id.* The Subcommittee stressed that this was the only report provided by the DED quantifying the economic impact of the historic preservation tax credit. *Id.*

239. This is the Drury Hotel in downtown St. Louis on 4th Street. *Id.* at app.

240. *Id.* at 4.

241. *Id.* at 4-5. This would include increases in property taxes as well as tax on the additional income generated by the Drury Hotel and other neighboring businesses. *Id.*

242. *Id.*

243. *Id.* at 5.

244. *Id.*

245. *Id.*

246. *Id.* at 5-6.

247. *Id.*

although the DED could not provide estimates for fiscal year 2011, it believed that the $140 million cap would not be reached.[248]

The Subcommittee also discussed the discrepancy between the amount of tax credits allowed under Missouri's rehabilitation program compared with programs in other states.[249] The Subcommittee noted that Iowa had a $75 million annual cap and Massachusetts had a $50 million cap.[250] On the other hand, the legislatures in both Kansas[251] and Minnesota[252] recently approved an uncapped program.[253]

Additionally, the Subcommittee considered the "entitlement" nature of the historic preservation tax credit program.[254] That is, the DED has no discretion as to whom it will issue the tax credits, as long as all the specified requirements for the tax credits are met.[255] The Subcommittee heard from several professional developers on this issue, as well as the DED, and the Subcommittee found that it was critical that the historic preservation tax credit program be designed as an "entitlement" in order for the program to be successful.[256] Because historic preservation projects often take several years to complete, it is essential that developers know that at the end of the project, they will receive a tax credit.[257]

In assessing the structure of Missouri's historic preservation tax credit program, the Subcommittee considered a report by the National Trust for Historic Preservation (National Trust Report).[258] This report discussed two factors that severely limit the effectiveness of state historic tax credits: a cap on the amount of the credit that may be authorized and a lack of transferability.[259] Additionally, the National Trust Report stated that most effective historic preservation tax credit programs allow a tax credit of 20 to 30% of qual-

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248. *Id.* at 6.

249. *Id.*

250. *Id.*

251. *See* KAN. STAT. ANN. § 79-32,211 (Supp. 2010).

252. *See* MINN. STAT. ANN. § 290.0681 (West, Westlaw through end of the 2011 1st Special Sess.).

253. SUBCOMMITTEE REPORT, *supra* note 43, at 6. Minnesota used Missouri's pre-2009 (before the annual cap was put in place) historic preservation tax credit program as a model for its own program. *Id.*

254. *Id.*

255. *Id.*

256. *Id.*

257. *See id.*

258. *Id.* at 7.

259. *Id.* The ABA study also found that program caps and transferability greatly affected the success of an historic preservation tax credit program. Schwartz, *supra* note 36, at 1037.

ified rehabilitation expenditures.[260] Because the Subcommittee found that Missouri's historic preservation tax credit program fits these characteristics,[261] it concluded that the historic preservation tax credit is "a successful program as currently designed, and is the model program for states around the nation seeking to implement historic tax credit programs."[262] Although the Subcommittee essentially found Missouri's historic preservation tax credit program to be an effective tax credit program based on various studies and reports presented to it, the Subcommittee still proposed a few recommendations.

2. Historic Preservation Subcommittee Recommendations

After much discussion, the Subcommittee proposed certain modifications to Missouri's historic preservation tax credit program in order "to address the legitimate concerns over the unpredictable impact of the [p]rogram on the state budget."[263] The Subcommittee recommended that the annual program cap remain at its current level of $140 million, based on the belief that "a reduction would not result in any significant positive impact to the state budget, and the lack of any meaningful history since the cap was put in place."[264] Additionally, to enhance budget predictability, it suggested that the carryback feature of the credit be reduced from three years to one year, and that the carryforward feature be reduced to five years for any credit transferred in accordance with state law.[265] Any credit retained by the original taxpayer to whom it was issued could continue to be carried forward ten years.[266]

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260. SUBCOMMITTEE REPORT, *supra* note 43, at 7. This study also found this range of qualified expenditures to be an appropriate amount for the historic preservation tax credit. Schwartz, *supra* note 36, at 1038.

