# Rehabilitation Credit (Historic Preservation) FAQs

The following frequently asked questions (FAQs) were prepared in response to inquiries that have been presented to the IRS. They are intended to provide a basic understanding and awareness of the Rehabilitation Credit.

These FAQs do not constitute legal authority and may not be relied upon as such. They do not amend, modify or add to the Income Tax Regulations or any other legal authority.



## Eligibility and Definitions

### Q1. Who can claim a rehabilitation credit? (updated June 9, 2021)

The rehabilitation credit is an investment credit and part of the general business credit that a taxpayer can claim against the income tax. Taxpayers that own an interest in the building directly or through a passthrough entity, or are lessees of the building in certain cases, are eligible to claim the rehabilitation credit and generally include:

- Individuals
- Corporations
- Partners, Shareholders, and Beneficiaries of a passthrough entity
- Estates and Trusts

A passthrough entity is not eligible to claim the rehabilitation credit. A passthrough entity can allocate qualified rehabilitation expenditures to its partners, shareholders, or beneficiaries. A partner, shareholder, or beneficiary may claim the rehabilitation credit provided all requirements are met.

Lessees of buildings may qualify for the rehabilitation credit if the lessor that owns a building elects to treat a lessee of the building (or a portion of the building) as having purchased the building solely for purposes of the rehabilitation credit. The lessee of the building (or a portion of the building) is allowed to take the qualified rehabilitation expenditures into account for claiming the rehabilitation credit provided certain requirements are met.

- Treasury Regulation § 1.48-4(a)(1) provides the requirements for the time and manner for making an election to treat the lessee as having purchased the building for purposes of the rehabilitation credit.
- The lessor of the property is required to provide the lessee of the property with all the information needed to complete Form 3468 Investment Credit.

In the case of a long-term lease, without the lessor's election, the lessee's expenditures may be qualified rehabilitation expenditures and the lessee can claim a rehabilitation credit provided certain requirements are met. However, if on the date the rehabilitation is completed, the remaining term of the lease (determined without regard to any renewal periods) is less than the recovery period determined under section 168(c), then the lessee's expenditures are not included as qualified rehabilitation expenditures.

- Under I.R.C. § 168(c) the recovery period for residential rental property is 27.5 years and the recovery period for nonresidential real property is 39 years.

For additional information on leasing transactions see Can a lessee of a building (or a portion of the building) claim a rehabilitation credit?

Visit the Business Tax Credits page for additional information concerning the general business credit.

## Q2. When can a taxpayer claim the rehabilitation credit? (updated June 9, 2021)

The rehabilitation credit is generally first allowed in the taxable year the "qualified rehabilitated building" is placed in service provided that all requirements are met.

- The amount of the rehabilitation credit is determined in the taxable year the building is placed in service.
- The amount of the credit is equal to 20 percent of the "qualified rehabilitation expenditures" with respect to a "qualified rehabilitated building."

For additional information on how to claim the rehabilitation credit over the 5-year period see What is the effect of the Tax Cuts and Jobs Act on the rehabilitation credit? See also Treasury Regulation § 1.47-7.

## Q3. What requirements must be met to claim the rehabilitation credit? (updated June 9, 2021)

In general, the taxpayer must have "qualified rehabilitation expenditures" with respect to a "qualified rehabilitated building." A qualified rehabilitated building includes any building (and its structural components) if:

- The building has been "substantially rehabilitated;"
- The building was placed in service as a "building" before the beginning of the rehabilitation;
- The building is a certified historic structure; and
- Depreciation (or amortization in lieu of depreciation) is allowable with respect to the building

In general, a building is considered "substantially rehabilitated" if, during the 24-month measuring period that is selected by the taxpayer and that ends within the taxable year:

- The qualified rehabilitation expenditures exceed the greater of
  - The adjusted basis of the building (and its structural components), or
  - $5,000

A 60-month measuring period can be substituted for the 24-month measuring period if certain requirements are met. For additional information on the 60-month measuring period see What conditions must be met to substitute a 60-month measuring period for a the 24-month measuring period?

## Q4. What is a "certified rehabilitation?" (added June 9, 2021)

Expenditures do not meet the definition of a qualified rehabilitation expenditure unless the rehabilitation is a "certified rehabilitation."

- A "certified rehabilitation" means any rehabilitation of a certified historic structure which the National Park Service has certified to the Internal Revenue Service as being consistent with the historic character of such property or the district in which such property is located.

For additional information, see I.R.C. §§ 47(c)(2)(B)(iv) and 47(c)(2)(C) and Treasury Regulation § 1.48-12(d)(3).

## Q5. What constitutes a final certification by the Secretary of the Interior? (added June 9, 2021)

A taxpayer submits the request for final certification to the National Park Service on Form 10-168, Part 3, Request for Certification of Completed Work. The National Park Service reviews the National Park Service Form 10-168, Part 3, for the property.

Final approval occurs when the National Park Services certifies, on National Park Service Form 10-168, Part 3, a determination that the completed rehabilitation meets the Secretary of the Interior's Standards for Rehabilitation and is consistent with the historic character of the property and, where applicable, the district in which it is located.

