

Historic Rehabilitation Tax Credits 101

www.novoco.com/webinars

Copyright 2012 © Novogradac & Company LLP

Novogradac | Search

YouTube iTunes Twitter

Novogradac Podcasts

www.novoco.com/products

Tom Boccia, CPA
Wayne Michael, CPA

NOVOGRADAC & COMPANY
CERTIFIED PUBLIC ACCOUNTANTS

www.novoco.com/services

Knowledge building on history
Experience Service

Whether you're
electing to preserve
history through
the use of the Section 47
rehabilitation tax credit.

NOVOGRADAC & COMPANY
CERTIFIED PUBLIC ACCOUNTANTS

288 New Street, 28th Floor
San Francisco, CA 94104
(415) 774-3800
www.novoco.com

Questions:

thomas.boccia@novoco.com

cpas@novoco.com

Historic Rehabilitation Tax Credits 101

www.novoco.com/webinars

Copyright 2012 © Novogradac & Company LLP

Instructors:

Play-by-play



Wayne Michael, CPA

Director of Education and
Business Development

wayne.michael@novoco.com

Color commentary/analysis



Tom Boccia, CPA

Partner – Cleveland Office

thomas.boccia@novoco.com

Overview

Questions:

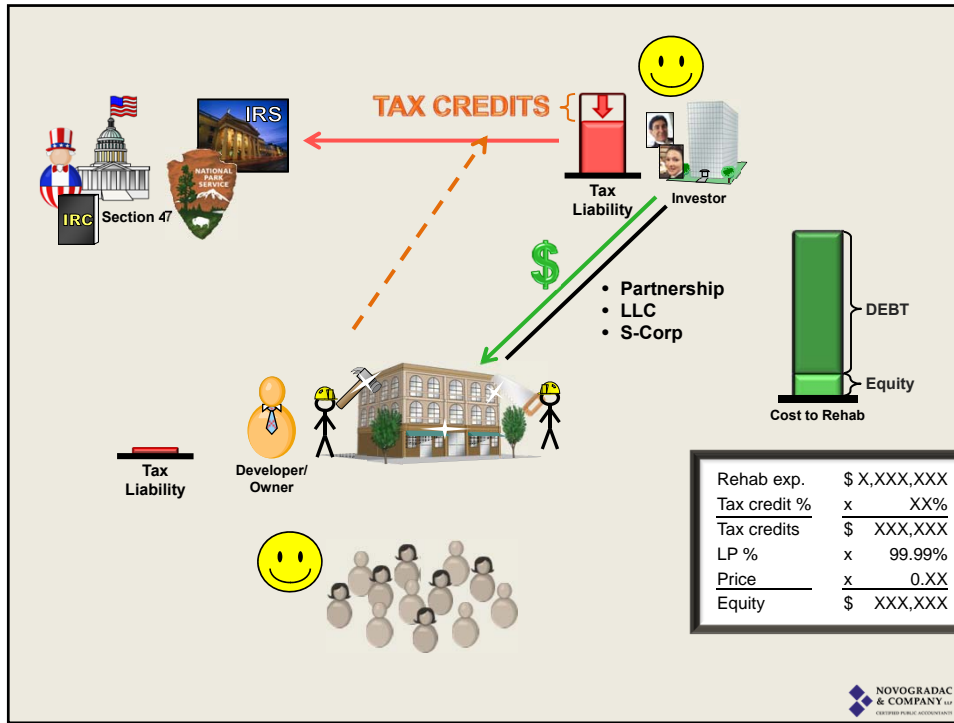
thomas.boccia@novoco.com

cpas@novoco.com

Historic Rehabilitation Tax Credits 101

www.novoco.com/webinars

Copyright 2012 © Novogradac & Company LLP



10% vs. 20% Credits

(and Certified Historic Structures and Certified Rehabilitations)

Questions:

thomas.boccia@novoco.com


cpas@novoco.com

Historic Rehabilitation Tax Credits 101

www.novoco.com/webinars

Copyright 2012 © Novogradac & Company LLP


10%
Tax Credit






**Built
Pre-1936**

Rehabilitation Tax Credits

1. Built before 1936 (10% Credit)
- 2.



20%
Tax Credit




National Register

www/nps.gov/hr

Rehabilitation Tax Credits

1. Built before 1936 (10% Credit)
2. Listed in National Register (20% Credit)



Questions:


thomas.boccia@novoco.com

cpas@novoco.com

Historic Rehabilitation Tax Credits 101

www.novoco.com/webinars

Copyright 2012 © Novogradac & Company LLP



20% Tax Credit

www/nps.gov/hr

National Register

Secretary of the Interior

Significant to district!

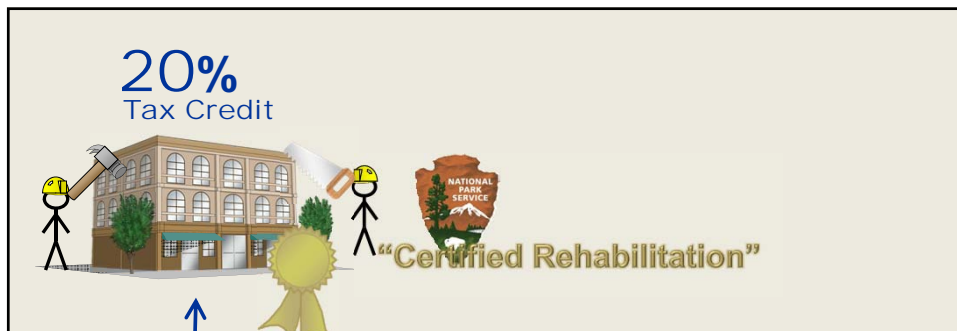

Registered Historic District

Rehabilitation Tax Credits

1. Built before 1936 (10% Credit)
2. Listed in National Register (20% Credit)

-OR-

Located in a *Registered Historic District* **AND** is listed as being of *significance* to that district (20% Credit)



20% Tax Credit

NATIONAL PARK SERVICE

"Certified Rehabilitation"


Certified Historic Structure

Rehabilitation Tax Credits

1. Built before 1936 (10% Credit)
2. Listed in National Register (20% Credit)

-OR-

Located in a *Registered Historic District* **AND** is listed as being of *significance* to that district (20% Credit)