261. The Subcommittee noted that although there is a $140 million annual cap, that because the cap was not met in 2010 and was not likely to be met for several years, that the cap would not hinder the effectiveness of the program. SUBCOMMITTEE REPORT, *supra* note 43, at 6. Missouri's tax credit program allows the transfer of historic preservation tax credits and provides a credit of 25% of qualified rehabilitation expenditures. *See supra* Part II.B.

262. SUBCOMMITTEE REPORT, *supra* note 43, at 7.

263. *Id.* The members of the Subcommittee were not in 100% agreement. *Id.* Some thought the historic preservation tax credit program would be best left unchanged. *Id.* Others supported modest changes, such as a slight reduction in the annual cap or a slight reduction in amount of the credit expressed as a percentage of qualified rehabilitation expenditures. *Id.* Still others advocated for a complete overhaul of the tax credit program. *Id.*

264. *Id.* at 8.

265. *Id.* Missouri's current program allows historic preservation tax credits to be carried back three years and carried forward ten years. MO. REV. STAT. § 253.557.1 (2000).

266. SUBCOMMITTEE REPORT, *supra* note 43, at 8.

The Subcommittee also recommended that qualified rehabilitation expenditures no longer include "deferred developer fees paid out of future cash flow beyond the qualifying construction period."[267] The rationale for this modification was that it "will eliminate the risk that credits are issued for costs not incurred due to defaults of projects and will reduce costs to the state."[268]

Additionally, the Subcommittee recommended that the percentage of qualified rehabilitation expenditures that may be claimed as a credit be reduced from 25 to 20% for projects in which the historic preservation credit is being used along with the state low-income housing tax credit.[269] This recommendation was made to address the criticism that some projects that are not commercially viable are being undertaken simply because a developer can stack multiple state tax credits to generate the necessary financing.[270] Also included in this recommendation was the suggestion that the percentage should otherwise remain at 25%, with the exception of projects using the low-income housing tax credit as mentioned above.[271] The Subcommittee also suggested reducing the owner-occupied per-project tax credit cap of $250,000 to $150,000.[272] Finally, the Subcommittee listed several issues that needed further discussion and consideration by the DED to make the historic preservation tax credit program more efficient.[273]

The Subcommittee approved its final report by a vote of thirteen to three with five members absent.[274] However, as discussed in the next section, the Tax Commission as a whole did not adopt all of the Subcommittee's recommendations.

3. Tax Credit Commission Recommendations

The Tax Commission made both general recommendations that applied to all of the tax credit programs, along with specific recommendations for each tax credit program. The Tax Commission recommended eliminating or not reauthorizing twenty-eight tax credit programs because they had "outlived

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267. *Id.* Missouri's current program allows developer fees to be included in qualified rehabilitation expenditures. *Id.*; *see* FINAL APPLICATION AND GUIDELINES, *supra* note 39, at 14. Often developer fees are deferred and paid out as the project generates cash flow. SUBCOMMITTEE REPORT, *supra* note 43, at 8.

268. SUBCOMMITTEE REPORT, *supra* note 43, at 8.

269. *Id.* at 9.

270. *Id.*

271. *Id.*

272. *Id.*

273. *Id.* at 9-10. These issues included the list of qualified rehabilitation expenditures, timing of qualified rehabilitation expenditures, requirements for preliminary approval, small deal exemption, excess certificates, appeals process, and issuance fee. *Id.* at 10-11.

274. *Id.* at 2.

their usefulness and do not create a justifiable benefit in relation to their cost to taxpayers."[275] Additionally, rather than have an annual appropriation process, the Tax Commission recommended that all tax credit programs be subjected "to review by the General Assembly according to an orderly sunset schedule."[276] Also, the Tax Commission proposed that all tax credit programs be subjected to a statutory cap to enhance budget certainty for the state.[277]

In a close vote of eleven to nine,[278] the Tax Commission decided that Missouri's historic preservation tax credit program needed to be cut back.[279] It recommended to Governor Nixon that the annual cap on the historic preservation tax credit program be drastically reduced from $140 million per year to $75 million per year.[280] This new annual cap would be permanent and

275. Tax Commission Letter, *supra* note 231.

276. *Id.* The Tax Commission suggests that the historic preservation tax credit be subjected to a six-year sunset provision. TAX CREDIT COMMISSION REPORT, *supra* note 51, at 10.

