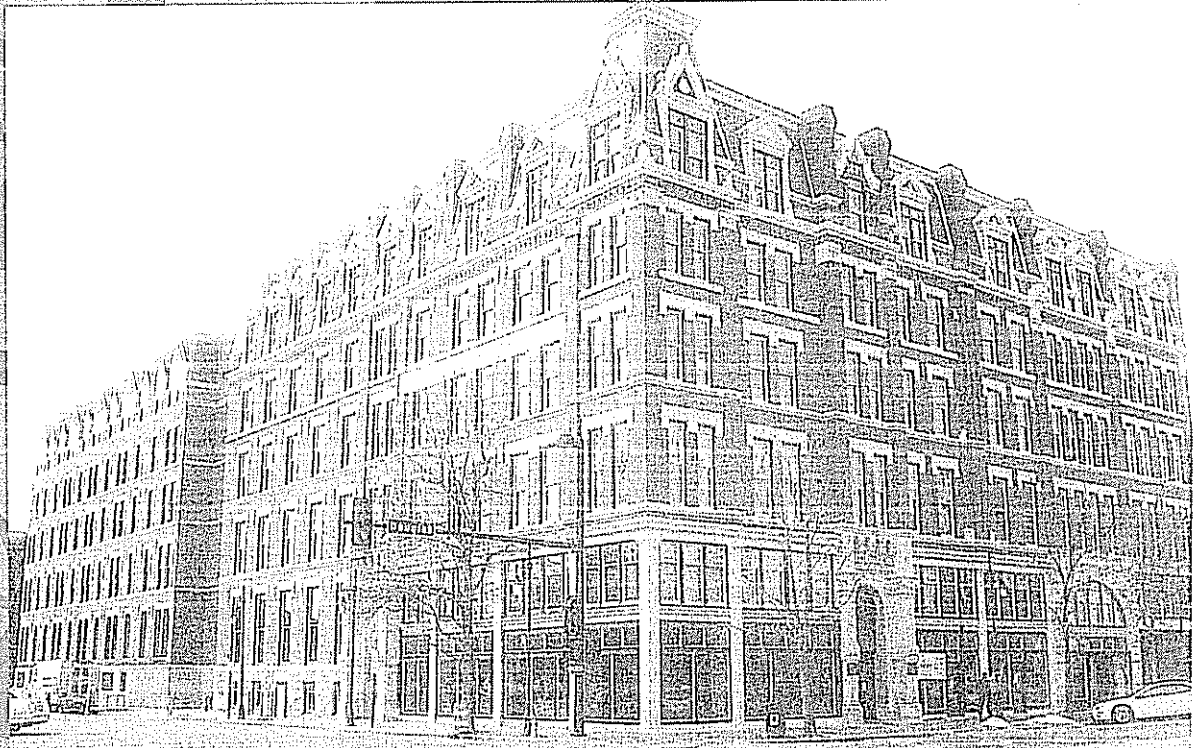


*a national trust publication*

# A Guide to Tax-Advantaged Rehabilitation

*by Fayne H. Boyle, Stuart Ginsberg and Sally G. Oldham  
revised by Donovan D. Rypkema*



# A Guide to Tax-Advantaged Rehabilitation

by Jayne F. Boyle, Stuart Ginsberg, and Sally G. Oldham  
revised by Donovan D. Rypkema

Between 1981 and 1986 more private money was invested in the rehabilitation of historic buildings than had been spent for the same purpose during all of the rest of American history combined. This investment was stimulated by federal tax incentives first adopted in 1976 and then expanded in 1978 and 1981.

Those incentives saved thousands of important historic buildings. What has been realized retrospectively, however, is that the federal historic rehabilitation tax credit program was one of the most potent urban revitalization tools ever created and certainly the most cost effective.

When *A Guide to Tax-Advantaged Rehabilitation* was first written, Congress had just passed the Tax Reform Act of 1986. That act eliminated most of the tax incentives that had been added to the tax code over the years. Rehabilitation credits were retained, however, because Congress recognized their important impact on communities of all sizes. Substantial changes were made to the earlier incentive program, however, including reducing the amount of the credit, precluding high-income tax payers from utilizing the credit, and adding a "passive loss" provision that severely limited the amount of the credit available to most individual taxpayers in any given year.

Optimists, including the U.S. Treasury Department, thought the effect of those changes would be minimal—Treasury estimated an 18 percent drop in activity. Preservationists predicted the

amount of investment could fall by as much as half. Unfortunately for both historic buildings and the urban revitalization that their rehabilitation spurred, even that projection was too rosy. Within eight years, certified rehabilitation projects fell 82 percent and investment in those projects was off 80 percent.

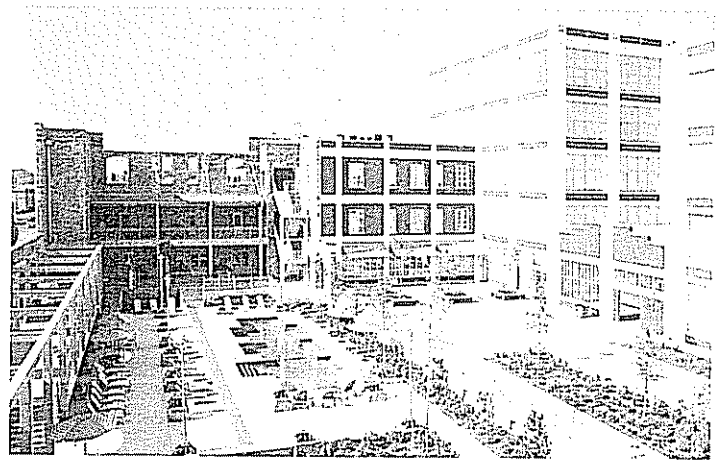
Recently, however, there have been indications of renewed interest around the country in the rehabilitation of historic buildings using the tax credits. This interest sparked the reissuing of *A Guide to Tax-Advantaged Rehabilitation*. The changes in this update deal primarily with amendments to the tax law since 1986.

The goal of this revised publication is to remind preservationists and investors that, while diminished from earlier years, the federal historic rehabilitation tax credit remains a valuable tool for saving historic buildings and revitalizing towns and cities throughout America.

## What Is the Rehabilitation Tax Credit?

Federal tax law offers a unique incentive to taxpayers who contribute to the preservation of this nation's old and historic buildings. By rehabilitating directly or investing in the rehabilitation of eligible buildings, taxpayers can take advantage of a two-tier tax credit.