## Q6. How is the rehabilitation credit claimed on a tax return? (updated June 9, 2021)

Taxpayers claim the rehabilitation credit on Form 3468, Investment Credit.

- Entities that do not claim a rehabilitation credit but pass though qualified rehabilitation expenditures also file Form 3468.

Form 3468, Instructions for Form 3468, as well as recent developments, related items and other information concerning Form 3468 are available on the About Form 3468, Investment Credit page.

## Q7. What is the effect of the Tax Cuts and Jobs Act on the rehabilitation credit?

The Tax Cuts and Jobs Act, signed December 22, 2017, affects the rehabilitation credit for amounts that taxpayers pay or incur for qualified expenditures after December 31, 2017. The credit is a percentage of expenditures for the rehabilitation of qualifying buildings in the year the property is placed in service.

The legislation:

- Requires taxpayers take the 20-percent credit ratably over five years instead of in the year they placed the building into service
- Eliminates the 10 percent rehabilitation credit for the pre-1936 buildings

A transition rule provides relief to owners of either a certified historic structure or a pre-1936 building by allowing owners to use the prior law if the project meets these conditions:

- The taxpayer owns or leases the building on January 1, 2018 and at all times thereafter
- The 24- or 60-month period selected for the substantial rehabilitation test begins by June 20, 2018

Notice 2020-58 grants relief for certain section 47 deadlines on account of the COVID-19 pandemic. As part of the relief granted, for taxpayers subject to the transition rule, Notice 2020-58 provides that, if the 24- or 60- month measuring period in which the requisite amount of qualified expenditures is paid or incurred to satisfy the substantial rehabilitation test for a building originally ends on or after April 1, 2020, and before March 31, 2021, the last day of the 24- or 60-month measuring period for a taxpayer to pay or incur the requisite amount with respect to the building is postponed to March 31, 2021.

## Q8. For taxpayers with amounts paid or incurred on or before December 31, 2017 or otherwise qualifying under the Tax Cuts and Jobs Act transition rule: Can a taxpayer claim the 10% rehabilitation tax credit on any building built before 1936?

No. A pre-1936 building must not be a certified historic structure and must have been placed in service before 1936. A certified historic structure is a building that is listed in the National Register of Historic Places or a building that is located within a Registered Historic District that has been certified by the National Park Service as contributing to the historic significance of the district.

Further, in the rehabilitation process: (i) 50% or more of the existing external walls of the building must be retained in place as external walls, (ii) 75% or more of the existing external walls of the building must be retained in place as internal or external walls, and (iii) 75% or more of the existing internal structural framework must be retained in place.

The amounts paid or incurred must also meet the definition of a qualified rehabilitation expenditure.

## Q9. Can a taxpayer claim the rehabilitation credit before receiving notice from the National Park Service that the rehabilitation is a certified rehabilitation? (added June 9, 2021)

In general, a taxpayer claiming the rehabilitation credit must enter the date that the final certification of completed work was received from the Secretary of the Interior with the tax return for the taxable year in which the credit is claimed along with evidence that the building is a certified historic structure;

- If the final certification of completed work has not been issued by the Secretary of the Interior at the time the tax return is filed for a year in which the credit is claimed,
    - The taxpayer must attach a copy of NPS Form 10-168, Historic Preservation Certification Application (Part 2-Description of Rehabilitation), with an indication that it was received by the Department of the Interior or the State Historic Preservation Officer, together with proof that the building is a certified historic structure (or that such status has been requested); and
    - after the final certification of completed work has been received, file Form 3468 with the first income tax return filed after receipt of the certification
- If a taxpayer fails to receive final certification within 30 months after the date the taxpayer filed a tax return on which the credit was claimed, the taxpayer must notify the Internal Revenue Service and shall be requested to consent to extend the statute of limitations relating to the item for which the credit was claimed. If the final certification is denied by the Department of Interior, the credit can be disallowed for any taxable year in which it was claimed.
    - The address to mail a consent to extend the statute of limitations for citation to § 1.48-12(d)(7)(ii)) can be on the Where to File Certain Elections, Statements, Returns and Other Documents page.

For additional information concerning the 60-month measuring period see What conditions must be met to substitute a 60-month measuring period for a the 24-month measuring period?

For additional information concerning claiming the rehabilitation credit when placed in service when a building is never taken out of service see How is the “placed in service” requirement met when a building is never taken out of service?

For additional information See Treasury Regulation § 1.48-12(d)(7) and § 1.48-12(f)(7).

## Q10. What is the definition of a building and structural components? (added June 9, 2021)

A building is generally defined as any structure or edifice enclosing a space within its walls, and usually covered by a roof, the purpose of which is, for example, to provide shelter or housing, or to provide working, office, parking, display, or sales space.

- The term building includes, for example, structures such as apartment houses, factory and office buildings, warehouses, barns, garages, railway or bus stations, and stores." It does not include a structure which is essentially an item of machinery or equipment or where the use is solely to house an item of machinery or equipment.

