

# A review of fiscal measures to benefit heritage conservation

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## Sixty second summary

Although they will vary in age and style from country to country, all countries possess buildings which are regarded as being integral parts of their heritage, worthy of protection and conservation. However, their continued existence cannot be taken for granted – many of them are in private ownership and they are constantly under threat from demolition by neglect to demolition to make way for new development. It is, however, generally thought to be a 'good thing' to try to devise some means by which heritage buildings can be conserved. A prime means by which this is done is through funding measures from government – offering some form of financial support or concession to the owners of these buildings.

With funding from the RICS Education Trust, Rob Pickard of Northumbria University and Tracy Pickerill of the Dublin Institute of Technology explored the use of fiscal incentives for heritage conservation in a range of countries in Europe and North America. The main incentives are:

- Income tax deductions and credits for costs incurred in heritage conservation activity;

- Income tax credits for the provision of social housing in heritage buildings;
- Property tax exemption, abatement or freeze for heritage buildings;
- Value added (sales) tax concessions or rebates relating to heritage conservation activity;
- Use of tax systems to provide an incentive to donations and corporate sponsorship activity through the establishment of heritage trusts and foundations;
- Inheritance, gift and capital gains tax exemptions and concessions.

A key message to emerge from this is that fiscal measures have a key role to play in heritage conservation, by providing incentives to owner-occupiers, investors and developers without requiring actual expenditure by government. The multiplier effects of expenditure on heritage conservation means that the income foregone by government in providing these incentives can be recouped through increased tax revenue, through the positive impact that heritage conservation has on neighbourhood revitalisation.



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## Introduction

Although they will vary in age and style from country to country, all countries possess buildings which are regarded as being integral parts of their heritage, worthy of protection and conservation. However, their continued existence cannot be taken for granted – many of them are in private ownership and they are constantly under threat from demolition by neglect to demolition to make way for new development. It is, however, generally thought to be a 'good thing' to try to devise some means by which heritage buildings can be conserved. A prime means by which this is done is through funding measures from government – offering some form of financial support or concession to the owners of these buildings.

These mechanisms for the conservation of the architectural heritage can be regarded as being either direct or indirect tools of government action. A direct incentive, such as grant aid, involves a government body directly transferring money to private owners to finance (or part finance) a conservation activity. An indirect incentive, such as a tax incentive, does not involve a direct transfer of money and no state expenditure is recorded.

With funding provided by the RICS Education Trust, Rob Pickard and Tracy Pickerill examined these indirect incentives in Western Europe (Belgium, Denmark, France, Germany, Ireland, Italy, Netherlands, Spain and the United Kingdom) and North America (Canada and USA), to see how they are used



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## Indirect fiscal incentives to encourage private investment in the architectural heritage – what are they?

What are the main forms of indirect funding incentives that can be used for encouraging the flow of private investment funds into heritage conservation activity? They are:

- Income tax deductions and credits for costs incurred in heritage conservation activity
- Income tax credits for the provision of social housing in heritage buildings
- Property tax exemption, abatement or freeze for heritage buildings
- Value added (sales) tax concessions or rebates relating to heritage conservation activity
- Use of tax systems to provide an incentive to donations and corporate sponsorship activity through the establishment of heritage trusts and foundations
- Inheritance, gift and capital gains tax exemptions and concessions.



## Summary of comparative fiscal funding mechanisms

### Income tax deductions and credits

With the exception of the United Kingdom and Canada, all the countries examined allow the cost of repairs and maintenance to protected heritage structures to be offset against income tax deductions. It should be noted however that the UK government has recently acknowledged that there may be a case for limited relief set against income for private owners for the maintenance of historic buildings, and the case for such incentives has also been made in Canada. Eligibility requirements to enable owners to benefit from income tax deductions vary greatly from country to country with regard to public access requirements, the quality of work undertaken and allowable additional expenses (such as acquisition costs, insurance, alarm installation and provision of modern utilities). Variations also apply in relation to owner occupied and rented property. Some countries allow additional expenses such as acquisition costs, management expenses for rented property, public liability insurance and alarm installation to be offset against income tax. Improvements such as the provision of modern utilities are only deductible in Germany and the Netherlands. The proactive policy operated by the Danish Historic Houses Owners Association (BYFO) encompassing income tax relief (subsidised 'decay per annum' figure) is designed to encourage systematic maintenance of architectural heritage by private owners to forestall decay and provides evidence that public support for regular maintenance negates the necessity for large scale publicly funded repair projects in the long term.