The federal income tax credit is equal to 20 percent of the cost of rehabilitating historic buildings or 10 percent of the cost of rehabilitating nonhistoric buildings constructed before 1936.



*In New Orleans, the former American Can factory was rehabilitated into a mixed-use development that included apartments and shops. Developers followed the Secretary's Standards and preserved much of the historic fabric of this early 20th century warehouse.*

— Photo courtesy of Sheridan Architectural Photography

These credits provide a dollar-for-dollar reduction of income tax owed. While the 20 percent credit is available for rental residential buildings, neither credit is available for homes or apartments occupied by their owners.

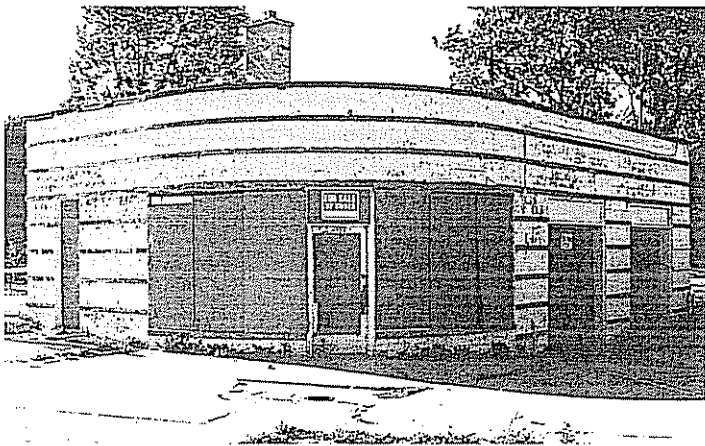
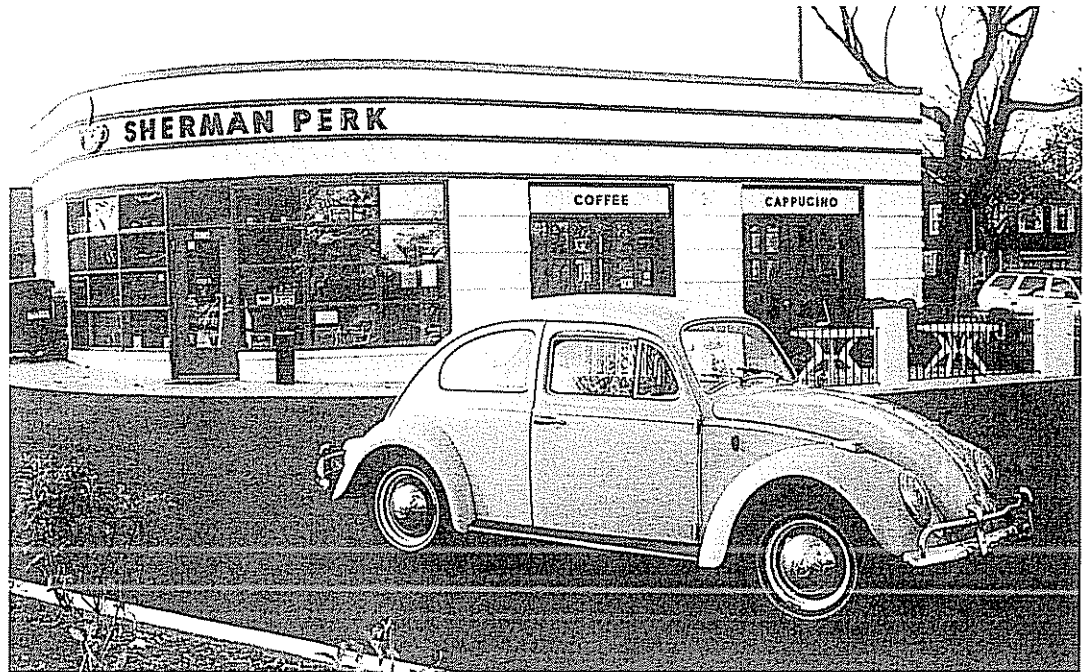
Rehabilitation investment gives old and historic buildings a more viable place in the contemporary real estate market, thereby guaranteeing their continued use and contribution to an area's economic vitality. In some cases rehabilitation involves relatively small expenditures to repair a building's roof and exterior. In others, rehabilitation may involve a substantial upgrade of structural and mechanical systems in the interior.

*Cover. The redevelopment of an entire block of 1887 buildings in downtown Wichita, Kans., created Eaton Place, a mixed-use project with 75 apartments and 300,000 square feet of commercial space. Historic rehabilitation tax credits brought more than \$2.4 million in equity to the \$15.6 million project.*

— Photo by Kathy L. Morgan

*In Milwaukee, an imaginative developer turned a deteriorated gas station into a neighborhood coffee shop. The developer used a combination of brownfield development funds, facade easement grants, and the historic rehabilitation tax credit to bring this Streamlined Moderne station back to life*

— Photo by Cliff Lepple



In the case of historic buildings, the goal of the rehabilitation credit is not to preserve a building as a museum, but to put it back to use to meet current housing, retail, commercial, and industrial needs. These needs, however, must be met through rehabilitation that is appropriate to a building's historic character.

From 1976 through 2001, the historic rehabilitation credit stimulated an estimated \$25 billion of investment in more than 29,000 historic properties. While large scale projects are often the most visible, in fact the rehabilitation credits have most often

been used for smaller projects. Since the inception of the first rehabilitation credits, more than 70 percent of projects involving historic buildings incurred expenditures of less than \$500,000, and nearly a third have been projects of less than \$100,000.

This range in the size and type of projects, and the similar diversity of rehabilitations of older nonhistoric buildings, such as the renovation of corner stores, brownstones, restaurants, and schools, demonstrates the breadth of opportunity that still exists for people to participate in this program.

The National Park Service, which administers the tax credit certification program in conjunction with state historic preservation offices, has observed that housing has been the single most important use for rehabilitated historic buildings. More than 149,000 units have been rehabilitated since the program began and over 75,000 units newly created. A substantial number of these units have been for use by low- and moderate-income households.

## What Buildings Qualify?

The rehabilitation credit is available for historic and nonhistoric buildings, but only if they are used in a trade or business or held for the production of income. Buildings eligible for the 20 percent rehabilitation credit include those that will be used for rental residential as well as nonresidential purposes, while buildings eligible for the 10 percent rehabilitation credit must be nonresidential, commercial, or industrial buildings.