Questions:


thomas.boccia@novoco.com

cpas@novoco.com

Historic Rehabilitation Tax Credits 101

www.novoco.com/webinars

Copyright 2012 © Novogradac & Company LLP



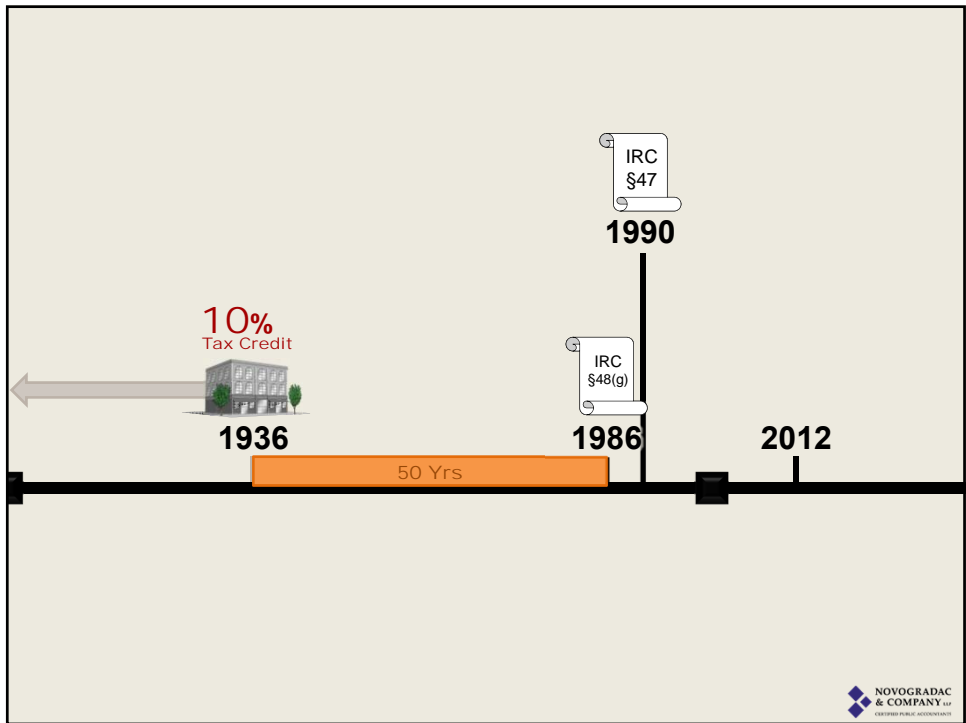

- Cannot be residential rental
- Internal/external wall preservation

Rehabilitation Tax Credits

1. Built before 1936 (10% Credit)
2. Listed in National Register (20% Credit)

–OR–

Located in a *Registered Historic District* AND is listed as being of *significance* to that district (20% Credit)



Questions:

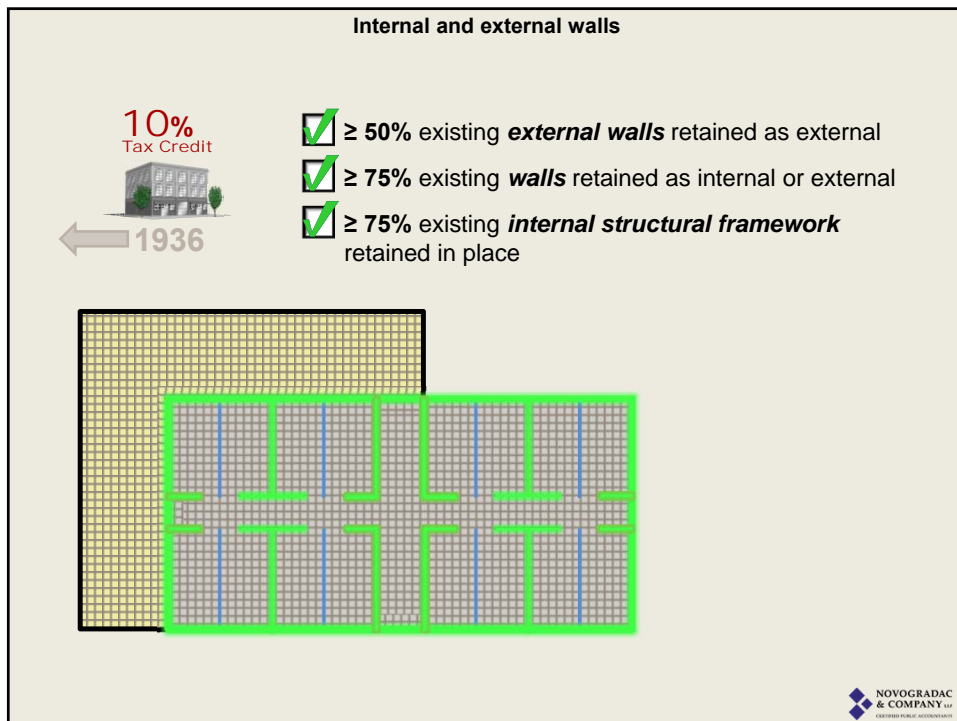
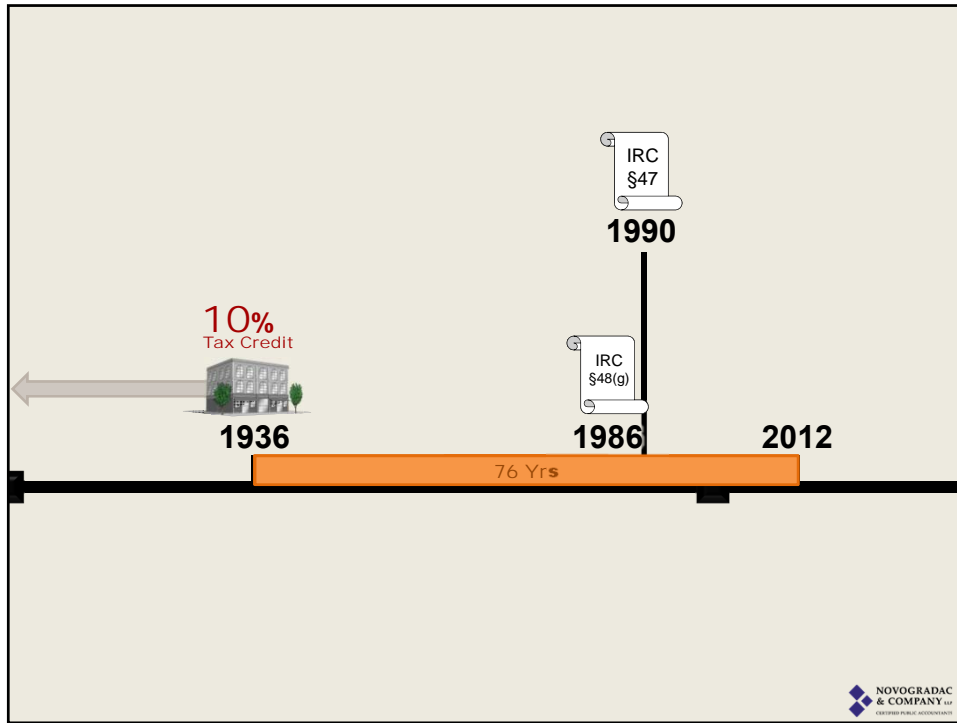
thomas.boccia@novoco.com

cpas@novoco.com

Historic Rehabilitation Tax Credits 101

www.novoco.com/webinars

Copyright 2012 © Novogradac & Company LLP



Questions:

thomas.boccia@novoco.com

cpas@novoco.com


Historic Rehabilitation Tax Credits 101

www.novoco.com/webinars

Copyright 2012 © Novogradac & Company LLP

Internal and external walls

10%
Tax Credit

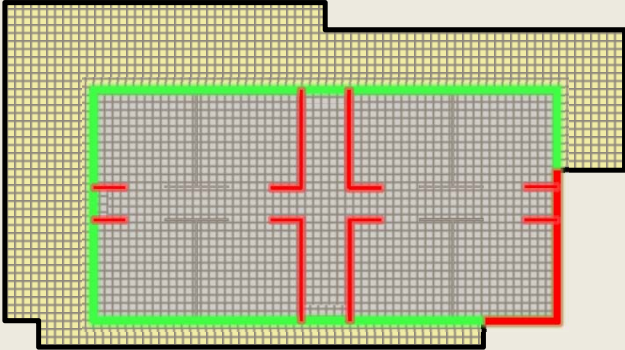



← 1936

≥ 50% existing **external walls** retained as external

≥ 75% existing **walls** retained as internal or external

≥ 75% existing **internal structural framework** retained in place



 **NOVOGRADAC & COMPANY** LLP
CERTIFIED PUBLIC ACCOUNTANTS

Certified Rehabilitation

- In order for a building to qualify for the 20% credit, the building must be a **certified historic structure** and the rehabilitation must be a **certified rehabilitation**.
 - Defined as “any rehabilitation of a certified historic structure which the Secretary of the Interior (NPS) has certified to the Secretary (of IRS) as being **consistent to the historic character of such property** or the district in which such property is located”

 **NOVOGRADAC & COMPANY** LLP
CERTIFIED PUBLIC ACCOUNTANTS

Questions:

thomas.boccia@novoco.com

cpas@novoco.com

The Two Tiers of the HTC

- Which credit applies?
 - The **IRS determines** if the project qualifies for the 20% credit
 - If the project qualifies for the 20% credit, then either the 20% credit can be taken **or no credit at all**
 - **The 10% credit cannot be claimed on a certified historic structure under any circumstance**



Qualified Rehabilitation Expenditures

Questions:

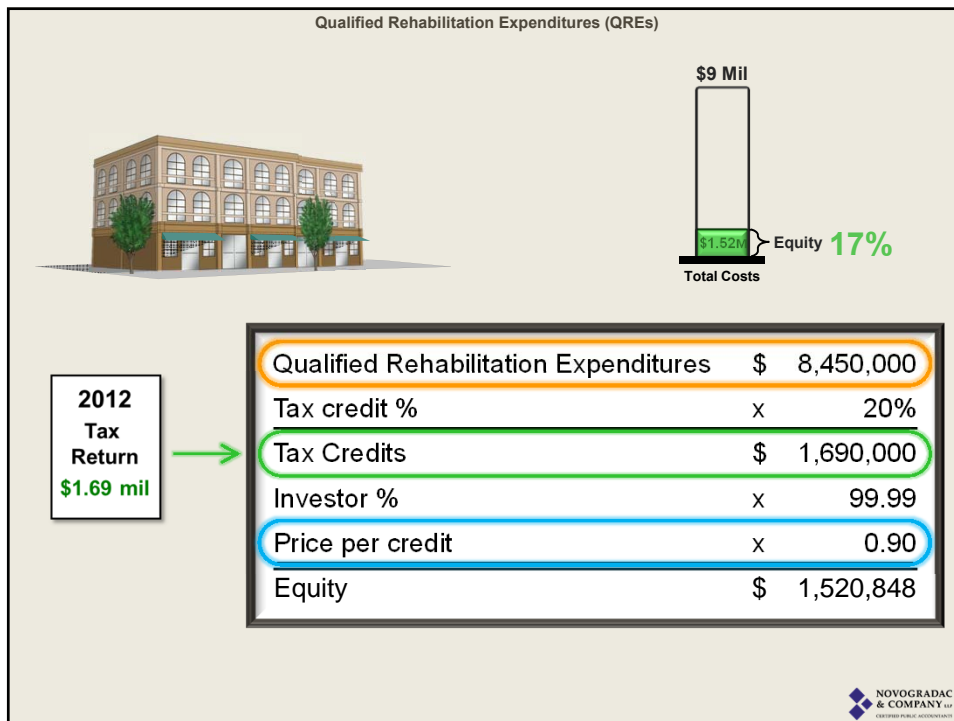
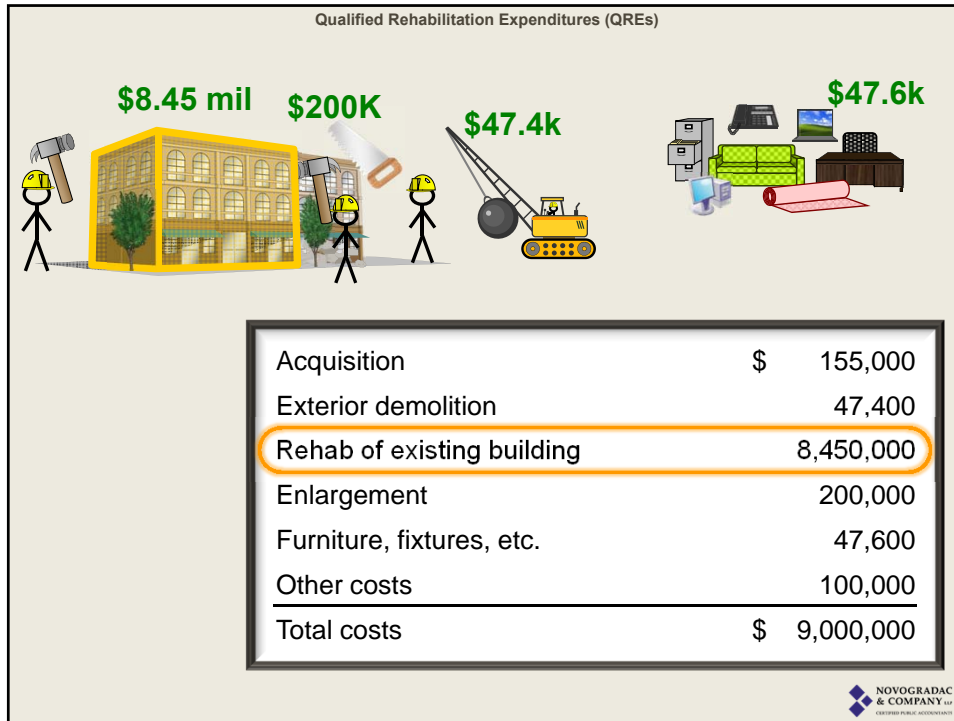
thomas.boccia@novoco.com

cpas@novoco.com

Historic Rehabilitation Tax Credits 101

www.novoco.com/webinars

Copyright 2012 © Novogradac & Company LLP



Questions:

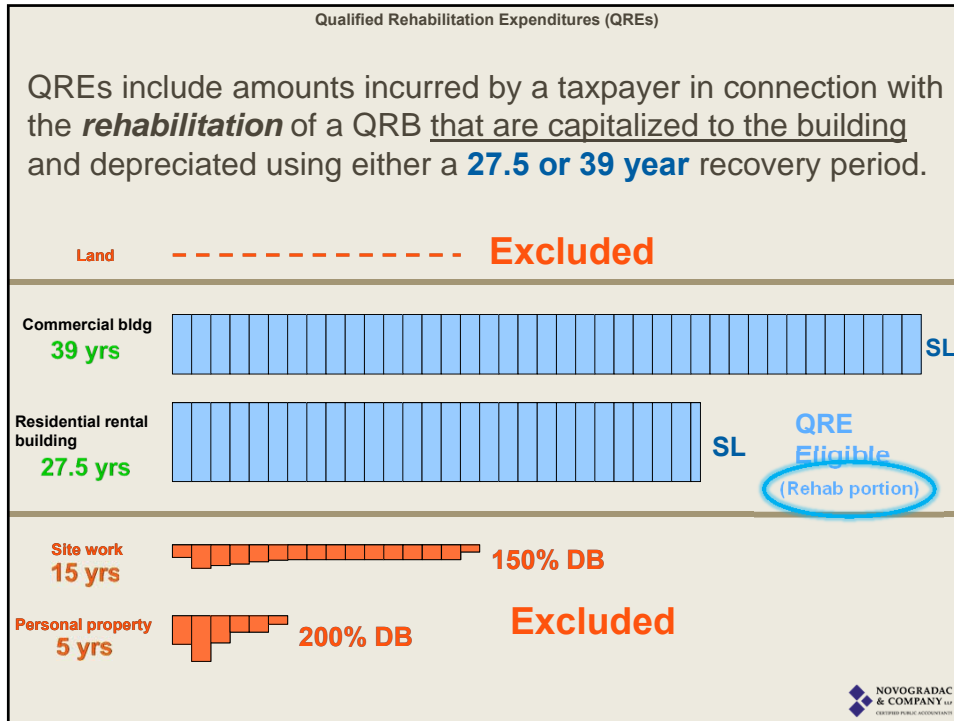
thomas.boccia@novoco.com

cpas@novoco.com

Historic Rehabilitation Tax Credits 101

www.novoco.com/webinars

Copyright 2012 © Novogradac & Company LLP



Qualified Rehabilitation Expenditures (QREs)

– Generally **includes**:

- Hard costs
- Insurance premiums
- **Legal costs**
- **Development fees**
- Site survey fees
- Architectural & engineering fees
- Interior demolition
- **Construction period interest and taxes**
- **“Additions”**



Questions:

thomas.boccia@novoco.com

cpas@novoco.com

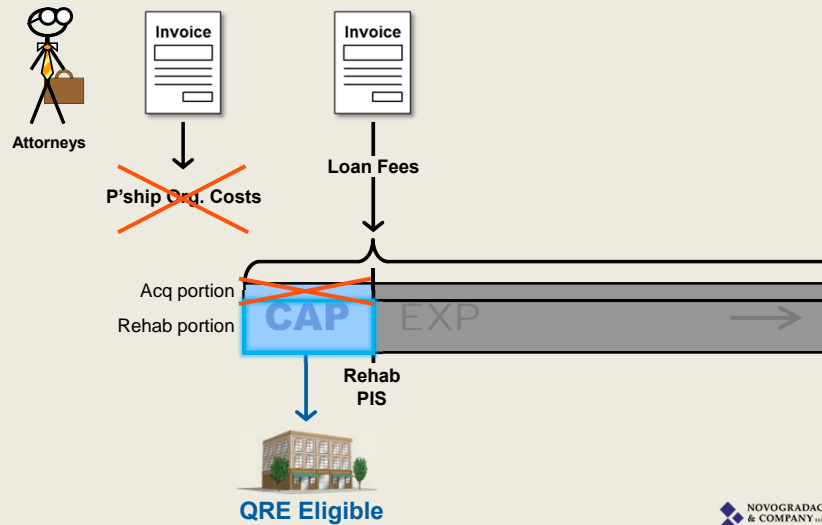
Historic Rehabilitation Tax Credits 101

www.novoco.com/webinars

Copyright 2012 © Novogradac & Company LLP

Qualified Rehabilitation Expenditures (QREs)

- Legal costs



Qualified Rehabilitation Expenditures (QREs)

- Development fees

Portion of fee *attributable to rehabilitation* of building is eligible and included as a QRE.

If the developer fee is paid to a related party, care must be taken so that the fee is considered *“reasonable”*

NOVOGRADAC & COMPANY LLP
CERTIFIED PUBLIC ACCOUNTANTS

Questions:

thomas.boccia@novoco.com

cpas@novoco.com

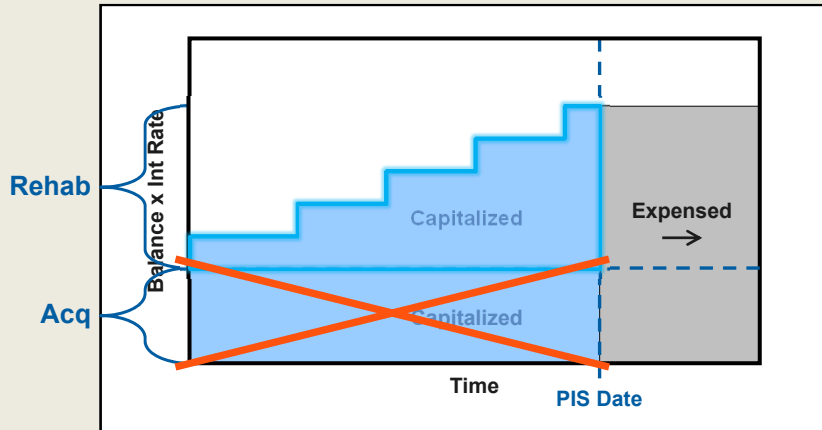
Historic Rehabilitation Tax Credits 101

www.novoco.com/webinars

Copyright 2012 © Novogradac & Company LLP

Qualified Rehabilitation Expenditures (QREs)

- Construction period **interest** and taxes



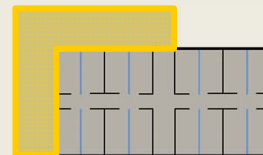
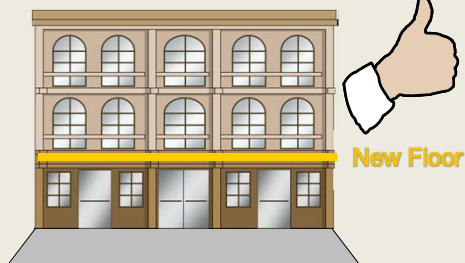
NOVOGRADAC & COMPANY LLP
CERTIFIED PUBLIC ACCOUNTANTS

Qualified Rehabilitation Expenditures (QREs)

- **“Additions”**
(Included)

vs.

- **“Enlargements”**
(Excluded)



NOVOGRADAC & COMPANY LLP
CERTIFIED PUBLIC ACCOUNTANTS

Questions:

thomas.boccia@novoco.com

cpas@novoco.com

Qualified Rehabilitation Expenditures (QREs)

Enlargements

- Any expenditure attributable to the enlargement of an existing building does not qualify as includable in HTC basis.
- It is important to differentiate between **additions**, which are includable in HTC basis and **enlargements**, which are not.
 - Additions refer to additional rehabilitation that does not go beyond the physical planes of the original building
- Neither term is defined in the IRC, however, **enlargement is defined in the IRS Regulations [1.48-12(c)(10)(i)]** which states that a building is enlarged to the extent that the total volume of the building is increased. Therefore, any **addition** that does not meet this definition can be classified as qualifying.