- The term structural components is generally defined to include such parts of a building as walls, partitions, floor and ceilings, as well as any permanent coverings, and certain components related to the operation and maintenance of a building.
    - The term structural components does not include certain types of machinery.
- A building does not include (i) a structure which is essentially an item of machinery or equipment or (ii) a structure that houses property used as an integral part of an activity specified in Treasury Regulation § 1.48-1(d)(1) if the use of the structure is so closely related to the use of such property that the structure clearly can be expected to be replaced when the property therein is replaced.

For additional information see Treasury Regulation § 1.48-1(e).

## Q11. What conditions must be met to substitute a 60-month measuring period for a the 24-month measuring period? (added June 9, 2021)

The 24-month measuring period is used to determine whether a building (or portion of a building) is substantially rehabilitated as part of determining whether the credit may be claimed, but the rehabilitation can occur over a longer time period. In general, the following requirements must be met to utilize a 60-month measuring period as a substitute for the 24-month measuring period:

- The rehabilitation may be reasonably expected to be completed in phases set forth in architectural plans and specifications completed before the rehabilitation begins.
    - A rehabilitation is reasonably expected to be completed in phases if it consists of two or more distinct stages of development.
    - Written plans that describe generally all phases of the rehabilitation process shall be treated as written architectural plans and specifications.
- If a taxpayer fails to complete the physical work of the rehabilitation prior to the date that is 30 months after the date the taxpayer filed a tax return on which the credit is claimed, the taxpayer must submit a written statement stating such fact and shall be requested to sign an extension to the statute of limitations.
    - The address to mail a consent to extend the statute of limitations for citation to § 1.48-12(d)(7)(ii)) can be on the [Where to File Certain Elections, Statements, Returns and Other Documents page].

For additional information concerning final certification see:

- [What is a “certified rehabilitation"?]
- [What constitutes a final certification by the Secretary of the Interior?]
- [Can a taxpayer claim the rehabilitation credit before receiving notice from the National Park Service that the rehabilitation is a certified rehabilitation?]

For additional information concerning the 60-month measuring period, see Treasury Regulation § 1.48-12(b)(2)(v).

For additional information concerning when the credit may be claimed, see Treasury Regulation § 1.48-12(f)(2).

## Q12. Is the length of a rehabilitation limited to 24 months? (added June 9, 2021)

No, the length of a rehabilitation is not limited to 24 months. The 24-month measuring period is used to determine whether a building (or portion of a building) is substantially rehabilitated as part of determining whether the credit may be claimed, but the rehabilitation can occur over a longer time period.

- A 60-month measuring period may be substituted for the 24-month measuring period if certain requirements are met.
- It is possible that portions of a building will apply separate 24-month measuring periods in different taxable years when a rehabilitation is completed in stages, over a period lasting longer than 24 months. In this case, the fact that a building qualified as a substantially rehabilitated building for one taxable year, has no effect on whether the building is a qualified rehabilitated building for property placed in service in a different taxable year.

For additional information on the 60-month measuring period for a phased rehabilitation see: What conditions must be met to substitute a 60-month measuring period for a the 24-month measuring period?

For additional information on multiple 24-month measuring periods, See Treasury Regulation § 1.48-12(b) and § 1.48-12(b)(2)(x), Example 2.

For additional information on rehabilitations when the building is never taken out of service see:

- How is the “placed in service” requirement met when a building is never taken out of service?
- What relationship exists between the “substantially rehabilitated” requirement and the “placed in service” requirement?

## Q13. Can a taxpayer switch to a 60-month phased project after starting under the default 24-month period? (added June 9, 2021)

A taxpayer can utilize a 60-month measuring period instead of a 24-month measuring period if all requirements to use a 60-month measuring period are met. Based on the requirements to use a 60-month period, it may be unlikely a taxpayer would meet these after starting a project.

For additional information on the requirements for the 60-month measuring period for a phased rehabilitation see What conditions must be met to substitute a 60-month measuring period for a the 24-month measuring period?

### Q14. Is the rehabilitation credit available for condominiums? (updated June 9, 2021)

Yes, a rehabilitation credit can be claimed for a condominium.  As with other property, a condominium will not be eligible for the rehabilitation credit if the property is used for the taxpayer's personal use.

### Q15. Is a sports stadium considered a building? (updated June 9, 2021)

Yes, a sports stadium can be considered a building.

For additional information See Treasury Regulation § 1.48-1(e) and Revenue Ruling 69-170 (1969-1 C.B. 28).

Back to top

## Qualified Rehabilitation Expenditures (QREs)

### Q1. Can a rehabilitation credit be claimed for an enlargement or addition to a building? (updated June 9, 2021)

No, any expenditure attributable to the enlargement of an existing building is excluded from the definition of qualified rehabilitation expenditure.

A building is enlarged to the extent that the total volume of the building increases.

However, an expenditure attributable to a prior addition or improvement that is made in connection with the substantial rehabilitation of a qualified rehabilitated building can be a qualified rehabilitation expenditure.

For additional information See I.R.C. § 47(c)(2)(B)(3) and Treasury Regulations § 1.48-12(c).