## Certified Historic Structures

To qualify for the 20 percent rehabilitation credit, a building must be a "certified historic structure." A certified historic structure is one that is:

- listed individually in the National Register of Historic Places; or
- located in a "registered historic district" and certified by the Secretary of the Interior as being of historical significance to the district.

A registered historic district is any district that is:

- listed in the National Register of Historic Places; or
- designated under a state or local statute certified by the Secretary of the Interior as containing criteria that will substantially achieve the purpose of preserving and rehabilitating buildings of significance to the district and that is certified as substantially meeting all of the requirements for the listing of districts in the National Register

The National Register of Historic Places is maintained by the U.S. Department of the Interior National Park Service. It includes individual buildings and sites as well as historic districts. The National Register contains more than 71,000 listings and encompasses nearly one million buildings and historic resources. Properties qualifying for National Register listing must meet one or more of four broad criteria (see page 13).

To nominate an individual property or historic district for listing, a nomination form is submitted for review to the state historic preservation officer (SHPO) appointed by the governor of each state. After review and approval at the state level, the nomination is forwarded to the National Park Service in the Department of the Interior for review and listing.

A building within a listed historic district is accorded certified historic structure designation through the submission of "Part 1" of the Historic Preservation Certification Application. This form is available from SHPOs and the National Park Service and on the NPS website [www.cr.nps.gov](http://www.cr.nps.gov). After review by the SHPO, the application is forwarded to the National Park Service for final approval.

If a property is individually listed in the National Register, it is already a certified historic structure and it is not necessary to complete Part 1 of the Historic Preservation Certification Application.

If the certification request is for a building not yet listed in the National Register or for a building in a potential historic district, the Part 1 form will be reviewed to make a preliminary determination as to whether the building may qualify for certified historic status when and if the property is listed in the National Register. Such determinations are not binding and become final as of the date of listing in the National Register.

The SHPO's recommendation for approval or denial of certified historic structure status is given significant weight; however, the National Park Service makes the final determination and notifies the owner of the decision.

### ***Old Nonhistoric Buildings***

A 10 percent rehabilitation credit is available for nonresidential, nonhistoric buildings built before 1936. No certification is required for these buildings.

The 10 percent rehabilitation credit is not available for certified historic structures. A building located within a registered historic district is not eligible for the 10 percent credit unless it is certified by the Department of the Interior as not contributing to the historical significance of the district. A request for certification of non-significance also is made through Part 1 of the Historic Preservation Certification Application. Review of such a request follows the general procedures outlined above.

## **What Rehabilitations Qualify?**

To receive a rehabilitation credit, a taxpayer must substantially rehabilitate a qualifying historic or old building.

### ***Substantial Rehabilitations***

A substantial rehabilitation means a taxpayer's expenditures must exceed the greater of the "adjusted basis" of the building, or \$5,000, during any 24-month period (or 60-month period in the case of "phased rehabilitations," defined below) selected by the taxpayer. The period must end with or within the taxable year in which the credit is claimed.

The adjusted basis in a building is its purchase price plus the amount of any previous capital improvements. This sum is reduced by depreciation deductions already taken and the cost of the property that can be allocated to the land value.

Thus, for example, if a taxpayer's basis in a building is \$100,000, the taxpayer generally would have to incur more than \$100,000 of rehabilitation expenditures during a 24-month period to have a substantially rehabilitated building.

A phased rehabilitation is a rehabilitation consisting of two or more distinct stages of development. These stages must be outlined in written architectural plans and specifications that are completed before the physical work on the rehabilitation begins.

### ***Certified Historic Rehabilitations***

For a rehabilitation to qualify for a 20 percent credit, the Department of the Interior must certify that the rehabilitation is consistent with the historic character of the building and, where

*In Lynchburg, Va., a former hospital (circa 1913) has been turned into a 56-unit apartment complex. The federal historic rehabilitation tax credit as well as the low-income housing credits helped make this \$4 million project feasible*

*— Photo courtesy of  
Gray & Pape, Inc.,  
Richmond, Va.*



applicable, with the district in which the building is located. Application for this determination is made through "Part 2" of the Historic Preservation Certification Application. Following review by the SHPO, the application is forwarded with a recommendation to the National Park Service for a decision. This application may be submitted to the SHPO and the National Park Service at any time during the course of rehabilitation. The National Park Service, however, strongly urges taxpayers to file

applications before commencement of work so that modifications to the work plan may be made more easily, if necessary.

Notice of approval of proposed work or certification of completed work is sent to the taxpayer by the National Park Service. If modifications are proposed during the course of construction, the National Park Service requests that amendments be submitted and the NPS has the opportunity to review and approve changes that might affect the historic qualities of the structure.

However, a rehabilitation receives final certification only after all work has been completed. A taxpayer whose proposed work has been approved must submit a Request for Certification of Completed Work (Part 3) with photographs documenting the completed project to receive final certification.

All elements of a rehabilitation project must meet the Secretary of the Interior's Standards for

Rehabilitation (see page 13). In evaluating rehabilitation work, state and federal officials review all aspects of the work, including any new construction. While the rehabilitation process may involve some repair or alteration of a historic building to provide for an efficient contemporary use, it must not destroy or damage the material and features, both interior and exterior, that are important in defining the building's historic character.

The National Park Service charges a processing fee to review projects involving more than \$20,000 of rehabilitation expenditures. Payment is made when requested by the National Park Service, not when the application is submitted to the SHPO. Fees are charged according to a two-tiered system: a preliminary fee and a final fee. The preliminary fee to review projects or ongoing rehabilitation projects of more than \$20,000 is currently \$250. The final fee covers NPS

review of completed projects and is based on the cost of rehabilitation according to the fee schedule below. The preliminary fee is deducted from the final fee.

| Fee     | Rehabilitation         |
|---------|------------------------|
| \$ 500  | \$ 20,000 to \$ 99,999 |
| \$ 800  | \$100,000 to \$499,999 |
| \$1,500 | \$500,000 to \$999,999 |
| \$2,500 | \$1 million or more    |

Certification decisions may be appealed to the Washington, D.C., office of the National Park Service.

### ***Nonhistoric Rehabilitations***

No certification of rehabilitation work is necessary to obtain the 10 percent credit for nonhistoric rehabilitation. However, certain existing building elements must be retained to qualify for this credit. Specifically, 50 percent or more of the existing external walls must be retained in place as external walls; 75 percent or more of the existing external walls must be retained in place as internal or external walls; and 75 percent or more of the existing internal structural framework must be retained in place.