In the USA certified historic buildings used for commercial purposes benefit from tax credits for 'rehabilitation work' which has been regulated by the State Heritage Preservation Officer. Additional tax credits are provided for rehabilitation of such buildings for social housing purposes.

The income tax credit system in operation in the USA is arguably more generous than the system of income tax deduction prevalent in Europe. The tax credit system lowers the amount of income tax owed (\$1 of tax credit reduces the amount of tax owed by \$1) whereas the tax deduction lowers the amount of income subject to taxation.

### Property tax incentives

Protected heritage structures in Belgium, Denmark, France, Germany, Italy, Netherlands, Spain, UK, USA and Canada may be entitled to either an exemption, abatement or freeze from property tax which is usually raised at municipal (local) government level. Protected heritage structures in the UK and Belgium must be unoccupied in order to claim an exemption. All residential property and unoccupied commercial property in Ireland is exempt from property tax regardless of heritage status.

### VAT/Sales tax exemptions and reductions

The standard rate of VAT on the supply of goods and services varies from 16% to 25% in the Western European countries examined. Denmark and Germany do not provide a VAT concession for works to protected heritage structures. Belgium, France, Italy and the Netherlands charge a reduced rate of VAT for dwellings which greatly reduces the cost of works to architectural heritage buildings in residential use. All construction activity is charged at a reduced rate of VAT in Ireland. Only Spain applies a lower rate of VAT specifically for works to protected heritage structures and in the UK some works are zero-rated or a lower rate of VAT is applied (in the case of repairs to historic places of worship).

Exemptions and reductions from sales tax liability vary greatly by state (USA) and province/territory (Canada) depending on the enactment of enabling legislation. Sales tax concessions are further complicated by the fact that tax liability is levied at federal, state and municipal level, thereby creating a situation where the concession may only be applied by one level of government, leaving taxpayers liable to pay the balance of sales tax to the other levels of government within the federal administrative system.

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...tax incentives are more effective in encouraging investment in heritage conservation in countries with higher levels of private ownership

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### Donations and sponsorship

All of the countries examined provide a system of tax deductions to encourage private donations/sponsorship to charitable heritage conservation organisations (such as non-profit heritage trusts and foundations), which, in turn, fund heritage conservation activity.

### Inheritance, gift tax and capital gains tax concessions/exemptions

Various forms of inheritance, gift tax and capital gains tax concessions/exemptions are available to the owners of protected heritage structures in all of the countries examined with the exception of Denmark and Canada (inheritance tax does not exist in Canada). Eligibility requirements vary greatly from country to country regarding public access, family continuity, holding period prior to sale of property and charitable status of recipient body. France only makes allowance for inheritance but not gift tax exemption. Concessions from capital gains tax applies to protected heritage structures in Germany, but income tax free donations of property in Canada may incur a liability to capital gains tax.

## What are the challenges facing policy makers?

### Consideration of international forms of fiscal incentive in national context

The first thing to note is that an international comparison of fiscal mechanisms relating to heritage conservation is complicated by the lack of uniformity of national fiscal regimes and terminology.

The huge range of indirect heritage funding mechanisms used in these countries highlights the existence of different and often conflicting perceptions of the threats facing architectural heritage resources and the inter-relationship between the various stakeholders involved within particular institutional settings.