Qualified Rehabilitation Expenditures (QREs)

Enlargements

- In general a building is enlarged to the extent that the **total volume of the building is increased**.
 - An increase in floor space resulting from interior remodeling is **not** considered an enlargement.
 - The total volume of a building is generally equal to the product of the floor area of the base of the building and the height from the underside of the lowest floor (including a basement) to the average height of the finished roof (as it exists or existed).
 - For purposes of the HTC rules, **“addition” refers to additional rehabilitation that does not go beyond the physical planes of the original building**, while “enlargement” refers to construction that occurs outside the physical planes of the original building.



Questions:

thomas.boccia@novoco.com

cpas@novoco.com

Qualified Rehabilitation Expenditures (QREs)

– Generally *excludes*:

- Costs for personal-use property
- Acquisition costs
- Amounts treated as **expenses** and deducted
- Capitalized **interest** for existing building and land
- New building construction (i.e. **enlargements**)



Qualified Rehabilitation Expenditures (QREs)

Other considerations

- Any expenditure that uses a depreciation method other than straight line does not qualify as includable in basis for the HTC
- Acquisition costs do not qualify as includable in HTC basis, only rehabilitation costs.



Questions:

thomas.boccia@novoco.com

cpas@novoco.com

Qualified Rehabilitation Expenditures (QREs)

Tax-Exempt Use Property

The IRC provides that the portion of any expenditure that is allocable to tax-exempt use property is not included in calculating QREs and, therefore, is not included in HTC basis.



Qualified Rehabilitation Expenditures (QREs)

Tax-Exempt Use Property

- Problems caused by the tax-exempt use property rules can arise in three ways:
 1. For residential rental property:
 - The allocable portion of the property leased to a tax-exempt entity to be treated as tax-exempt use property.
 2. Nonresidential real property:
 - Property that is subject to a “disqualified lease” may be treated as tax-exempt use property. Disqualified lease is:
 - i. Tax-exempt financing used and lessee or related entity participated in financing.
 - ii. Lease contains fixed purchase property or an option to buy
 - iii. Lease term exceeds 20 years
 - iv. Lessee involved in sale leaseback with tax credit entity
 3. Special rules apply to partnerships with tax-exempt partners if the partnership agreement provides for allocations of partnership items that are not considered a “qualified allocations.” IRC applies highest % of any allocated item to determine tax-exempt use portion and amount disallowed



Questions:

thomas.boccia@novoco.com

cpas@novoco.com

Qualified Rehabilitation Expenditures (QREs)

Tax-Exempt Use Property

- Can be a non-profit owner of the for-profit tax credit entity if non-profit elects to be taxed as a for-profit entity to avoid portion of property considered as tax-exempt use property.
- The IRC provides that the portion of any expenditure that is allocable to tax-exempt use property is not included in calculating QREs and, therefore, is not included in HTC basis.
- Portion of property considered as non-tax exempt use property still available to earn HTCs.



Qualified Rehabilitation Expenditures (QREs)

Placed-in-service considerations

- Qualified rehabilitation expenditures generally shall be taken into account for the taxable year in which such qualified rehabilitated building is placed in service.
- It is important to note that placing in service is not dependent on *actual* use, only that it is or *was ready* for its *intended* use.



Questions:

thomas.boccia@novoco.com

cpas@novoco.com

Qualified Rehabilitation Expenditures (QREs)

Expenditures incurred by others

- Generally HTC is claimed by the taxpayer who owns the building at placed in service
- A taxpayer who purchased the building may claim the previous owner's QREs as long as the rehabilitation expenditures were not placed in service



Qualified Rehabilitated Buildings (QRBs)

Questions:

thomas.boccia@novoco.com

cpas@novoco.com

Historic Rehabilitation Tax Credits 101

www.novoco.com/webinars

Copyright 2012 © Novogradac & Company LLP

What is a Qualified Rehabilitated Building (QRB)?

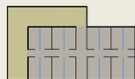
- The building must be located in the United States or in a territory of possession of the United States
- And must meet the four tests:



Qualified Rehabilitated Building (QRB)

There are 4 tests to determine if the building is a QRB:

1. Building must be **“substantially rehabilitated”**
2. Building must have been originally placed in service before the beginning of the rehabilitation
3. In the case of **any building other than a certified historic structure**, during the rehabilitation process:
 1. **50 percent or more of the existing external walls** of such building are retained in place as external walls,
 2. **75 percent or more of the existing walls of such building are retained in place as internal or external walls, and**
 3. **75 percent or more of the existing internal structural framework of such building is retained in place.**
 - There is no requirement regarding external walls for certified historic rehabilitations **since they are subject to more stringent rehabilitation requirements** imposed under the rules applicable to certified historic structures.
4. Depreciation must be allowable with respect to the building



Questions:

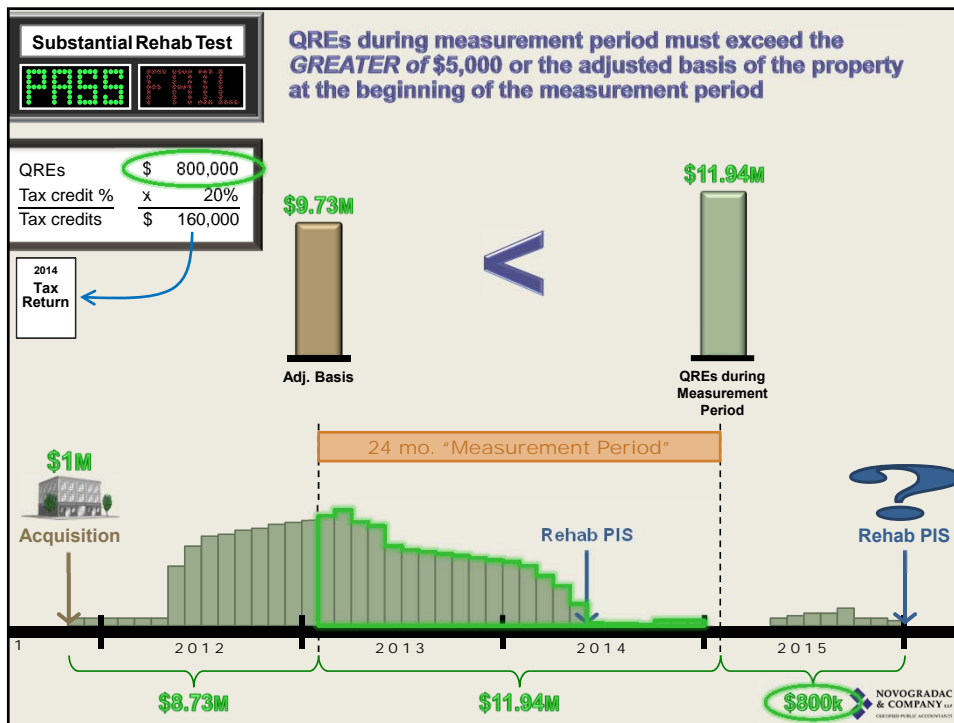
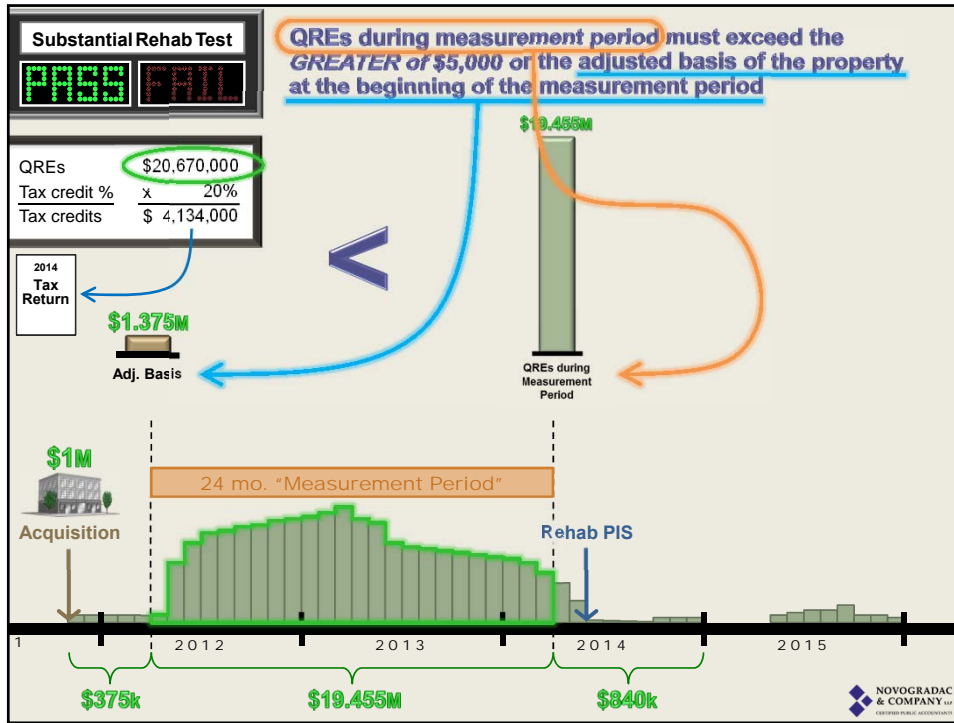
thomas.boccia@novoco.com

cpas@novoco.com

Historic Rehabilitation Tax Credits 101

www.novoco.com/webinars

Copyright 2012 © Novogradac & Company LLP



Questions:

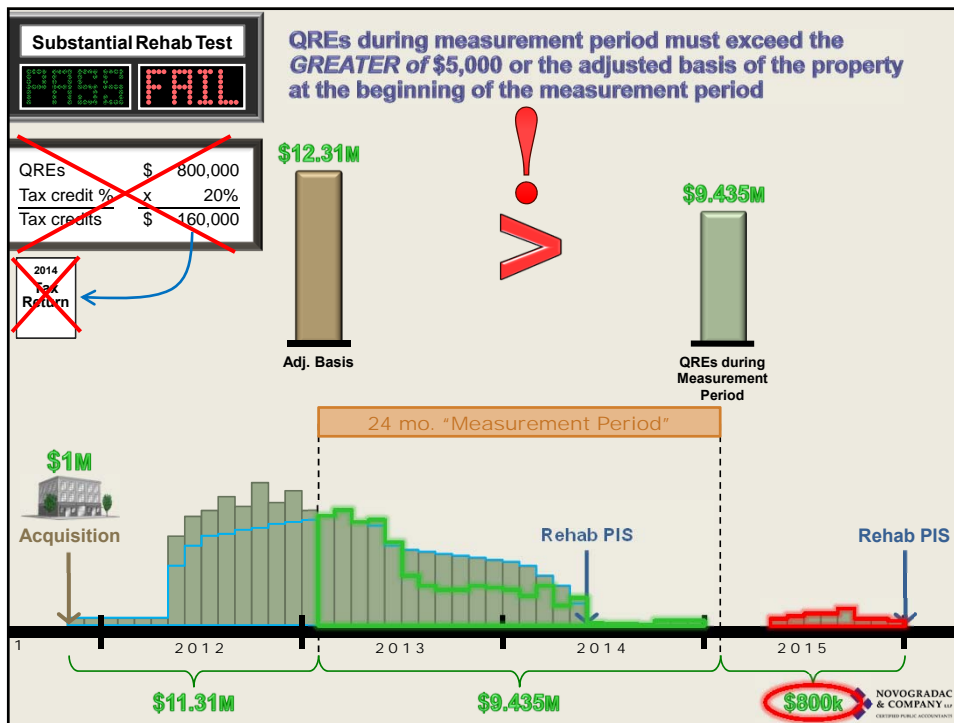
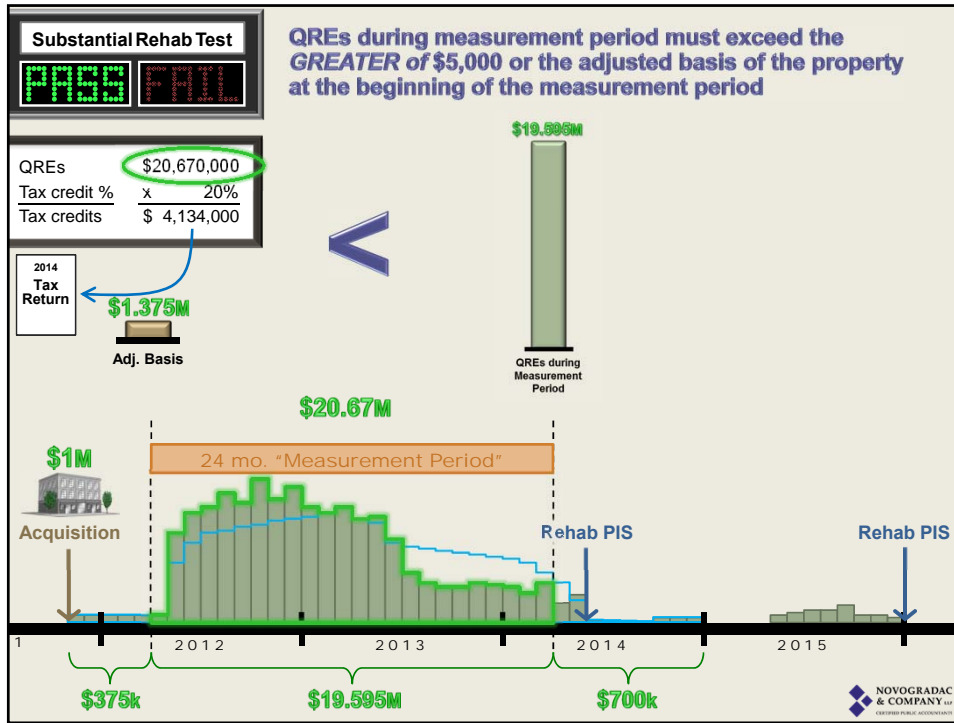
thomas.boccia@novoco.com

cpas@novoco.com

Historic Rehabilitation Tax Credits 101

www.novoco.com/webinars

Copyright 2012 © Novogradac & Company LLP



Questions:

thomas.boccia@novoco.com

cpas@novoco.com

Substantial Rehabilitation

Recap:

- The qualified rehabilitation expenditures (QREs) **during the measurement period** must exceed the greater of \$5,000 or the adjusted basis of the property at the **beginning of the measurement period**
- The 24-month period must end within **the tax year** in which the rehabilitation is placed in service
- If 10% credit is planned to be taken, adjusted basis will exclude post -1935 additions to the property
- Unless the rehabilitation qualifies as a **“phased” rehabilitation**, the entire building must be substantially rehabilitated



Phased Rehabilitation

- For rehabilitations that are sufficiently large enough in scope that completion will require a greater amount of time than 24 months, a **60-month measuring period** can be used.
- To qualify, the taxpayer must:
 1. Elect to use the 60-month period with tax return filing,
 2. NPS Part 2 filing must indicate project is a phased rehabilitation, and
 3. The rehabilitation “may be reasonably expected to be completed in phases set forth in **architectural plans and specifications** completed **before** the rehabilitation begins”



Questions:

thomas.boccia@novoco.com

cpas@novoco.com

Phased Rehabilitation (cont.)

- The rehabilitation must have been **contemplated** as a phased rehabilitation **in the planning phase**
- The 60-month rule can not be used because the rehabilitation unexpectedly exceeded the 24-month measuring period



Credit Recapture

Questions:

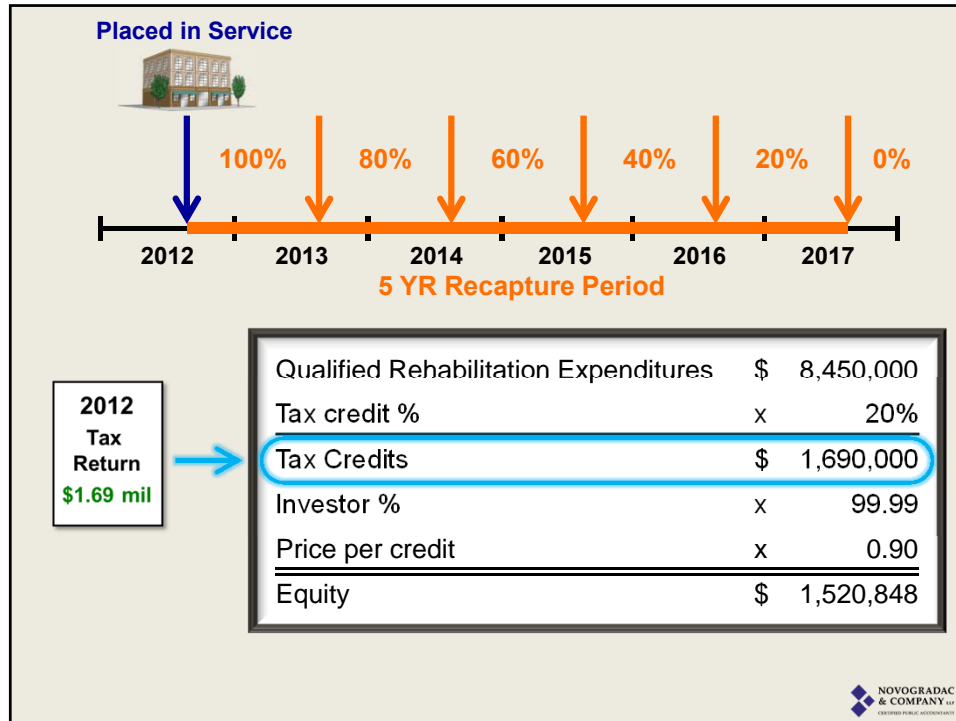
thomas.boccia@novoco.com

cpas@novoco.com

Historic Rehabilitation Tax Credits 101

www.novoco.com/webinars

Copyright 2012 © Novogradac & Company LLP



HTC Recapture

- Recapture of the credit occurs if, within five years of placing in service:
 - ownership of the property changes,
 - the property ceases to be investment credit property,
 - sale of a partnership interest, or
 - reduction of a partner's interest to less 2/3 of original ownership interest
- The recapture amount is equal to 100 percent of the credit claimed and used to reduce tax if the recapture event occurs before the first anniversary of the placed in service date, and is reduced by 20 percent for each subsequent year.

NOVOGRADAC & COMPANY LLP
CERTIFIED PUBLIC ACCOUNTANTS

Questions:

thomas.boccia@novoco.com

cpas@novoco.com

Housing & Economic Recovery Act of 2008

- Exempts the HTC from AMT – HTCs can now reduce AMT for Qualified Rehabilitation Expenditures taken **after December 31, 2007**
- Non-residential property is treated as tax-exempt use property only if the portion of such property leased to tax-exempt entities under disqualified leases is more than 50 percent of the property (previously 35 percent)

Basis Reduction Requirements

- Depreciable basis reduced by amount of tax credits
- Reduction in basis is treated as a reduction in partners' capital accounts
- Reduction in basis treated as accelerated depreciation for purposes of determining ordinary gain upon sale of property

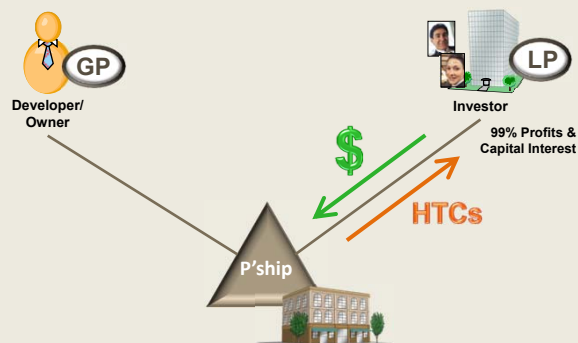
Questions:

thomas.boccia@novoco.com

cpas@novoco.com

Deal Structuring

Basic Structure: Direct



Questions:

thomas.boccia@novoco.com

cpas@novoco.com

Historic Rehabilitation Tax Credits 101

www.novoco.com/webinars

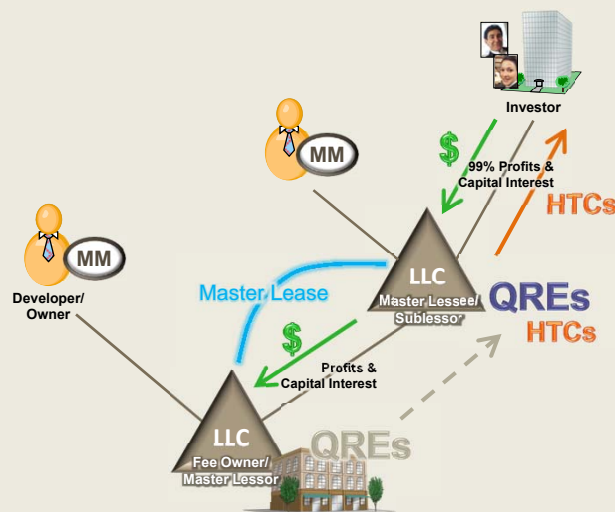
Copyright 2012 © Novogradac & Company LLP