No wall test requirements apply to certified historic structures although the 50 percent/75 percent rules are used as a guideline.

### **What Expenditures Qualify?**

Rehabilitation expenditures must be capital in nature and depreciable as real property to qualify for a credit. This includes new plumbing, mechanical, and electrical systems, sprinklers, "life safety systems," elevators, brick and facade cleaning, and any other work including cosmetics done to the structural components of the buildings. Additionally,

such costs as architect's fees, consulting fees, developer fees, and construction period interest and taxes are also allowable as part of the qualified rehabilitation expenditures.

Acquisition, site work (such as landscaping, parking lots, sidewalks), and building enlargement costs do not qualify. Likewise furniture and appliances and other personal property items do not qualify.

Rehabilitation expenditures that can be allocated to that portion of a building that is, or is reasonably expected to be, "tax-exempt use property" also do not qualify.

### **When Can the Credit Be Claimed?**

Generally, the credit is claimed for the taxable year in which the building or an identifiable portion thereof is placed in service. "Placed in service" generally means that the entire building, or an identifiable portion thereof, has been placed in a condition or state of readiness and availability for its intended function. It is not necessary that the building actually be put in use but only that it be ready and available for its use. Receipt of a certificate of occupancy for the building or a portion thereof is commonly used to establish the date of placement in service, although other facts may be relevant. In some cases, the building will not have been taken out of service (for example, when the building continues to be occupied during the rehabilitation). In that situation, the placed in service date is generally the date of project completion.

In addition to placement in service, the substantial rehabilitation test must also be met before the credit can be earned. Thus, if the substantial rehabili-

tation test has not been met at the time the building has been readied for its intended function, the credit is not deemed earned until the point in time when the substantial rehabilitation test is actually met.

An approved Request for Certification of Completed Work is not required in order to claim the credit so long as the taxpayer reasonably expects that National Park Service approval will ultimately be granted. However, if the taxpayer fails to receive a Certification of Completed Work within 30 months after filing the tax return on which the credit was claimed, the taxpayer must file a statement with the IRS extending the time period during which the relevant tax returns can be audited.

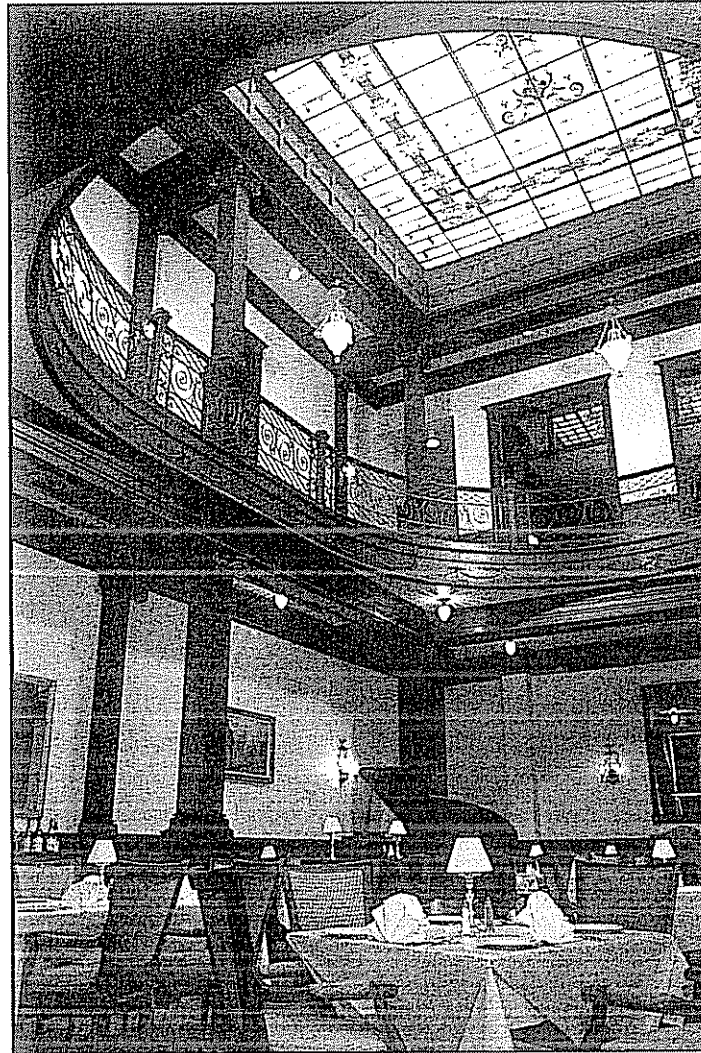
If a taxpayer is unable to use all or portion of the credit earned (because, for example, the credit earned exceeds the taxpayer's tax liability), the unused portion of the credit can be carried back one year and forward for 20 years.

### **Who Can Take the Credit?**

The credit is available to the owners and, in certain situations, long-term renters of a qualified rehabilitated building. Renters may obtain the credit for rehabilitation expenditures that they have incurred provided that the lease term remaining on the date the rehabilitation is completed is at least as long as the depreciable life of the building. Under current tax law that would mean a lease in excess of 39 years for a commercial tenant. Special care must be taken in structuring transactions of this type where the landlord is a tax-exempt organization such as a unit of state, local government, or a nonprofit organization.

*Built in 1889 during the gold mining boom, the Geiser Grand Hotel in Baker City, Ore., underwent a five-year painstaking restoration which was completed in 1998. This \$7 million project, which benefited from the historic rehabilitation tax credit, is now described as "Eastern Oregon's living room."*

*— Photo courtesy of the Geiser Grand Hotel*



In addition to permitting renters under long-term leases to claim credit for rehabilitation expenditures incurred by the renter, under certain circumstances a landlord can elect to treat a renter as having incurred the rehabilitation expenditures actually incurred by the landlord. This feature allows the landlord to pass through to the tenant the credit it would have earned itself. This pass-through option is not available where the landlord is a tax-exempt entity.

Purchasers of a rehabilitated building who acquired it before the completion of its rehabilitation are eligible to receive the credit.

### How Is Depreciation Computed?

A taxpayer may deduct annually a portion of the adjusted basis of a rehabilitated building. The deduction generally is computed using the straight-line method over a period of 39 years for commercial properties and 27.5 years for residential rental property. The depreciable basis of a rehabilitated building must be reduced by the amount of rehabilitation credit claimed.