277. Tax Commission Letter, *supra* note 231.

278. Tim Logan, *Historic Tax Credit Could Face Big Cut*, ST. LOUIS POST-DISPATCH, Nov. 18, 2010, at A1, *available at* http://www.stltoday.com/business/article_68845b6c-c276-5bb0-866a-a98520e4c3d4.html. [hereinafter *Historic Tax Credit*]. Most of the votes in favor of the cut came from conservative legislators and representatives of education groups. *Id.* The votes against the reduction came from representatives of both the development industry and the St. Louis region. *Id.*

279. *See* Tim Logan, *State Commission Recommends Sharp Cuts to Historic Tax Credit*, ST. LOUIS POST-DISPATCH, Nov. 17, 2010, http://www.stltoday.com/business/columns/building-blocks/state-commission-recommends-sharp-cuts-to-historic-tax-credit/article_9c31ad16-f272-11df-8a66-00127992bc8b.html [hereinafter *Commission Recommends Sharp Cuts*]. As for the other sixty tax credit programs, the Tax Commission recommended ending twenty-eight of the programs. *Creditworthy Our View*, *supra* note 204. These programs that were recommended for elimination included tax credit programs that were focused on narrow interests such as film production, wine growing, and charcoal production. *Id.* The justification for elimination was that these programs were either no longer relevant to the state economy or their economic returns did not justify their costs. *Id.*

280. TAX CREDIT COMMISSION REPORT, *supra* note 51, at 34; *Commission Recommends Sharp Cuts*, *supra* note 279. The Historic Preservation Subcommittee that studied the historic tax credit for the rest of the Tax Commission rejected the proposition of a cap in subcommittee. *Historic Tax Credit*, *supra* note 278. However, they were outvoted when the whole Tax Commission met to vote. *See id.* The Tax Commission also recommended transition rules for implementing the new annual cap, so as to not harm projects that were currently underway and relying on the use of the historic tax credit. TAX CREDIT COMMISSION REPORT, *supra* note 51, at 34. The recommendations allowed that "certain distressed projects and projects where significant funds [had already] been expended [to be] 'grandfathered' under the new annual cap." *Id.* at 34-35. Additionally, the Tax Commission's recommended transition rules required historic preservation tax credit applicants to meet an "expenditure test"

would not be adjusted based on increases or decreases in state revenue.[281] Moreover, the new annual cap would cover all activity under the tax credit program, not just projects that used more than $275,000 in historic tax credits.[282]

Additionally, the Tax Commission recommended that non-income producing personal residences be limited to a $50,000 tax credit[283] and that, to qualify for the credit, the personal residence must have been originally purchased for less than $150,000.[284]

Finally, the Tax Commission made recommendations concerning the use of the historic preservation tax credit with other economic development tax credits.[285] The Tax Commission recommended that the General Assem-

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to be subject to the old $140 million annual cap. *Id.* at 35. Under the "expenditure test,"

> applicants must evidence that they have incurred eligible rehabilitation costs and expenses in the particular project which exceed the lesser of (i) fifteen percent (15%) of the total estimated development costs for the project, or (ii) Three million dollars ($3 million). The expenditure test presumes that qualifying rehabilitation expenses incurred before state approval may be counted, a potential administrative change to the program that the Department of Economic Development has agreed to meet with representatives of the historic preservation community to discuss.

Id. In addition to meeting the "expenditure test" to remain subject to the old $140 million annual cap, the applicant must also meet any of the following criteria:

> 1. The project contemplates rehabilitation of property owned by a developer as of December 31, 2010, where such developer has also met the above-described Expenditure Test prior to that date; or
>
> 2. The project contemplates rehabilitation of property foreclosed upon by financial institutions (or foreclosure equivalent such as deed in lieu) where the financial institution owned such property before December 31, of 2010, and the developer foreclosed upon had, prior to the date of foreclosure, met the Expenditure Test; or
>
> 3. The project contemplates the rehabilitation of property foreclosed upon by financial institutions, where the financial institution transferred such property to a political subdivision (or any agency thereof) prior to December 31, 2010, and the developer foreclosed upon had, prior to the date of foreclosure, met the Expenditure Test.