Fiscal incentives offer an effective mechanism to encourage private investment in the repair and maintenance of the architectural heritage by owner-occupiers, owner-investors, developers and investors. The form and use of fiscal mechanisms designed to relieve the financial burden of private owners of historic buildings vary considerably from country to country. It appears that tax incentives are more effective in encouraging investment in heritage conservation in countries with higher levels of private ownership. Countries with a more limited use of tax advantages, such as the UK, usually have alternative funding mechanisms in place such as direct grant aid.

While the legislation relating to categories of tax incentives in individual countries provide varied measures to lighten the conservation burden placed on the owners of old buildings, most only relate to heritage structures with some degree of formal or legislative protection. This has implications for the protection of the architectural heritage as a whole, as government policy in some countries only allows the formal classification or protection of a very small proportion of architectural heritage buildings considered to be exceptional in terms of their historical significance. Furthermore, many countries classify or grade the level of significance of individual heritage monuments, and countries that have a federal administrative system provide different heritage protection registers at federal, state and municipal level. In some cases, tax incentives are only available at the higher levels of protection classification.



Property tax anomalies exist in many countries, which acts as a disincentive to sustainable conservation repair and maintenance activity



### Eliminating 'demolition by neglect' by encouraging the repair and systematic maintenance of heritage assets

One of the most sustainable and cost effective intervention methods in architectural heritage conservation is the encouragement of systematic maintenance, as it reduces the need for large-scale publicly funded repair projects in the long term. The far-sighted system of income tax relief for maintenance expenditure on protected structures in Denmark (BYFO) is noteworthy, although it cannot be used for improvements that would add to the capital value of the property. The reluctance of government in some countries (notably Canada) to provide financial subsidies to cover ongoing maintenance costs for the architectural heritage has resulted in a situation where some owners refuse to carry out regular maintenance as it is more beneficial to let properties deteriorate and then repair the damage in large scale funded projects. The challenge for policy makers is to eliminate the economic factors that compel owners to defer cyclical maintenance in favour of major repairs stemming from neglect.

Property tax anomalies exist in many countries, which acts as a disincentive to sustainable conservation repair and maintenance activity. For example, where property tax assessments are related to market value assessments, heritage property owners are reluctant to undertake substantial repairs for fear of raising the market value assessment and thus the tax liability.

A number of Western European countries have initiated various forms of property tax relief to give special recognition to heritage protection (Belgium, Denmark, France, Germany, Italy, Netherlands, Spain and the UK). In Canada architectural heritage is further threatened by the fact that the property tax is reduced for vacant property which actually encourages the demolition of heritage assets, although the City of Edmonton provides an exemplar system to remedy this situation. In the USA the zoned development potential of land beneath heritage buildings is assessed to establish property tax liability. This encourages demolition and redevelopment of heritage assets in areas zoned for high-density development. Many municipal governments in Canada and the USA have initiated property tax exemptions, rebates and freezes to combat this problem and specifically to encourage action on historic buildings.

### The VAT conundrum for heritage policy makers

An EU-wide campaign is gaining momentum among heritage lobby groups to encourage unanimity among member governments to specifically recognise the regular maintenance and repair of the architectural heritage in the European Commission's VAT Directive (thereby reducing the necessity for major capital restoration work). Most of the Western European countries levy VAT on works to historic structures at the standard rate with the exception of Spain and UK, which provide some specific VAT exemptions for the protected heritage. Although not specifically directed towards architectural heritage conservation, some European countries charge a reduced rate of VAT for works to all dwellings (Belgium, France, Italy and the Netherlands) or general construction activity (Ireland) thereby indirectly benefiting conservation activity. Denmark and Germany do not provide any VAT concessions for works to heritage buildings. While the VAT treatment of listed places of worship in the UK is commendable, an anomaly remains in relation to the existence of a VAT liability for repair and maintenance but not for alterations to other listed buildings. Sales tax relief for heritage conservation is allowed in many Canadian provinces at provincial level but only relates to the provincial element of taxes (full sales tax is payable at the federal and municipal level). While many state, federal and enabled sales tax rebate programmes have been legislated for in the USA, only a small number of municipal governments have chosen to initiate them.