### What Other Restrictions Apply?

Many factors other than the benefits described above must be taken into account before considering undertaking or investing in a rehabilitation project. The rehabilitation incentives operate within the context of a building's local real estate market, its economic profile, and project investors' individual tax situations.

The following sections discuss some of the federal tax provisions that may affect the ability of investors to make full use of the tax benefits. Taxpayers should seek the advice of tax accountants and lawyers before initiating or investing in a rehabilitation project.

### Recapture of the Credit

Generally, if a taxpayer disposes of a building for which a rehabilitation credit has been claimed within five years of completing a rehabilitation, part or all of the credit claimed must be repaid. This "recaptured" amount ranges from 100 percent of the credit claimed for property sold within one year of the completion date to 20 percent of the credit claimed for property sold in the fifth year. Similar rules apply if all or part of a rehabilitated building becomes "tax-exempt use property" within five years of the placed-in-service date. Recapture of the credit could also occur if the National Park Service revokes certification of the rehabilitation after the property is completed because work that does not meet the Secretary's Standards has been undertaken.

### At Risk Rules

The "at-risk" rules may be relevant when either individuals or closely held corporations seek to claim tax credits. Congress enacted a general set of at-risk rules to limit the losses

taxpayers can claim from an activity, including the holding of real estate, to the amount the taxpayer has "at-risk" in the activity. The amount at-risk generally equals the cash or property contributed by the taxpayer to the activity and amounts borrowed for use in the activity for which the taxpayer is personally liable. A taxpayer may also be treated as being at-risk with respect to certain types of nonrecourse financing ("Nonrecourse" meaning that the taxpayer is protected against loss from the debt.)

Congress also has enacted an additional set of at-risk rules applicable to individuals and closely held corporations that seek to claim tax credits. Under these rules, an individual's or closely held corporation's share of a project's qualified rehabilitation expenditures is reduced by its share of certain kinds of nonrecourse loans if those loans were used to finance the qualified rehabilitation expenditures. These loans include seller financing and loans made by related parties or most nonprofits. It may also include any deferred developer fees. In addition, qualified rehabilitation expenditures can be reduced or disallowed when the total of all nonrecourse loans (not just the types of nonrecourse loans listed above) made to a project exceeds 80 percent of the project's qualified rehabilitation expenditures. A reduction in an individual's or closely held corporation's share of qualified rehabilitation expenditures will result in a reduction of tax credits available to these taxpayers.

### ***Passive Activity Rules***

In the Tax Reform Act of 1986, Congress for the first time restricted the ability of real estate developers and investors to use deductions and credits to "shelter" income other than that directly

related to the deductions or credits. Corporations by and large are not covered by these rules.

Generally, these rules prohibit the use of deductions and credits from "passive activities" to offset income and taxes owed from "non-passive activities." Passive activities are those in which the taxpayer is not involved on a regular, continuous, and substantial basis. Limited partner investors in rehabilitation projects are presumed to be involved in a passive activity. In addition, rental activities, including the rental of rehabilitated buildings, are considered passive activities. Non-passive activity income includes wages and portfolio income such as stock dividends, stock capital gains, and interest on bank accounts.

Under these limitations, deductions generated by all of a taxpayer's passive investments may only be deducted from income from these passive investments. Similarly, credits generated from passive activities, such as the rehabilitation credit, may only be used to offset tax liability on income from passive activities.

Credits and deductions that cannot be used in the current year because of the passive activity rules may be used in future years to offset income or taxes from passive activities. They may not be used to offset such income or taxes from previous years.

There is an exception to these rules that allows individual taxpayers to use rehabilitation tax credits to offset a limited amount of non-passive income. Under this exception, an individual can use rehabilitation credits to offset the "deduction equivalent" of \$25,000 in income. This does not mean that the taxpayer can claim \$25,000 in credits. It means that the taxpayer can claim credits in an amount equal

to the taxes he or she would owe on \$25,000 in income. For example, under this exception, a taxpayer in the 36 percent marginal tax bracket can use up to \$9,000 in tax credits per year (36 percent x \$25,000 = \$9,000). The individual need not be involved in management or decision making to qualify (see the next heading). The deduction equivalent is reduced by the amount of rental losses taken by the taxpayer.