### Q2. What types of expenditures are qualified rehabilitation expenditures? (updated June 9, 2021)

In general, the term “qualified rehabilitation expenditure” means:

- Any amount properly chargeable to a capital account,
- That is incurred by the taxpayer,
- For property for which depreciation is allowable under I.R.C § 168, which is
    - nonresidential real property,
    - residential real property,
    - real property which has a class life of more than 12.5 years, or
    - an addition or improvement to the property describe above, and
- that is made in connection with the rehabilitation of a qualified rehabilitated building.

For additional information the term “qualified rehabilitation expenditures” see I.R.C. § 47(c)(2), Treasury Regulation § 1.48-12(b) and (c).

## Q3. What types of expenditures are not qualified rehabilitation expenditures? (updated June 9, 2021)

The term “qualified rehabilitation expenditures” does not include:

- Any expenditure with respect to which the taxpayer does not use the straight line method of depreciation over a recovery period determined under section I.R.C. § 168(c) or (g). That requirement does not apply to any expenditure to the extent the alternative depreciation system of I.R.C. § 168(g) applies to such expenditure by reason of I.R.C. § 168(g)(1)(B) or (C),
- The cost of acquiring any building or interest therein,
- Any expenditure attributable to an enlargement of an existing building,
- Any expenditure attributable to the rehabilitation of a qualified rehabilitated building unless the rehabilitation is a certified rehabilitation,
- In general, any expenditure allocable to the portion of property, which is tax-exempt use property,
- Any expenditure of a lessee, if on the date the rehabilitation is completed, the remaining term of the lease is less than the recovery period determined under section 168(c).

For additional information concerning qualified rehabilitation expenditures and certain expenditures not included, see I.R.C. § 47(c)(2) and Treasury Regulation § 1.48-12(c).

## Q4. What are some examples of expenses that are not qualified rehabilitation expenditures? (updated June 9, 2021)

- Acquisition costs

    - For this purpose the cost of acquisition includes any interest incurred on indebtedness the proceeds of which are attributable to the acquisition of a building, an interest in a building, or land upon which the building exists.
- Interest incurred on a construction loan the proceeds of which are used for qualified rehabilitation expenditures, however, is not treated as a cost of acquisition
- Enlargement costs
    - 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
- Expenditures not made in connection with the rehabilitation of a qualified rehabilitated building
- Expenditures attributable to work done to facilities related to a building, for example
    - sidewalks
    - parking lots
    - landscaping

For additional information, see Treasury Regulation § 1.48-12(b) and (c).

Back to top

# Basis

## Q1. How do you compute adjusted basis? (updated June 9, 2021)

Adjusted basis of a building is the cost of the property (excluding land) plus or minus adjustments to basis. The County Assessor's office would be able to provide a building to land value ratio. Increases to basis include capital improvements, legal fees incurred in perfecting title, zoning costs, etc. Decreases to basis include deductions previously allowed or allowable for depreciation. See I.R.C. § 1016 and Treasury Regulation 1.48-12(b)(2)(iii).

For the substantial rehabilitation test, the date to determine the adjusted basis of the building is the first day of the 24-month measuring period or the first day of the taxpayer's holding period of the building, whichever is later. Generally, the holding period is deemed to begin the day after acquisition.

## Q2. What is the effect on basis when a structure is rehabilitated or when recapture occurs? (updated June 9, 2021)

A taxpayer is required to reduce the basis of the property by the full amount of the rehabilitation credit determined. The rehabilitation credit is determined in the taxable year the property is placed in service. The taxpayer can claim the ratable share of the rehabilitation credit determined in each year over a 5-year period. If there is a recapture of the credit in a taxable year, the basis of the property is increased by the recapture amount.

Different rules apply in leasing arrangements where the lessor of the property elects to treat the lessee as having acquired the property. Instead of a basis adjustment, a lessee must include in gross income, over a certain period of time, an amount equal to the amount of the rehabilitation credit determined. If there is recapture of the credit in a taxable year, Treasury Regulation § 1.50-1 provides rules that coordinate the income inclusion rules with the recapture rules.

For additional information, see I.R.C. § 50(c) and (d) and Treasury Regulations § 1.47-7, § 1.48-12(e)(3), and § 1.50-1.

Back to top

# Placed in Service

## Q1. What is the definition of "placed in service"? (updated June 9, 2021)

In general, property is "placed in service" when the property is placed in a condition or state or readiness and availability for a specifically assigned function. A building generally is "placed in service" when the appropriate work has been completed which would allow for occupancy of either the entire building, or some identifiable portion of the building. See Treasury Regulation § 1.46-3(d).

## Q2. How is the "placed in service" requirement met when a building is never taken out of service? (updated June 9, 2021)

If a building remains in service (or partially in service) during the rehabilitation, property that is attributable to qualified rehabilitation expenditures will not be considered as placed in service until the building with respect to which the property is a part meets the definition of a qualified rehabilitated building.

For additional information See Treasury Regulation § 1.48-12(f)(2), including the example in § 1.48-12(f)(2)(iii).

For additional information concerning qualified rehabilitation expenditures see:

- What types of expenditures are qualified rehabilitation expenditures?
- What types of expenditures are not qualified rehabilitation expenditures?
- What are some examples of expenses that are not qualified rehabilitation expenditures?