Id. Lastly, the Tax Commission recommended that any taxpayer applying for the historic preservation tax credit after July 1, 2011, would be subject to the new annual cap of $75 million. *Id.*

281. TAX CREDIT COMMISSION REPORT, *supra* note 51, at 34.

282. *See id.*

283. TAX CREDIT COMMISSION REPORT, *supra* note 51, at 35. In other words, a 25% credit would be allowed for $200,000 in expenditures.

284. *Id.*

285. *See id.*

bly prohibit stacking[286] the historic preservation tax credit with the neighborhood preservation tax credit.[287] Additionally, the Tax Commission recommended prohibiting the use of the historic preservation tax credit and the low income housing credit "in the same project (anti-stacking), except on housing projects using the tax exempt bond only (without the State Low Income Housing 4% Tax Credit program)."[288] The Tax Commission justified these recommendations based on its finding that even with a $75 million annual program cap, the historic preservation tax credit would still result in over $3 billion in development over the next six years.[289]

D. A Continuing Debate Over Missouri's Historic Preservation Tax Credit

Some legislators support the Tax Commission's recommended cuts to the historic preservation tax credit program, claiming that if Missouri did reduce the annual program cap to $75 million per year, Missouri would still have the largest historic tax credit program in the nation.[290] Others support the cut by claiming it is financially necessary to balance the budget.[291]

Another contentious budget issue is the allocation of tax revenue. Some argue that tax dollars should be shifted from tax incentives for real estate development to new priorities, such as worker training and small-business development.[292] They criticize development incentives, such as the historic preservation tax credit, because it allegedly does not "create permanent, high-paying jobs" like other tax incentive programs.[293] Additionally, some argue that tax dollars used to support real estate development would be better spent in developing new, small businesses and developing a smarter workforce.[294]

286. Stacking typically refers to the use of multiple tax credits for the same development project. SUBCOMITTEE REPORT, *supra* note 43, at 9. Essentially, this gives the developer more financing from the state.

287. TAX CREDIT COMMISSION REPORT, *supra* note 51, at 35. For more details on the low income housing credit and the Tax Commission's recommendations, see *id.* at 37-44.

288. *Id.* at 35.

289. *Creditworthy Our View*, *supra* note 204.

290. *See Commission Recommends Sharp Cuts*, *supra* note 279.

291. *See id.*

292. Tim Logan, *Developing Our Economy: Ideas Include Redirecting Incentives, Aiding Startups, Training Work Force*, ST. LOUIS POST-DISPATCH, Nov. 16, 2010, at A7 [hereinafter *Developing Our Economy*].

293. *See id.* Logan insinuates that a lower cap on the historic tax credit program is justified because there are already lower caps on other programs that help to directly create jobs, such as the Missouri Quality Jobs Program, which "waives withholding taxes for companies that add employees with better-than-average wages and health insurance." *See id.* The Quality Jobs' budget is currently $80 million, compared with the $140 million cap on the historic tax credit program. *Id.*

294. *Id.*

Tim Logan, a journalist for the St. Louis Post-Dispatch, wrote in one article of his series "Can St. Louis Compete?," "While great buildings and a happening downtown might make St. Louis a bit more attractive to smart workers who can live where they choose, buildings themselves do little to boost the region's skill set. And with a tight budget, there's only so much money to go around."[295]

Education is another area that has seen cuts in funding, and Governor Nixon, in his drive for tax credit reform, "has pitted education against economic development" in a competition for state dollars.[296] Critics argue that this should not be a choice.[297] Economic development and education are strongly linked; there must be a skilled workforce and new companies to fill the buildings being built by developers.[298] Yet, some of these critics argue for diverting some of the money being used for development financing to tax credits to employers for job training.[299]

Those opposing the reduction in the historic preservation tax credit point to the success the historic tax credit has had in the redevelopment of places like downtown St. Louis[300] and the credit's effect on job creation.[301] They argue that if the credit is cut, there will be a loss in economic activity in the next three to five years.[302]

IV. PROPOSAL

A. Proposal to Amend the Missouri Historic Preservation Tax Credit Statute

This article makes several proposals to amend the current Missouri historic preservation tax credit program. First, the General Assembly should remove the annual program cap of $140 million by eliminating section

295. *Id.* Tim Logan and David Nicklaus, of the St. Louis Post-Dispatch, pointed out Missouri's shortcomings in their "Can St. Louis Compete?" series published during 2010. *See Can St. Louis Compete?*, STLTODAY.COM, http://www.stltoday.com/news/special-reports/compete/ (last visited Dec. 1, 2011).