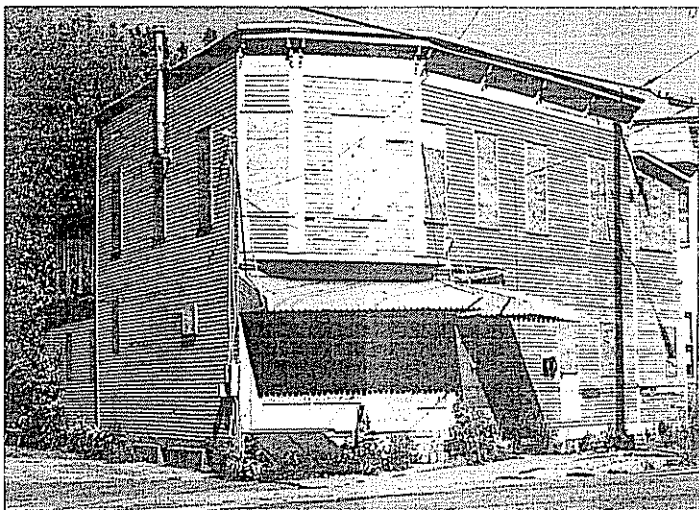
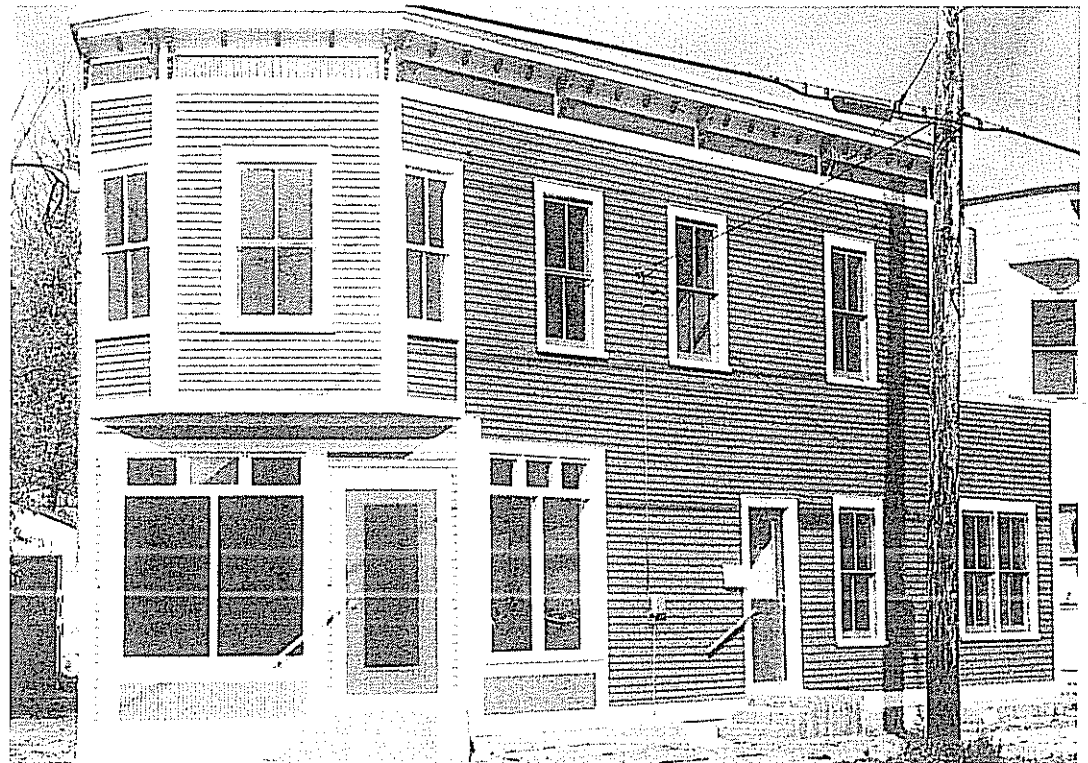
The deduction equivalent exception phases out incrementally for taxpayers whose adjusted gross incomes (determined without regard to deductions from passive activities) is between \$200,000 and \$250,000. Generally, taxpayers with adjusted gross incomes greater than \$250,000 are not eligible for the exception at all and thus cannot use the tax credit to offset income from non-passive activities. Note, however, that there is no phase out for projects that combine both rehabilitation and low-income housing tax credits. Credits that cannot be used in any single year as a result of the passive activity rules can be carried forward indefinitely.

### ***Exemption from Passive Activity Rules for Full-Time Real Estate Practitioners***

In the latest change in the federal tax code, those involved full time in real estate activities became exempt from the passive activity loss limitations. Now full-time real estate developers, brokers, property managers, and other real estate professionals may offset their earnings from salary or commissions with losses generated by investment real estate. This also means that more than the \$9,000 per year of the rehabilitation credit may be available

*A boarded-up corner store in Burlington, Vt., has been transformed into two low- to moderate-income apartment units and one small commercial space. This small (\$195,000 total eligible costs) tax credit project has helped brighten up Burlington's Old North End neighborhood.*

*— Photo by Amy Demetrowitz:  
Burlington Community Land Trust*



to taxpayers in the real estate business. Individuals who believe they may qualify for this exemption from passive loss provisions should consult their tax counsel.

**Alternative Minimum Tax**

The alternative minimum tax ("AMT") is a method of determining tax liability that is imposed on higher-income taxpayers to limit the use of various

tax shelters and preferences. AMT is computed from regular taxable income with certain adjustments and the addition of all appropriate tax preferences. Although the tax credits are not a preference item for purposes of the alternative minimum tax, the credits cannot be used to offset the tax. Credits that are unused because of the alternative minimum tax can be carried back one year and forward 20 years.

**Rehabilitations Involving Tax-Exempt Entities**

In 1984 Congress established the "tax-exempt use" rules with the goal of restricting tax benefits flowing from certain types of business arrangements between taxable and tax-exempt entities. Tax-exempt entities include, among others, most nonprofit corporations as well as governmental entities. Property that is subject to one of these arrangements is called "tax-exempt use property." One type of tax-exempt use property is prop-

erty that is leased to a tax-exempt entity under a disqualified lease.

In general the tax credit may not be taken on that portion of the expenditure attributable to space occupied by a tax-exempt entity if the circumstances amount to a "disqualified lease." A disqualified lease would be one with a governmental or non-profit organization if any of following tests were met:

- the lease term exceeded 20 years;
- the lease occurred after the sale of the property by, or the property was leased from, the tax-exempt entity (sale-lease-back situation);
- the lease included an option to purchase or sell the property at a fixed or determinable price; or
- part or all of the property was financed, directly or indirectly, by a tax-exempt obligation, and the tax-exempt entity (or a related entity) participated in the financing.

However, even if one or more of these tests were met, the tax credit could still be taken if the total percentage of space leased by tax-exempt entities under a disqualified lease is less than 35 percent of the “net rentable floor space” of the property. The net rentable floor space of a building does not include the common areas. Furthermore, even if a disqualified lease exists and more than 35 percent of the space is occupied by tax-exempt entities, the tax credit is still available to the expenditure attributable to the balance of the space.

Alternatively, even if more than 35 percent of the net rentable floor space were occupied by a tax-exempt entity but none of the disqualified lease tests applied, the tax credit would be fully available.

Since considerable confusion exists over these distinctions, it bears repeating that having a “disqualified lease” covering more than 35 percent of the building only precludes the credit on the expenses allocated to that space. The costs attributable to the balance of the building are still eligible for the credit.

Note that Section 50 of the Internal Revenue Code contains another set of rules that further complicates claiming tax credits on projects involving tax-exempt organizations. These additional rules have particular relevance to those attempting to claim credits on properties owned by or leased from governmental entities.

Another type of tax-exempt use property involves property owned by partnerships or a limited liability company (LLC) that have both tax-exempt and non-tax exempt partners or members where the tax-exempt partner is not allocated an identical share of the partnership’s income, gain, loss deduction, credit, and basis.

In this case, a portion of the tax credit equal to the tax-exempt partner’s highest level of allocation will be disallowed. This result can be avoided, however, if the tax exempt organization enters the partnership using a for-profit affiliate rather than in its own name, so long as the for-profit affiliate files an election with the IRS.

### What Other Tax Benefits Are Available?

Other tax provisions may contribute to the preservation and rehabilitation of historic buildings. They include the deduction for donating a historic preservation easement, the low-income housing credit, and state and local incentives.