### **Encouraging heritage conservation activity via private patronage**

Heritage sponsorship schemes enable individual and corporate taxpayers to make a charitable contribution deduction, based on financial gifts, legacies and transfer of property ownership to charitable and non-profit organisations such as heritage trusts and foundations. The charitable donation to support heritage conservation (such as an historic building façade or interior feature) to a municipal government or a local area-based heritage trust or foundation is particularly important in the USA where federal, and some state, heritage regulatory policy is weak. However, apart from the subjective nature of the market valuation of such a donation, they are also prone to tax complications. In order to alleviate cash flow problems, property owners undertaking historic rehabilitation projects in the USA may syndicate their entitlement to the federal and state historic rehabilitation income tax credit in order to receive the credit prior to work commencing. Also, in the USA, local heritage conservation activity may be funded via state enabled exempt bond issues.

Tax-exempt non-government organisations (NGOs), such as national and local heritage trusts and foundations with non-profit charitable status have a significant role to play in encouraging area-based sustainable architectural heritage conservation activity. Examples of heritage trusts and foundations include the Heritage Foundation (France), Deutsche Stiftung Denkmalshutz (Germany), 'Hendrick de Keyser' and 'Stadsherstel' Foundations (Netherlands), Heritage Canada Foundation (Canada), the National Trust and the Building Preservation Trusts (UK) and State Heritage Trusts (USA). The work of these organisations highlights the positive results that can be achieved by strong state and local authority commitment working in partnership with regeneration agencies and voluntary action (including non-profit heritage bodies and committed local community representatives).

### **Justification for government investment of limited financial resources to encourage heritage conservation activity – a cost benefit analysis**

In periods of budgetary constraint, many national governments find it difficult to justify fiscal incentives to support heritage conservation, on the basis that they represent a direct loss to the exchequer rather than being an investment likely to produce a return. While only limited research has been carried out internationally to dispel such views, studies in the UK and the USA show that long-term conservation activities, involving the repair, maintenance and reuse of vacant or derelict architectural heritage, actually result in an increase in tax revenues to the government. While it is true that new development could have taken place elsewhere, heritage repair projects have the added bonus of having a positive impact on the rehabilitation of derelict areas within traditional urban boundaries, creating a stimulus for housing and thereby removing the need for new infrastructure in the suburbs.

Despite the obvious benefits that can be achieved by policy makers in the use of fiscal benefits to encourage private investment funds into conservation activity, it is important to consider both the positive and negative aspects of the introduction of such incentives.

### **Benefits of fiscal incentives – the positive perspective**

From a positive perspective, heritage tax incentives are not coercive as they encourage individuals and corporations to behave in socially desirable ways, but they do not compel such behaviour. This point must be qualified by the fact that such tax incentives are most effective when they are used in conjunction with a national architectural heritage regulatory policy to ensure the permanent protection of important heritage assets. Heritage tax incentives are highly efficient to operate, as new incentives can be attached onto existing income tax collection procedures. Once the eligibility rules have been defined in the tax laws to reward specific kinds of behaviour regarding heritage conservation practice and methods for calculating benefits, tax incentives are available to all who qualify. This cost effective ease of administration by a generally well resourced arm of government makes tax incentives particularly attractive to policymakers. It is also worth noting that third-party providers, such as conservation architects and skilled craft workers, rely on the provision of tax incentives to foster demand for their goods and services (which in turn generates income and value added tax revenues to the government).

One very clear example of the positive attributes of tax incentives can be found in the USA, with their innovative system of linking the 'rehabilitation tax credit' with a special low-income housing tax credit. This has encouraged many developers and traditional property investors to work in the heritage sector, often in partnership with community organisations (creating a social benefit), particularly in deprived downtown areas. This has been found to act as a catalyst to neighbourhood revitalisation, with great benefits for the heritage and also for the local economy and society. It has created a market for investors to rehabilitate old buildings and protected structures for the particular purpose of providing good and affordable homes in historic buildings. Moreover, much can be learned from this approach, particularly in countries such as the United Kingdom where the current under-provision of affordable housing is a major issue. Work by English Heritage in supporting sustainable communities and encouraging the renovation of 'low demand housing' in 'pathfinder' designated areas is one step in this direction.