## Q3. What relationship exists between the "substantially rehabilitated" requirement and the "placed in service" requirement? (updated June 9, 2021)

In general, the rehabilitation credit can be first claimed in the taxable year in which a qualified rehabilitated building is placed in service. For a building to be a qualified rehabilitated building, the building must have been substantially rehabilitated. As part of making the determination that a building has been substantially rehabilitated, a taxpayer must select a 24-month measuring period ending with or within the taxable year. As a result of the timing for claiming the rehabilitation credit and making the determination as to whether a building has been substantially rehabilitated, a qualified rehabilitated building will generally be considered "substantially rehabilitated" and "placed in service" in the same taxable year.

Fact patterns different from this general fact pattern could include:

- The building is never taken out of service so that it remains in service during the rehabilitation as described in How is the "placed in service" requirement met when a building is never taken out of service?; or
- A 60-month measuring period is substituted for the 24-month measuring period in the case of a phased rehabilitation. Note, under a phased rehabilitation, the building must still be considered a qualified rehabilitated building (and, thus, be considered substantially rehabilitated) prior to claiming the credit. See Ford vs. U.S., 989 F.2d 450 (11th Cir. 1993) (contains an analysis of the statute and regulations consistent with this note).

For additional information, See I.R.C. §§ 47(a)(1), (b)(1), and (c)(1)(C) and Treasury Regulations § 1.48-12(f)(2) and § 1.48-12(c)(6). For additional information on the substantial rehabilitation test, see Treas. Reg. § 1.48-12(b)(2)(x), Example 2.

## Q4. If a taxpayer claims a rehabilitation credit in a taxable year, can the taxpayer add expenditures incurred in subsequent taxable years to that credit? (updated June 9, 2021)

No. The amount of the rehabilitation credit is determined in the taxable year the qualified rehabilitated building (or portion of the basis of the building attributable to the qualified rehabilitation expenditures) is placed in service. Once the substantial rehabilitation test is met for a taxable year, the amount of qualified rehabilitation expenditures that can be claimed can include expenditures incurred:

- Before the beginning of the measuring period if made in connection with the rehabilitation of the qualified rehabilitated building;
- Within the measuring period during which the building was substantially rehabilitated (the measuring period must end with or within the taxable year); and
- After the end of the measuring period during which the building was substantially rehabilitated but prior to the end of the taxable year with or within which the measuring period ends.

However, a taxpayer can generally claim the rehabilitation credit in a subsequent taxable year provided the building (or portion of the building attributable to the qualified rehabilitation expenditures) meets the substantial rehabilitation test in that taxable year.

For additional information and examples, see I.R.C. § 47(b) and Treasury Regulations § 1.47-7, § 1.48-12(c)(6), § 1.48-12(b)(2), and § 1.48-12(f)(2).

## Q5. If a building is rehabilitated and placed in service, does the time of application for certification that the building is a "certified historic structure" have an impact on the taxpayer's ability to claim the rehabilitation credit on the rehabilitation? (updated June 9, 2021)

The term "certified historic structure" means any building (and its structural components) that is listed on the National Register of Historic Places, or located in a registered historic district and certified by the Secretary of the Interior to the Internal Revenue Service as being or historic significance in the district.

The National Park Service certification decision is provided on Form 10-168, Part 1 – Evaluation of Significance. When a taxpayer submits a National Park Service Form 10-168, Part 1 before the date a building is placed in service, the building shall be considered to be a certified historic structure on the date it is placed in service if:

- the taxpayer reasonably believes on that date that the building will be determined to be a certified historic structure, and
- the Department of Interior later determines the building is a certified historic structure.

If the building is individually listed in the National Register of Historic Places the request can be made after the building is placed in service.

If the building is located within a registered historic district the request cannot be made after the building is placed in service.

A taxpayer that failed to file National Park Service Form 10-168, Part 1 of the Historic Preservation Certification Application with the Department of Interior prior to placing property in service may be able to request relief under Treasury Regulations §301.9100-1 through §301.9100-3.

For additional information see Treasury Regulation § 1.48-12(d)(1).

Back to top

# Buying and Selling Credits

## Q1. Can the rehabilitation credit be bought and sold? (updated June 9, 2021)

No, the rehabilitation credit cannot be bought or sold.

- Taxpayers can invest in a rehabilitation and validly claim the credit
- Revenue Procedure 2014-12 (2014-3 I.R.B. 415, 2014) provides a safe harbor under which the Internal Revenue Service will not challenge partnership allocations of qualified rehabilitation expenditures by a partnership to its partners.

For additional information concerning a lessor election to treat the lessee of the building (or a portion of the building) as having purchased the building see Can a lessee of a building (or a portion of the building) claim a rehabilitation credit?

## Q2. Can a buyer claim the rehabilitation credit for qualified rehabilitation expenditures incurred by the seller of the building? (updated June 9, 2021)

Yes. In general, a buyer is allowed to treat qualified rehabilitation expenditures incurred by the seller as incurred by the buyer if the following conditions are met:

- The building, or the portion of a building (for example, a condominium unit to which rehabilitation expenses have been allocated), acquired by the buyer was not used or placed in service after the rehabilitation expenditures were incurred and prior to the date of acquisition, and
- No rehabilitation credit is claimed with respect to the qualified rehabilitation expenditures by anyone except the buyer.