#### ***Historic Preservation Easements***

A charitable contribution deduction is allowed for the donation of a historic preservation easement to a preservation organization. This deduction applies to both commercial property and owner-occupied housing. An easement is an agreement by owners of property to relinquish their right to alter or demolish property and to abide by other preservation conditions that are enforced by the donee preservation organization or governmental body. These restrictions must be permanent, to qualify for a federal charitable deduction and must apply to all future purchasers of the property. A typical agreement protects the facade of a building but may also restrict the development of adjoining lands and interior features or require maintenance of property elements. In addition, the public must have some visual access to the donated property.

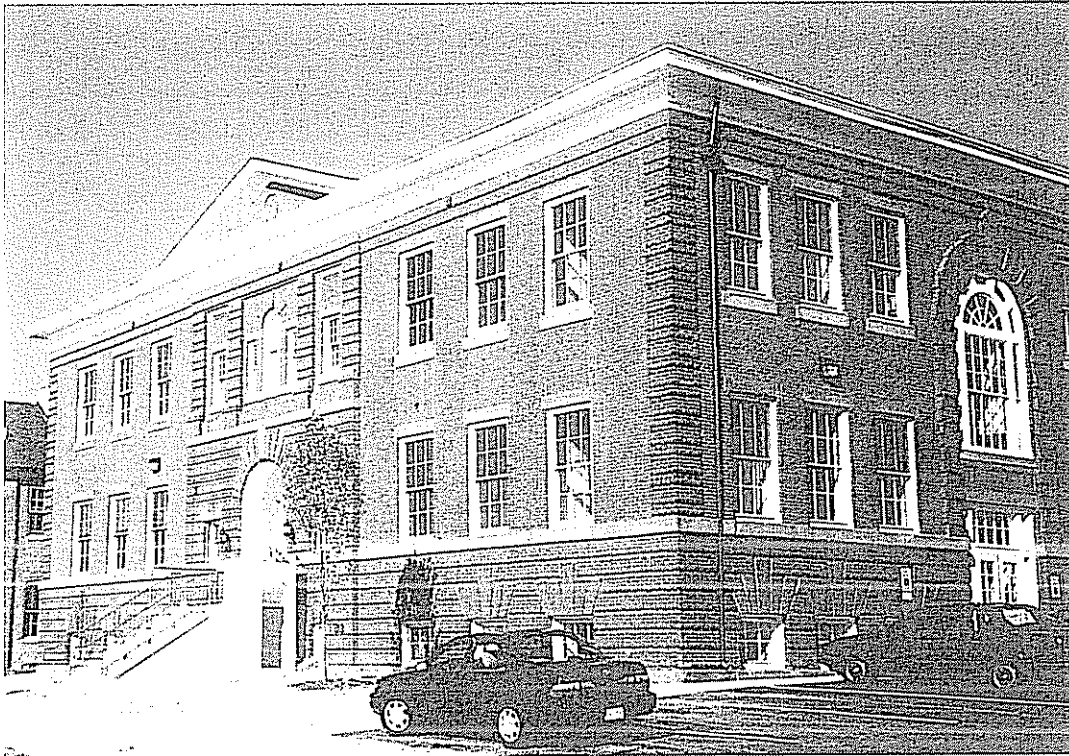
The value of the contribution of a historic easement is the difference between the fair market value of the property before the granting of the restriction and the fair market value of the property after the granting of the restriction. The basis of the structure must be reduced by the value of the easement. This basis reduction must be allocated between the building itself and the underlying land.

The taxpayer is not entitled to claim the portion of the rehabilitation tax credit attributable to the easement. Moreover, if the taxpayer claimed a tax credit and subsequently donates an easement with respect to that property, the donation is considered a partial disposition of the property. This event will trigger recapture of all or part of the credit if the contribution is made within the recapture period. For the foregoing reasons, property owners who intend to claim tax credits and donate an easement will sometimes wait until the end of the tax credit recapture period before making the donation.

#### ***Low-Income Rental Housing Credit***

Owners of residential rental property providing low-income housing may claim separate tax credits for new construction and rehabilitation of low-income housing and for certain costs of acquisition of existing housing to serve low-income individuals, if such credits are issued by the state. The credits are claimed annually for a period of 10 years.

There are two low-income housing credit percentages—70 percent and 30 percent. (Those percentages are increased to 91 percent and 39 percent in certain census tracts that have been designated by HUD as being par-



*Two historic schools in York, Pa , were transformed into a low- to moderate-income 17 unit apartment complex using the historic rehabilitation tax credit. In order to comply with fire safety regulations while still retaining the school's historic character, the second floor hall was enclosed with custom-made wood and glass smoke barrier walls that allow a clear view of the round-arched windows at each end of the building*

— Photo courtesy of Historic York, Inc

exterior paint, rehabilitation of storefronts, plaster repair, cast iron buildings and much more. For a catalog write: Heritage Preservation Services, National Center for Cultural Resources, National Park Service, 1849 C Street NW, Washington, D.C., 20240 or email [hps\\_info@nps.gov](mailto:hps_info@nps.gov) or log on to [www2.cr.nps.gov](http://www2.cr.nps.gov)

*The Secretary of the Interior's Standards for Rehabilitation* is available from the National Park Service in an illustrated and non-illustrated format. The Standards are used primarily to determine whether the historic character of a building is preserved in the process of rehabilitation. All projects that owners wish to have certified for purposes of federal tax incentives are reviewed and evaluated in accordance with the 10 Standards for Rehabilitation. The accompanying guidelines, intended to assist in applying the Standards, recommend responsible methods and approaches and also list those treatments that should be avoided. *The Secretary*

*of the Interior's Standards for Rehabilitation with Illustrated Guidelines for Rehabilitating Historic Buildings* is \$13 per copy (GPO stock number 024-005-01091-2) and the non-illustrated version is \$4 (GPO stock number 024-005-01061-1). To order call (202) 783-3238 or fax to (202) 512-2250. Or visit the GPO online bookstore at [bookstore.gpo.gov](http://bookstore.gpo.gov)