296. *Developing Our Economy*, *supra* note 292.

297. *Id.*

298. *Id.*

299. *See id.* ("Missouri has programs that give tax credits to employers for job training. . . . But much more money for these programs sits in the incentives we use now to finance building.").

300. Jeff Rainford, Chief of Staff to St. Louis Mayor Francis Slay, in referring to the historic tax credit, stated, "This is one of the most important tools we have for revitalizing our city." *Historic Tax Credit*, *supra* note 278 (internal quotation marks omitted).

301. *See Commission Recommends Sharp Cuts*, *supra* note 279.

302. *Id.*

253.550.2 in its entirety.[303] An annual cap is one of the biggest deterrents to an effective historic preservation tax credit program.[304] An annual cap not only limits the number of redevelopment projects that are undertaken, but it also discourages many attempts at redevelopment because of the uncertainty in achieving the necessary financing via the historic preservation tax credit.

Second, the historic preservation tax credit should be refundable when the taxpayer is an individual homeowner using the tax credit to rehabilitate a non-income producing property. There should be no requirement that the home have been originally purchased for less than a specified amount.[305] A maximum purchase price requirement such as this would severely limit the number of homes that would be eligible for the historic preservation tax credit. As a result, there would be fewer city neighborhoods, such as Forest Park Southeast in St. Louis, that would make a "comeback."[306] Finally, the General Assembly should eliminate the per project cap of $250,000 in tax credits for these owner-occupied residential projects.

Third, the historic preservation tax credit should continue to be able to be carried back to apply to any of the three years preceding the issuance of the tax credit and carried forward ten years after the year of issuance. This feature enhances the transferability of the tax credit, and transferability has been found to be one of the essential factors of a successful historic preservation tax credit program.[307]

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303. MO. REV. STAT. § 253.550.2 (Supp. 2010). Because this Comment proposes the elimination of section 253.550.2, it also proposes the elimination of section 253.550.4, which provides that certain taxpayers are exempt from section 253.550.2. *See id.* § 253.550.4.

304. *See generally* NATIONAL TRUST REPORT, *supra* note 35; Schwartz, *supra* note 36; Rypkema, *supra* note 1.

305. The Tax Commission proposed the requirement that the home have been originally purchased for less than $150,000. TAX CREDIT COMMISSION REPORT, *supra* note 51.

306. *See* EVALUATION OF THE TAX CREDIT, *supra* note 180, at 23. This study compared various statistics to show how Missouri's historic preservation tax credit transformed the Forest Park Southeast neighborhood. *Id.* In 2000, before developers began investing in Forest Park Southeast, the neighborhood had a 48% vacancy rate and a $56,316 median housing value. *Id.* In 2008, after considerable developer investment, there was a 21% vacancy rate and a $93,723 median housing value. *Id.* Additionally, once redevelopment of historic homes improved the local housing market, developers began investing in the neighborhood with new construction in fills. *Id.* The study explains that, "[t]he tax credits allowed [the developers] to leverage equity they otherwise did not have in these risky neighborhoods." *Id.* Thus, the historic preservation tax credit can create a catalyst for development activity in city neighbors in two ways: it creates a market where one did not previously exist and it stabilizes neighborhoods. *Id.*

307. *See* NATIONAL TRUST REPORT, *supra* note 35, at 3; Schwartz, *supra* note 36, at 1038-39; Rypkema, *supra* note 1, at 1.

Finally, the tax credit should remain at 25% of qualified rehabilitation expenditures. The most effective historic preservation tax credit programs have been in the range of 20 to 30%;[308] thus, 25% will allow Missouri to continue to maintain a successful historic preservation tax credit program.