The amount of the rehabilitation expenditures treated as incurred by the buyer is the lesser of:

- The amount of rehabilitation expenses incurred before the date of acquisition, or
- The portion of the cost of the property that is allocable to the property resulting from the rehabilitation expenditures.

For additional information see Treasury Regulation § 1.48-12(c)(3)(ii).

[Back to top](#)

## Tax Exempt and Lessee Issues

### Q1. Can a taxpayer claim the rehabilitation credit on property that is leased by a tax-exempt entity, i.e. a governmental agency or a non-profit organization? (updated June 9, 2021)

Yes, taxpayers can lease their property to a tax-exempt entity provided the lease does not result in a "disqualified lease" as defined in I.R.C. § 168(h)(1)(B). A disqualified lease occurs when:

1. Part or all of the property was financed directly or indirectly by an obligation in which the interest is tax exempt under I.R.C. § 103(a) and such entity (or related entity) participated in the financing,
2. Under the lease there is a fixed or determinable purchase price or an option to buy,
3. The lease term is in excess of 20 years, or
4. The lease occurs after a sale or lease of the property and the lessee used the property before the sale or lease. See I.R.C. § 168(h)(1)(B)(ii).

An exception under the Treasury Regulations provides that property is not considered tax exempt use property if 50% or less of the property is leased to tax-exempt entities in disqualified leases.

### Q2. Are tax-exempt entities and other similar entities allowed to utilize the rehabilitation credit? (updated June 9, 2021)

The rehabilitation credit generally is not determined for property used by tax-exempt entities, governments, foreign persons, or foreign entities (each considered a “tax-exempt entity” for this purpose). However, a rehabilitation credit may be determined in the following situations:

- In the case of an exempt organization (other than a cooperative described in I.R.C. § 521) if the property is used predominantly in an unrelated trade or business the income of which is subject to tax under I.R.C. § 511, and
- If the property is leased to a tax-exempt entity. However, care should be taken when leasing property to a tax-exempt entity because it is possible for a leased property to be considered “tax-exempt use property” which would limit the ability to claim the rehabilitation credit.

In situations where a partnership owns or leases the property, the rules provided in I.R.C. § 168(h)(5) and (6) apply, which will generally mean that a portion of the property equal to the tax-exempt entity's proportionate share will be considered property used by a tax-exempt entity and no rehabilitation credit is determined for that portion. Often, the partnership makes "qualified allocations" that meet the requirements of I.R.C. § 168(h)(6)(B) so that a portion of the qualified rehabilitation expenditures is allocable to the taxable partners and qualified allocations of a portion of the other partnership items are allocable to the tax-exempt entity partner(s) in order to ensure that the partnership's goals are being met.

See also Can a taxpayer claim the rehabilitation credit on property that is leased by a tax-exempt entity, i.e. a governmental agency or a non-profit organization?

## Q3. Can a lessee of a building or a portion of the building claim a rehabilitation credit? (updated June 9, 2021)

Yes, in certain circumstances the lessee of a building (or portion of the building) can claim a rehabilitation credit.

In the case of a long-term lease, without the lessor's election pursuant to Treasury Regulation § 1.48-4(a)(1), the lessee's expenditures may be qualified rehabilitation expenditures and the lessee can claim a rehabilitation credit provided certain requirements are met. However, if on the date the rehabilitation is completed, the remaining term of the lease (determined without regard to any renewal periods) is less than the recovery period determined under section 168(c), then the lessee's expenditures are not included as qualified rehabilitation expenditures.

- Under I.R.C. § 168(c) the recovery period for residential rental property is 27.5 years and the recovery period for nonresidential real property is 39 years.

Additionally, the lessor of a building can elect to treat the lessee of the building (or a portion of the building) as having purchased the building (or portion of the building) solely for purposes of the rehabilitation credit. The lessee of the building (or a portion of the building) is allowed to claim a rehabilitation credit provided certain requirements are met.

- A tax-exempt entity cannot pass the rehabilitation credit to its lessee(s) because Treasury Regulation § 1.48-4(a)(1) generally requires that the property must be property with respect to which depreciation is allowable to the lessor.

For information concerning specific requirements regarding the election of a lessor to treat the lessee as purchaser, see Treasury Regulation § 1.48-4(a)(1).

For additional information concerning tax-exempt entities and the rehabilitation credit see Are tax-exempt entities and other similar entities allowed to utilize the rehabilitation credit? and Can a taxpayer claim the rehabilitation credit on property that is leased by a tax-exempt entity, i.e. a governmental agency or a non-profit organization?

For information concerning the income inclusion required when a lessee is treated as having acquired investment credit property, see Treasury Regulation § 1.50-1 and § 1.47-7.