The National Trust for Historic Preservation's Community Partners (CP) program assists preservation organizations, local governments, developers, and community development corporations in revitalizing historic properties in mixed-income communities. Its services include debt and equity financing, technical assistance, and real estate consulting services. Community Partner's Heritage Property Services (HPS) is a historic real estate consulting service specializing in the syndication of state and federal tax credits for historic property rehabilitation. HPS provides for-profit, nonprofit, and local government developers of historic properties with the consulting assistance and equity capital they need to complete financial packages for projects that meet local economic development and community revitalization needs. CP's Bank of America Historic Tax Credit Fund is a unique partnership with Bank of America that invests in projects eligible for the federal and state historic rehabilitation tax credits. The fund is unique in that it provides equity to developers of smaller historic tax credit projects that qualify for as little as \$500,000 in historic tax credit equity. For more information call (202) 588-6054 or visit the National Trust website at [www.nationaltrust.org](http://www.nationaltrust.org)

*The Preservation Law Reporter* is published monthly by the National Trust for Historic Preservation. This loose-leaf ser-

vice contains articles on tax issues, updates on legislative and regulatory activities, litigation summaries, and a comprehensive reference volume. A one-year subscription costs \$90. To order write: Preservation Law Reporter, National Trust for Historic Preservation, 1785 Massachusetts Avenue, N.W., Washington, D.C., 20036 or call (202) 673-4035 or email [law@nithp.org](mailto:law@nithp.org)

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## National Register Criteria for Evaluation

The quality of significance in American history, architecture, archeology, engineering, and culture is present in districts, sites, buildings, structures, and objects that possess integrity of location, design, setting, materials, workmanship, feeling, and association and

- (a) that are associated with events that have made a significant contribution to the broad patterns of our history; or
- (b) that are associated with the lives of persons significant in our past; or

- (c) that embody the distinctive characteristics of a type, period, or method of construction, or that represent the work of a master, or that possess high artistic values, or that represent a significant and distinguishable entity whose components may lack individual distinction; or
- (d) that have yielded, or may be likely to yield, information important in prehistory or history

## *The Secretary of the Interior's Standards for Rehabilitation*

1. A property shall be used for its historic purpose or be placed in a new use that requires minimal change to the defining characteristics of the building and its site and environment.
2. The historic character of a property shall be retained and preserved. The removal of historic materials or alteration of features and spaces that characterize a property shall be avoided.
3. Each property shall be recognized as a physical record of its time, place, and use. Changes that create a false sense of historical development, such as adding conjectural features or architectural elements from other buildings, shall not be undertaken.
4. Most properties change over time; those changes that have acquired historic significance in their own right shall be retained and preserved.
5. Distinctive features, finishes, and construction techniques or examples of craftsmanship that characterize a property shall be preserved.

6. Deteriorated historic features shall be repaired rather than replaced. Where the severity of deterioration requires replacement of a distinctive feature, the new feature shall match the old in design, color, texture, and other visual qualities and, where possible, materials. Replacement of missing features shall be substantiated by documentary, physical, or pictorial evidence.
7. Chemical or physical treatments, such as sandblasting, that cause damage to historic materials shall not be used. The surface cleaning of structures, if appropriate, shall be undertaken using the gentlest means possible.
8. Significant archeological resources affected by a project shall be protected and preserved. If such resources must be disturbed, mitigation measures shall be undertaken.
9. New additions, exterior alterations, or related new construction shall not destroy historic materials that characterize the property. The new work shall be differentiated from the old and shall be compatible with the massing, size, scale, and architectural features to protect the historic integrity of the property and its environment.
10. New additions and adjacent or related new construction shall be undertaken in such a manner that if removed in the future, the essential form and integrity of the historic property and its environment would be unimpaired.

## Five Year Operating Statement

| Year                              | 1        | 2        | 3        | 4        | 5        |
|-----------------------------------|----------|----------|----------|----------|----------|
| Net Operating <sup>1</sup> Income | \$27,500 | \$28,325 | \$29,175 | \$30,049 | \$30,951 |
| Depreciation                      | \$ 6,154 | \$ 6,154 | \$ 6,154 | \$ 6,154 | \$ 6,154 |
| Interest                          | \$15,906 | \$15,686 | \$15,452 | \$15,198 | \$14,916 |
| Taxable Income <sup>2</sup>       | \$ 5,440 | \$ 6,485 | \$ 7,569 | \$ 8,697 | \$ 9,881 |
| Tax Rate                          | 36%      | 36%      | 36%      | 36%      | 36%      |
| Taxes <sup>3</sup>                | \$ 1,958 | \$ 2,335 | \$ 2,725 | \$ 3,131 | \$ 3,557 |
| Useable Credit <sup>4</sup>       | \$ 9,000 | \$ 9,000 | \$ 9,000 | \$ 5,982 | \$ 0     |
| Useable Credit <sup>5</sup>       | \$ 1,958 | \$ 2,335 | \$ 2,725 | \$ 0     | \$ 0     |
| Accumulative Credit Used          | \$10,958 | \$22,293 | \$34,018 | \$40,000 | \$40,000 |

## Five Year Cash Flow Statement

| Year                                | 1        | 2        | 3        | 4        | 5        |
|-------------------------------------|----------|----------|----------|----------|----------|
| Net Operating Income                | \$27,500 | \$28,325 | \$29,175 | \$30,049 | \$30,951 |
| Debt Service <sup>6</sup>           | \$18,524 | \$18,524 | \$18,524 | \$18,524 | \$18,524 |
| Before Tax Cash Flow <sup>7</sup>   | \$ 8,976 | \$ 9,801 | \$10,651 | \$11,525 | \$12,427 |
| Taxes                               | \$ 1,958 | \$ 2,335 | \$ 2,725 | \$ 3,131 | \$ 3,557 |
| After Tax Cash Flow <sup>8</sup>    | \$ 7,018 | \$ 7,466 | \$ 7,926 | \$ 8,394 | \$ 8,870 |
| Useable Tax Credit                  | \$10,958 | \$11,335 | \$11,725 | \$ 5,982 | \$ 0     |
| After Credit Cash Flow <sup>9</sup> | \$17,976 | \$18,801 | \$19,651 | \$14,376 | \$ 8,870 |

<sup>1</sup> Income increasing at 3% per year

<sup>2</sup> Net operating income less depreciation and interest

<sup>3</sup> Taxable income x tax rate

<sup>4</sup> This is the amount of credit the owner is entitled to under the passive loss exception provision

<sup>5</sup> This is the amount of the credit usable to offset passive gains

<sup>6</sup> Principal and interest payment

<sup>7</sup> Net operating income less debt service

<sup>8</sup> Before tax cash flow less taxes

<sup>9</sup> After tax cash flow plus useable tax credit

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