Alternative Structure: Pass-Through Lease

- Pass-Through of Tax Credits to Lessee
- QRE's are incurred by Lessor/Owner
- Lessor and lessee make an election to "Pass-through" to the Lessee all or portion of the QRE's
 - Lessee is deemed to have incurred QREs



Alternative Structure: Pass-Through Lease



Questions:

thomas.boccia@novoco.com

cpas@novoco.com

Alternative Structure: Pass-Through Lease

- Requirements:
 - Must be IRC Section 38 property
 - Lessee must be original user of property
 - Lessor must make election to treat QRE's as incurred by Lessee
- No mandatory basis reduction applies
- Lessee includes in gross income each year an amount equal to the HTC it received from the lessor ratably over the recovery period or tax depreciable life of the property in the hands of the lessor.
 - Generally, the HTC that will be required to be recognized as income for residential property is 1/27.5th and for non-residential property is 1/39th



Application Process

Questions:

thomas.boccia@novoco.com

cpas@novoco.com

Application Process

- Consists of the preparation of Historic Preservation Certification Application - Form 10-168 (Rev 2011)
 - Part 1 – Evaluation of Significance
 - Part 2 – Description of Rehabilitation
 - Part 3 – Request for Certification of Completed Work
- All parts of the application are submitted to the SHPO where staff members review the application for completeness and accuracy
- SHPO then sends application to NPS with recommendation



HTC Application – Part 1

- Presents information about the significance and appearance of the building
- Required for taxpayers wishing to claim the HTC for buildings other than those listed on the National Register of Historic Places
- Owners of buildings already listed on the National Register do not need to request this determination
- For claiming the 10 percent credit, this form must be used to certify that a building listed in a registered district **does not** contribute to the historical significance of the district.



Questions:

thomas.boccia@novoco.com

cpas@novoco.com

HTC Application – Part 2

- Describes the condition of the building
- Used to document the rehabilitation of the structure
- Reviewed by NPS in order to determine whether the rehabilitation itself is consistent with the historic significance of the building or district and, therefore, qualify as a certified rehabilitation.
- Proposed work evaluated based upon the 10 rules referred to as the *Secretary of the Interior's Standards for Rehabilitation*
- *The NPS strongly advises that the Part 2 application be filed before any rehabilitation activities commence, although this is not required.*



HTC Application – Part 2 (cont.)

- What can happen next after submission of NPS Part 2 application? NPS will rule as follows:
 1. The proposed rehabilitation will meet the Secretary of Interior's standards but is preliminary pending a certification of the completed work,
 2. The proposed rehabilitation will meet the Secretary of the Interior's standards if conditions that accompany the returned Part 2 application are met, or
 3. The rehabilitation does not meet the Secretary of the Interior's standards and, therefore, does not qualify for the HTC (either credit percentage).



Questions:

thomas.boccia@novoco.com

cpas@novoco.com

HTC Application – Part 2 (cont.)

- NPS charges a fee with the Part 2 application.
 - For proposed or ongoing rehabilitation, an initial fee of \$250
 - A total fee between \$500 and \$2,500 is charged for review of completed rehabilitations (Part 3), and the initial \$250 serves as a credit to the entire fee.
- As with Part 1, the review timeframe of the Part 2 application should take no longer than 60 days.



HTC Application – Part 2 (cont.)

- The owner may resubmit its application again if it believes it has made sufficient changes to a previously denied rehabilitation proposal or wishes to modify its original submission due to a change in scope of the rehabilitation
- However, if work has commenced and a feature that NPS has denied as meeting its standards has been irretrievably altered, the entire project will be denied.



Questions:

thomas.boccia@novoco.com

cpas@novoco.com

HTC Application – Part 2 (cont.)

- The Part 2 application requires the owner to indicate:
 - original construction type,
 - the original use of the building,
 - proposed use after the rehabilitation, and
 - estimated total cost of the rehabilitation.
- Requires housing information before and after the rehabilitation for prior or future residential use, and the floor area in square feet before and after rehabilitation.



HTC Application – Part 2 (cont.)

- Requests very detailed information about each feature and how it is to be rehabilitated.
- Must include drawings and sketches of the proposed work to show planned alterations or new construction.
- The Part 2 application may be provided to the IRS by NPS.



Questions:

thomas.boccia@novoco.com

cpas@novoco.com

HTC Application – Part 3

- Upon completion of the rehabilitation work, the owner must provide a completed Part 3 Request for Certification of Completed Work.
- NPS determination on Part 3 is the final certification of whether the project does in fact qualify as a certified rehabilitation for purposes of the HTC.
- A representative of NPS or the SHPO will inspect the final product and make a determination on whether the proposed rehabilitation from the Part 2 application was in fact followed.



HTC Application – Part 3 (cont.)

- If a negative determination is rendered on the completed work, the owner may appeal the decision with the Chief Appeals Officer within 30 days of the determination.
 - The decision of the Chief Appeals Officer is the final administrative decision.
- Part 3 is required to be received no later than 30 months from date taxpayer filed tax return that claimed credits
- Part 3 is required to be supplied to the IRS by NPS and it is what allows credits to be claimed on the project.



Questions:

thomas.boccia@novoco.com

cpas@novoco.com

Historic Rehabilitation Tax Credits 101

www.novoco.com/webinars

Copyright 2012 © Novogradac & Company LLP

HTC Application – Part 3 (cont.)

- Part 3 requires the taxpayer to provide two key pieces of information:
 1. The starting date of the rehabilitation and the date the rehabilitation work was “completed and the building placed in service.”
 2. Requires that the owner estimate the total costs attributed
 1. Solely to rehabilitation of the certified historic structure, and
 2. To new construction associated with the rehabilitation, including additions, site work, parking lots and landscaping



Historic Rehabilitation Tax Credits Webinar

Thanks for joining us today!
Here are some additional Historic Tax Credits resources:

<p>LIHTC 101: The Basics Webinar Wednesday, February 29, 2012 10:00 AM to 12:30 PM PST LIHTC 101: The Basics Webinar</p>	<p>Webinar Survey</p>	<p>Historic Rehabilitation Handbook Historic Tax Credits Products</p>
<p>Historic Tax Credit Conference Louisville, Kentucky September 6-7, 2012 Historic Tax Credit Conference Novogradac YouTube Channel</p>	<p>YouTube Tax Credits. Simplified.</p>	<p>SUBSCRIBE To Industry Alert Emails Your Email: _____ Subscribe Sign up for Industry Alert Emails</p>

<http://www.novoco.com/events/other/webinar/htc/thankyou.php>



Questions:

thomas.boccia@novoco.com

cpas@novoco.com