

QUALIFYING FOR THE FEDERAL REHABILITATION TAX CREDIT

Prepared by the Architectural Department of Wiley|Wilson

The Federal rehabilitation tax credit program is a significant form of investment incentive that is available to owners of historic structures and old non-historic buildings. The program has been around for several decades and has helped preserve our architectural heritage at a time when new residential and commercial developments were replacing older and historic buildings at an alarming rate. The National Park Service, which co-administers the rehabilitation tax credit program with the Internal Revenue Service, describes the program as “one of the Federal government’s most successful and cost-effective community revitalization programs”. The National Trust for Historic Preservation goes further, describing “the historic rehabilitation tax credit [as] the Nation’s largest federal incentive promoting urban and rural revitalization through private investment in reusing historic buildings.”

The program continues to play an important role in the revitalization of downtown areas and the restoration of historic districts and landmarks across the United States by offering property owners tax credits that help offset the cost of rehabilitation. The program has been popular with investors, developers and local businesses involved in downtown and neighborhood redevelopments. The program has also been popular with local governments that have old school buildings and municipal buildings in need of repair, proving that tax-exempt entities can benefit from the program as well. For property owners, whether they are private sector or public sector, the Federal rehabilitation tax credit program is one worth considering, as it offers property owners a cost effective way to defray the cost of rehabilitating old buildings and historic structures.

What does the program offer?

The Federal rehabilitation tax credit program offers two incentive options: a 10% tax credit and a 20% tax credit.

The 10% Tax Credit

The 10% option offers tax credits to owners of non-historic old buildings built before 1936. To be eligible for the 10% option, owners must show that the property is non-historic by requesting certification from the National Park Service stating that the structure is neither historic, nor is it a contributing structure within a historic district.

For projects that qualify for the 10% option, the tax credit can only be applied to rehabilitation expenses used to repair and restore the existing building. The credit cannot be applied to the purchase price of an existing property or to cover the cost of building an addition or new construction.

10% Option Example:

If an owner decides to spend \$1.3 million to purchase an old warehouse and \$2.1 million to renovate it into luxury loft apartments, then his tax credit would be 10% of \$2.1 million or \$210,000, since the purchase price would be excluded from the calculation.

The 20% Tax Credit

The 20% option offers tax credits to owners of certified historic structures with rehabilitation work that meets and exceeds the *Secretary of the Interior's Rehabilitation Standards*. To be eligible for the 20% option, owners must show that the property is historic by requesting certification from the National Park Service stating that the structure has historic significance or is a contributing structure within a historic district.

For projects that qualify for the 20% option, the tax credit can only be applied to expenses for rehabilitation work approved and certified by the National Park Service.

20% Option Example:

If an owner decides to spend \$1.3 million to purchase a historic landmark and \$2.1 million to renovate it to comply with the Secretary of the Interior's Rehabilitation Standard, then his tax credit would be 20% of \$2.1 million or \$420,000.

How much does the program cost?

Projects with rehabilitation costs at or above \$20,000 have a fee that ranges from \$500 to \$2,500. The application fee is waived for rehabilitation projects under \$20,000. The fees the National Park Service charges are as follows:

Fee	Cost of Rehabilitation
\$0	Under \$20,000
\$500	\$20,000 to \$99,999
\$800	\$100,000 to \$499,999
\$1,500	\$500,000 to \$999,999
\$2,500	\$1,000,000 or more

Property owners should factor in these application fees when considering whether or not to pursue the Federal rehabilitation tax credit. Owners should also consider design fees for architectural services, as well as legal fees that may occur, especially if tax credit equity is being pursued by a non-profit organization, local government, or other entity with tax-exempt status.

What does the program require?

Participants are required to complete and submit a three-part Historic Preservation Certification Application to the National Park Service before they can qualify for a rehabilitation tax credit claim. The applications are for buildings that were built before 1936 and structures with historic significance. Old buildings that have been relocated after 1936 are immediately disqualified, as are structures with less than \$5000 in rehabilitation costs, and houses being used by owners as personal residences. The application process requires owners to submit documentation of the existing structure, descriptions of any proposed improvements, and documentation of the completed rehabilitation work. These documents may include photographs of architectural features, drawings of floor plans and elevations, and written descriptions.

What steps should owners take?

There are several steps owners should take in preparing their project for a rehabilitation tax credit. These steps include determining whether a project qualifies for the credit, completing and submitting an application to the National Park Service, forming a public-private partnership if the property owner is tax exempt, and making a claim using IRS tax form 3468. These steps have been outlined below with brief descriptions of what owners should do to streamline the application process:

- **Qualify!** As mentioned earlier, property owners with old buildings and historic structures can qualify for one of two Federal rehabilitation tax credits, the 10% tax credit for old non-historic buildings that were in service prior to 1936 and the 20% tax credit for certified historic structures. Owners pursuing either tax credit must show that the property is either historic or non-historic. In both instances, the National Park Service has to make the determination as to the status of the property.
- **Apply!** Interested property owners must complete and submit the three-part Historic Preservation Certification Application to participate. Applicants for the 20% historic structures tax credit must complete all three sections, while applicants for the 10% old building tax credit must complete the first two sections. The applications are distributed, collected and reviewed by the National Park Service. The three parts include a request for certification as a historic structure, a request for approval of proposed rehabilitation work, and a request for approval of completed rehabilitation work.
- **Syndicate!** Nonprofit organizations and local governments have the option of pursuing rehabilitation tax credit equity through a process referred to as syndication. Syndication allows such tax-exempt entities to partner with private investors to help offset the cost of renovating old or historic school buildings and municipal facilities.
- **Claim!** The Rehabilitation Tax Credits provide reimbursement for a percentage of the rehabilitation costs, including materials, labor and design fees. Costs from land and property acquisitions, building additions and contracting fees are not included when calculating the rehabilitation tax credits. Only costs incurred from the rehabilitation and design fees are eligible.
- **Avoid Recapture!** Owners must own the property for five years after it has been placed in service to keep the entire tax credit, or 20% of the tax credit must be returned to the Federal government for every year the property is not owned during the required 5 year period. It is important to note that property that has been placed in service does not have to be occupied. Property only has to be usable to be considered placed in service.

Property owners who follow the steps described above will find that the Federal rehabilitation tax credit can be an effective way to offset the cost of rehabilitating an old building or historic structure. Tax exempt entities should also consider the benefits of participating, especially since syndication may offer a way for Cities and Counties to partner with private investors to renovate older public schools and municipal buildings in need of repair. Even without syndication, Cities and Counties should be able to use the tax credits to attract businesses and individuals to invest in local revitalization efforts.

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