**Opinion Letter**

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| **Letter Number:** | **O-2001-025** |

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| **Tax Type:** | **Corporate Income Tax; Individual Income Tax** |
| **Brief Description:** | **Historic preservation tax credit.** |
| **Keywords:** |  |
| **Approval Date:** | **11/19/2001** |

**Body:**

Office of Policy & Research  
  
  
November 19, 2001

XXXXX  
XXXXX  
XXXXX  
  
  
  
Dear XXXXX:  
  
I have been asked to respond to your letter of November 1, 2001 regarding the new state rehabilitation tax credit.  
  
In your letter you have posed the following questions:  
  
1. Transferability  
Is the state rehabilitation tax credit transferable? The Missouri credit, on which the Kansas credit was based, is transferable. It can be bought, and sold. The federal rehabilitation tax credit (IRS Section 47), on which the Kansas credit is also based, is allocated based upon an ownership percentage. Investors tell us that allocating the credit based upon ownership percentage would make the credit ineffective as the investors with whom they partner on large projects – those who have a federal tax liability – do not have a Kansas tax liability.  
  
Kansas Department of Revenue Response:  
Kansas law does not provide for the transfer of the rehabilitation tax credit under K.S.A. 79-32, 211. K.S.A. 79-32,211 provides an income tax credit for a “qualified taxpayer” that makes qualified expenditures in the restoration and preservation of a qualified historic structure pursuant to a qualified plan.  
  
Qualified taxpayer is defined as the owner of the qualified historic structure or any other person who may qualify for the federal rehabilitation credit allowed by section 47 of the federal internal revenue code.  
  
Therefore the owner of the structure or any other person who qualifies for the federal rehabilitation credit shall be eligible for the state rehabilitation tax credit. While the Kansas rehabilitation tax credit statute does not address when the owner or the entity is a partnership, S

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corporation, LLC or some other entity in which the income or loss flows down, the Kansas Department of Revenue has determined with other tax credits that the credit shall be allocated to each partner, shareholder, or member based upon their ownership percentage in the legal entity. We will apply the same approach with this tax credit.  
  
2. Bifurcation  
Can the state tax credit be bifurcated? State rehab tax credits in many other states are “bifurcatable.” This means that some investors could take advantage of the federal rehabilitation tax credit and others could take advantage of the state tax credit. A development firm which was actively involved in getting the legislation passed provided the following quote with their view on the issue:

“The basis of our presentations to the Kansas Legislature was that the ‘ownership’ of the State Historical Preservation Tax Credits (HPTC) could be allocated among the owners of the property being preserved. For example, assume the property in question is owned by a Limited Partnership, the limited partners of which are the purchasers of the Federal HPTC and of the State HPTC. The Limited Partnership Agreement could allocate the ownership of the Federal HPTC between the General Partners and the Class A Limited Partners. It also could allocate the ownership of the State HPTC between the General Partners and the Class B Limited Partners. The two classes of Limited Partners have different investment goals and, consistent with Kansas law, can be provided different treatments…without the ability to sell those state tax credit, few if any, developers will be able to help the Kansas Legislature accomplish the intended economic stimulus.”

Another developer noted that “other states allow for state credits to be stripped from the partnership and sold for the highest price, thereby providing the highest economic benefit from this state resource.” In our presentations to the legislature, we noted that Kansas was losing developer dollars to Missouri where a state tax credit made rehab more economically feasible. One developer told us that they were able to find an investor for a project in Kansas but since that investor did not have a Kansas tax liability, they would opt not to use the state credit.  
  
Kansas Department of Revenue Response:  
Many of the current tax credit statutes specifically provide that if “the company is a corporation having an election in effect under subchapter S of the federal internal revenue code, a partnership or a limited liability company, the credit provided by this section shall be claimed by the shareholders of such corporation, the partners of such partnership or the members of such limited liability company in the same manner as such shareholders, partners or members account for their proportionate shares of income or loss of the corporation, partnership or limited liability company”. Absent this type of language, the Department has been consistent in applying any tax credits earned by a flow through entity to the partners, shareholders, or members based on their ownership percentage.

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3. Privilege Tax versus Income Tax  
When we wrote the legislative proposal, we assumed that local banks would be able to invest in rehabilitation projects. We have since learned that banks and insurance companies pay privilege tax rather than income tax. Is there any way, under the current statute and tax laws, that banks and insurance companies could take advantage of the rehabilitation tax credit?  
  
Kansas Department of Revenue Response:  
K.S.A. 79-32,211(a) provides in part,

“…**there shall be allowed a tax credit against the income tax liability imposed upon a taxpayer pursuant to the Kansas income tax act** in an amount equal to 25% of qualified expenditures incurred in the restoration and preservation of a qualified historic structure …” (emphasis added)

As provided under the current statutory language, only income taxpayers are eligible to take advantage of the rehabilitation tax credit. As you have stated, banks and insurance companies pay a privilege or premium tax rather than an income tax. To remedy this situation, amendments will need to be made to current statutory language to allow for privilege taxpayers and insurance taxpayers to take advantage of the credit.  
  
If I may be of further assistance, please contact me at your earliest convenience.  
  
Sincerely,  
  
  
  
Kathleen M. Smith  
Tax Specialist, Office of Policy and Research  
  
  
**Date Composed: 11/20/2001 Date Modified: 11/20/2001**