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#### Costs of fiscal incentives – the negative perspective

A number of negative aspects of the use of fiscal benefits from the perspective of policy makers must, however, be noted. The main argument against tax relief measures generally is that they are inequitable as they only benefit taxpayers, and high-income earners in particular. Heritage tax incentives, like all tax incentives, are inequitable to the extent that their financial benefits flow primarily to affluent taxpayers. Thus, tax incentives are distributed according to tax liability, rather than proportional need, as progressive income tax rates make the value of avoiding taxation greater for those in the upper tax brackets. Potential inequities of this nature can be resolved, for example, by allowing tax-exempt entities (such as non-profit charitable bodies) and low-income earners to receive a higher level of heritage grant assistance, as is the case in the Netherlands. Although not specifically implemented for the purpose of heritage conservation, the precedent of the tax credit rebate programme in the USA highlights the possibility of providing a rebate of earned tax credits to tax-exempt and low-income earners. Due to the indirect nature of heritage tax incentives, it is difficult for government policy makers to estimate how much tax incentives will cost and who will benefit from them, because the decision to claim incentives lies with the taxpayer. From a national accounting perspective, tax incentives have a low degree of visibility, but from an economic perspective they have a higher degree of visibility because it is possible to estimate the economic or opportunity cost associated with tax incentives. While tax incentives provide a very visible gesture from governments to individuals and corporations, one of the chief criticisms of this mechanism is that it confers benefits on taxpayers for actions they may have taken anyway. Thus, it is difficult to determine exactly to what extent the introduction of tax incentives have affected the behaviour of taxpayers.

The ability of fiscal incentive schemes to encourage heritage conservation activity is hindered in countries with weakly regulated fiscal policies which allow routine legal tax avoidance mechanisms. Fiscal incentives will be of reduced effectiveness in countries which have a tradition of 'black market' economic activity (such as 'cash in hand' payment for repair and maintenance work).

#### Conclusion

Despite the inequitable nature of tax incentives, they are increasingly put forward as an efficient and effective tool for encouraging private investment funds into conservation activity. There is a strong argument for providing specific tax incentives for the conservation of the architectural heritage in addition to more general urban renewal tax provisions (if available) as there is the danger that without such specific attention to historic resources the resulting renewal will be at the expense of the built heritage. Problems associated with tax incentives may be evidence of poor programme design (for example, offering income tax incentives to low income earners who are unable to take advantage of the incentive) rather than a structural flaw with the mechanism.

Tax incentives can be portrayed simultaneously as both an extension and a retraction of government power, explaining why this tool is capable of generating support from a broad range of politicians. The rationale for policymakers to use tax incentives as a tool of government is based on the lack of coercion characteristic of tax incentives, on the basis that greater choice leads to efficient economic outcomes. If used correctly, tax incentives can correct market failure and avoid costly and politically unpopular direct forms of government action. Political conservatives who embrace limited government favour tax incentives as they do not require the creation of new government bureaucracies. By contrast, political liberals gravitate toward direct government actions such as regulation and grants as the wealthy are more likely to benefit from tax incentives.

The search for pioneering funding mechanisms designed to promote private investment and sponsorship in the conservation of the architectural heritage will continue to challenge heritage policy makers in the years ahead. The findings of this research study have the capacity to support the evolution of architectural heritage conservation policies and related fiscal funding strategies in developed market economies and to inform the development of innovative fiscal mechanisms to encourage private investment in the architectural heritage in emerging market economies.

#### About the study

The study was carried out by Rob Pickard of Northumbria University and Tracy Pickerill of Dublin Institute of Technology, with a grant from the RICS Education Trust. The full research paper is available at [www.rics.org/research](http://www.rics.org/research)

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