B. Potential Criticism of the Proposal

There are many who believe that an annual cap on the historic preservation tax credit program is not only necessary, but needs to be decreased from its current level of $140 million.[309] The argument that an annual cap will not deter development because there was less than $100 million of authorized historic preservation tax credits in fiscal 2010 is unsubstantiated. The number of authorized historic preservation tax credits steadily increased in the three years preceding 2010.[310] There are a number of possible reasons for the decline in tax credits authorized in 2010. First, House Bill 191 made the $140 million annual cap effective halfway through fiscal year 2010.[311] The cap in and of itself is a deterrence to rehabilitation efforts because of the uncertainty of receiving funding.[312] Also, because the program cap only applied to projects receiving tax credits of over $275,000,[313] any large projects that were deterred from being brought into existence would have significantly affected the number of authorized credits.[314] Second, Missouri's economy and real estate market were still in a slump during fiscal year 2010, and thus many rehabilitation projects were likely not financially feasible. Because there are other possible causes for the decline in the number of authorized tax credits, the low number of authorized credits cannot be used to support a lower annual program cap.

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308. *See* NATIONAL TRUST REPORT, *supra* note 35, at 3; Schwartz, *supra* note 36, at 1038.

309. *See supra* Part III.C.3.

310. *See* SUBCOMMITTEE REPORT, *supra* note 43, at 5-6. For fiscal years 2007, 2008, and 2009, there were a total of $128,334,638, $170,058,700, and $211,950,941 tax credits authorized. *Id.*

311. H.B. 191, 95th Gen. Assemb., 1st Reg. Sess. (Mo. 2009). For the second half of fiscal year 2010, beginning January 1, 2010, a $70 million annual program cap was put in place for projects receiving tax credits of more than $275,000. *See id.* The full $140 million annual program cap was effective at the beginning of fiscal year 2011, as of July 1, 2010. *See id.*

312. A developer might not even apply for the historic preservation tax credit because he thinks that he might not be eligible, because the annual program cap had already been reached for the year, or is not worth the time and effort he must put into the tax credit application.

313. *See supra* note 74 and accompanying text.

314. For example, if there were ten projects that were deterred, each requiring approximately $10 million of private investment, that would amount to $25 million in tax credits that were not authorized.

One of the biggest criticisms of eliminating an annual cap on the historic preservation tax credit is the "unpredictable impact of the [p]rogram on the state budget."[315] Missouri's budget is a legitimate concern, and it is true that tax credits are a substantial portion of net general revenue.[316] Moreover, the historic preservation tax credit program is the third-largest tax credit program in Missouri.[317] However, a successful tax credit program should not be cut or reduced when that program is spurring economic development, especially when the economy is in need of a boost. Millions of dollars of private investment have found their way into Missouri's economy because of the historic preservation tax credit program.[318] But there is more to the program than private investment. The increase in property value of the redeveloped property, along with the value of neighboring properties, must be factored into the equation.[319] When all of these economic benefits are considered, Missouri's historic preservation tax credit program pays for itself.[320]

Additionally, the imposition of an annual cap on the historic preservation tax credit program will result in a loss of revenue to Missouri. First, there is the tax on the income of a laborer hired to rehabilitate a building. Second, when the laborer spends his earned wages at the grocery store, there is a tax on the grocery store's income. Additionally, there is the indirect sales and income tax on the general increase in business in the area surrounding the rehabilitated building. From 2000 to 2008, $670 million in state and local sales and income tax resulted from the historic preservation tax credit.[321] One might argue that this tax revenue is insignificant considering that in the past four years more than $600 million in historic preservation tax credits were authorized; however much of this tax revenue resulting from the historic preservation tax credits will continue into the future.

Some have made the argument that Missouri already has the most generous historic preservation tax credit program in the country, and thus a smaller program will not hurt Missouri.[322] However, it is possible that Missouri has the most generous historic preservation tax credit program in the

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315. SUBCOMMITTEE REPORT, *supra* note 43, at 7; *see* STATE AUDITOR REPORT, *supra* note 209, at 4 (suggesting that an annual program cap ought to be implemented for budgetary certainty).

316. Tax credits in general accounted for 7.7% of Missouri's net general revenue in 2010. TAX CREDIT COMMISSION REPORT, *supra* note 51, at 3.