Back to top

# Accounting Issues

### Q1. What method of depreciation is required when claiming the rehabilitation credit? (updated June 9, 2021)

Generally, the rehabilitation credit is available only if the taxpayer uses the straight-line method of depreciation. Treasury Regulation § 1.48-12(c)(7)(i). Exceptions are contained in Treasury Regulation § 1.48-12(c)(8). The current recovery period under I.R.C. § 168(c) is 15 years for qualified improvement property placed in service after 2017, 27.5 years for residential rental property, and 39 years for non-residential real property. The current recovery period under I.R.C. § 168(g) is 20 years for qualified improvement property placed in service after 2017, 30 years for residential rental property placed in service after 2017, and 40 years for non-residential real property.

### Q2. How does a cash basis taxpayer account for qualified rehabilitation expenditures?

Treasury Regulation 1.48-12(c)(3) states that an expense is incurred by the taxpayer on the date such expenditure would be considered incurred under an accrual method of accounting, regardless of the method of accounting used by the taxpayer with respect to the other items of income and expense.

### Q3. May a taxpayer claim a rehabilitation credit for the portion of basis of rehabilitated property deducted as additional first year depreciation? (added June 9, 2021)

No. If the rehabilitated property is qualified property for purposes of the additional first year depreciation deduction under I.R.C. § 168(k), the rehabilitation credit may not be claimed for the portion of the basis of the rehabilitated property deducted as additional first year depreciation. Treasury Regulations § 1.48-12(c)(8), § 1.168(k)-1(f)(10), and § 1.168(k)-2(g)(9). However, a taxpayer may claim the rehabilitation credit for the remaining basis, if any, of such rehabilitated property.  Treasury Regulation § 1.168(k)-1(f)(10)(i)(B) and § 1.168(k)-2(g)(9)(i)(B).

Back to top

# Recapture

## Q1. How do the recapture rules apply? (updated June 9, 2021)

The rehabilitation credit is recaptured if the property is disposed of or otherwise ceases to be investment credit property during the 5-year recapture period.

- The recapture percentage is 100 percent for property that ceases to be investment credit property within one full year after it is placed in service, reduced by 20 percentage points for each year held during the 5-year recapture period.

For additional information see I.R.C. § 50(a) and Treasury Regulation § 1.47-7 and § 1.50-1.

For additional information concerning recapture in the case of a partnership see Is a partner's sale of a partnership interest or other reduction in a partner's interest in a partnership a recapture event?

## Q2. Is a partner's sale of a partnership interest or other reduction in a partner's interest in a partnership a recapture event? (updated June 9, 2021)

In general, if a partner's interest in a partnership is reduced by more than one-third, for example by:

- A sale of a partnership interest,
- Change in the partnership agreement, or
- The admission of a new partner.

The reduction is treated as a proportional disposition of the property.

For additional information concerning recapture of the investment credit upon the disposition of a partnership interest see Treasury Regulation § 1.47-6(a)(2).

For additional information on recapture of the investment credit see How do the recapture rules apply?

### Q3. Is the rehabilitation credit recaptured if the property is destroyed by a casualty? (updated June 9, 2021)

In general, the rehabilitation credit is recaptured if the property is disposed of or ceases to be investment credit property during the 5-year recapture period.

- The rehabilitation credit is recaptured if the property is destroyed by a casualty within the 5-year recapture period. Examples of a casualty include:
    - Hurricane
    - Flood
    - Tornado
    - Earthquake

In practice, partially damaged property would not trigger recapture if the owner makes the necessary repairs and places the property back in service.

The rehabilitation credit is not subject to recapture after the 5-year recapture period even if the property for which the rehabilitation credit was claimed is destroyed by a casualty.

For additional information on recapture of the investment credit see How do the recapture rules apply?

Back to top

## Carry Back/Forward, Passive Activities, and Other Limitations

### Q1. Can the rehabilitation credit be carried back and carried forward? (updated June 9, 2021)

The rehabilitation credit is an investment credit that is part of the general business credit that a taxpayer can claim against the income tax.

- A taxpayer is generally allowed to carryback one year and carryforward 20 years unused portions of the general business credit.

For additional information see I.R.C. § 39.

Visit the Business Tax Credits page for additional information concerning the general business credit.

## Q2. Can other sections of the Internal Revenue Code prevent a taxpayer from claiming the rehabilitation credit? (updated June 9, 2021)

Yes, the rehabilitation credit is an investment credit and part of the general business credit that a taxpayer can claim against the income tax. The general business credit rules and other provisions of the Internal Revenue Code can limit a taxpayer's ability to claim the credit in a taxable year. Examples of those limitations are the:

- Alternative Minimum Tax
- The general business credit is not allowed to be claimed against the alternative minimum tax
- Passive Activity Loss Rules
- At-Risk Rules

For additional information concerning the general business credit visit the Business Tax Credits page.

For additional information concerning the Passive Activity Loss rules and At-Risk Rules visit the About Publication 925, Passive Activity and At-Risk Rules page.

## Q3. What are Passive Activity Restrictions? (updated June 9, 2021)

The Tax Reform Act of 1986 introduced tax law changes which indirectly impacted the rehabilitation tax credit. One of these changes, the "Passive Activity Provisions," was intended to stop "abusive tax shelters." Although not directly related, these changes have impacted the availability of the rehabilitation tax credit for certain types of investors.