317. *Id.* at 4.

318. *See supra* Part. III.B.

319. *See* Rypkema, *supra* note 1, at 8.

320. *See* EVALUATION OF THE TAX CREDIT, *supra* note 180, at 26.

321. SUBCOMMITTEE REPORT, *supra* note 43, at 4. Additionally, Dr. Coffin noted that this number was a minimum because her "economic modeling does not accurately reflect the added economic impact on local entrepreneurial enterprises, or the so called 'induced' or 'indirect' economic effect" of the historic preservation tax credit program. *Id.*

322. *See supra* Part II.B.

country because it needs this tax credit program and puts it to good use. When the federal historic preservation tax credit program was initially enacted, Missouri was one of the biggest users of the rehabilitation credit.[323]

Budgetary concerns seem to be the strongest argument for the Tax Commission's proposed reduction of the per-project cap on owner-occupied residences from $250,000 to $50,000, and the additional requirement that the home be originally purchased for less than $150,000.[324] Both of these recommendations would destroy the purpose of the historic preservation tax credit program.[325] A homeowner is not likely to put a significant effort into rehabilitating an old home if he is only allowed a credit of 25% of up to $200,000 in qualified rehabilitation expenditures. Many old buildings that would require much more than $200,000 to significantly rehabilitate will never be redeveloped. A similar argument can be made for not having the original purchase requirement. Many old homes have been purchased for more than $150,000, and the value of the home might have been based on the location rather than the physical condition of the building. These homes will not be eligible for the credit and, as a result, might not be redeveloped.

Finally, many argue that Missouri's historic preservation tax credit program should be reduced or cut because the only beneficiaries of the program are the major metropolitan cities of St. Louis and Kansas City. While it is true that on a dollar-by-dollar basis, most historic preservation tax credits go to applicants from St. Louis and Kansas City, those are not the only cities benefiting from the program.[326] Many applicants in other cities, such as Columbia and West Plains, have also used the credit to redevelop their downtown areas.[327] Missouri's historic preservation tax credit program is used in 42 of the 115 – 37% – of Missouri counties.[328] "Not all counties have taken advantage of [this] program, but there are tens of thousands of potentially historic properties" in Missouri that could be rehabilitated.[329]

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323. Miles, *supra* note 16, at 12. From 1982 to 1988, more than $745 million was invested in Missouri historic preservation projects. *Id.* The amount of this investment made Missouri "one of the leading states in the nation using the rehabilitation credits." *Id.*

324. *See supra* Part III.C.3.

325. The purpose is to provide property owners an incentive to rehabilitate and preserve old buildings, rather than letting them go to waste or tearing them down and putting up new construction. *See supra* notes 305-06 for a discussion of the positive economic effects of the historic preservation tax credit when it is used to redevelop homes in a city neighborhood.

326. *See* EVALUATION OF THE TAX CREDIT, *supra* note 180, at 1.

327. *Historic Preservation Tax Credits in West Plains, Missouri*, *supra* note 200; *Preservation Matters!*, *supra* note 89.

328. EVALUATION OF THE TAX CREDIT, *supra* note 180, at 1.

329. *Id.* at 2.

V. CONCLUSION

Putting a cap on the historic preservation tax credit for budgetary reasons is extremely short-sighted. From the time the historic preservation tax credit was created until House Bill 191 went into effect on January 1, 2010, Missouri's historic preservation tax credit program did not have an annual cap. The program was so successful in spurring economic development and improving run-down, historic buildings that several other states created their own historic preservation tax statutes in order to emulate Missouri's success.[330] These states used Missouri's historic preservation tax credit statute as a model for their own and did not impose annual caps on their programs.[331]

Although the Tax Commission recommended an annual cap of $75 million because of budget concerns, it did recognize that the "[r]enovation of historic structures positively impacts local tax collections from property, sales, and income taxes, and benefits an area from increased attractiveness, further investment and, lower crime rates related to higher-visibility/higher use areas."[332] The benefits of the historic preservation tax credit program clearly outweigh its cost to the state.

330. SUBCOMMITTEE REPORT, *supra* note 43, at 5-6.

331. *See id.*

332. TAX CREDIT COMMISSION REPORT, *supra* note 51, at 33.