A passive activity is any trade or business in which the taxpayer did not materially participate, and any rental activities. Material participation is defined under I.R.C § 469(h) and generally requires a taxpayer to be involved in the activity on a regular, continuous, and substantial basis. Modifications to the Passive Activity provisions under the Omnibus Budget Reconciliation Act of 1993, (effective for taxable years after December 31, 1993), provided some relief for rental activities by adding I.R.C. § 469(c)(7). I.R.C. § 469(c)(7) provides an exception to the per se passive rule applicable to rental real estate for eligible taxpayers engaged in a real property trade or business, as defined in I.R.C. § 469(c)(7)(C). To be eligible, a taxpayer must meet the following requirements:

1. more than one-half of the personal services the taxpayer performed in all businesses during the taxable year were performed in real property trades or business in which the taxpayer materially participated, and
2. the taxpayer performed more than 750 hours of services during the tax year in real property businesses in which the taxpayer materially participated.

## Q4. How do the passive activity restrictions affect taxpayers with adjusted gross income greater than $250,000? (updated June 9, 2021)

Individuals who do not have net passive income sufficient to offset the passive losses, including limited partners, with adjusted gross income greater than $250,000 who invest in a rehabilitation tax credit project cannot use the tax credit to offset income tax from non-passive income in that tax year. The credit is suspended and carried forward and will be available when either income falls below $200,000 (it is partially available when income falls between $200,000 and $250,000) or there exists net passive income sufficient to offset the passive losses generated by the rehabilitation project. See I.R.C. § 469(i)(3)(B).

A computation is required to figure the regular tax liability allotted to passive activities. In other words, even if a taxpayer has net passive income, they might not be able to utilize entire rehabilitation tax credit. Please see net passive income example below.

## Q5. If a taxpayer's investment is passive and income is below $200,000, how is the tax credit affected? (updated June 9, 2021)

Generally, rental real estate losses up to $25,000 may be deducted in full by anyone whose modified adjusted gross income is less than $100,000 regardless of the passive nature of these losses. For investors in rehabilitation projects, this income level is raised to $200,000. The rehabilitation tax credit, however, is limited to the credit equivalent of $25,000 loss. This does not mean that the taxpayer can deduct a credit of $25,000. Instead a taxpayer is allowed the tax credit equivalent of $25,000 loss. Thus, for example, if a taxpayer was in a 36% tax bracket, the taxpayer could use $9,000 of tax credits per year (36% x $25,000 = $9,000). Unused credits can be carried forward indefinitely until they can be used.

## Q6. If a taxpayer has net passive income, could the full use of the rehabilitation credit be restricted? (updated June 9, 2021)

Perhaps, as illustrated in the following example:

John rehabilitates a certified historic structure used in a business in which he does not materially participate and generates a rehabilitation tax credit of $43,000. He files a joint return in 2021 reflecting $160,000 in taxable income. Of this total, $40,000 is from a passive activity (commercial rental). John's total tax liability on the $160,000 taxable income is $42,095.

John's taxable income reduced by net passive activity income is $120,000 ($160,000-$40,000). Tax on $120,000 is $29,080. Tax liability applicable to the passive activity is $13,015 ($42,095-$29,080). John can use passive credits up to $13,015 and carry forward unused credits of

$29,985 ($43,000-$13,015). Simply stated, the more passive income, the more tax credit can be used. The less passive income, the less tax credit can be used.

Please note: Credits generated from non-passive rehabilitation projects will not be limited.

## Q7. Under what circumstances would a taxpayer's rehabilitation credit not be limited by the Passive Activity Rules? (updated June 9, 2021)

***Material Participation.*** Generally, if a taxpayer either works more than 500 hours a year or performs substantially all of the work in a business, he or she is deemed to be materially participating, and losses and/or income are non-passive. However, the material participation rules do not apply rental real estate activities. Real estate rental is passive by definition regardless of the amount of time a taxpayer may participate in the rental real estate activity.

**Example:** John is an architect and rehabilitates a certified historic structure. If John uses the building for his architectural business, the credit is not limited because it is stemming from a non-passive activity. (Non-passive credit)

If John rehabilitates the same building and rents the space to a restaurant, the rehabilitated building is now rental real estate (passive by definition) and will be limited. (Passive credit)

***Real Estate Professionals.*** . If more than one half of a taxpayer's personal services in all business are performed in real property businesses (property development, construction, acquisition, conversion, rental, management, leasing, or brokering) and the taxpayer works more than 750 hours a year in real property trade or businesses, the taxpayer is a real estate professional. If a taxpayer is a real estate professional, then the taxpayer’s rental real estate activities in which the taxpayer materially participates are not passive activities.

***Short-term rentals.*** If a taxpayer rehabilitates a historic building and uses it for short term rental, such as a Bed & Breakfast or a Hotel/Motel, and materially participates in the operation of the business (i.e. spends more than 500 hours), the rehabilitation tax credit generated from this project is deemed to be non-passive, and the credit will not be restricted.

***Corporate entity.*** While the passive activity loss rules do not generally apply to regular C-Corporations, they do apply to personal service corporations and to closely held corporations in a limited way. For personal service corporations and closely held corporations, material participation is determined based on the level of participation of the shareholders. One or more individuals who hold more than 50% of the outstanding stock must materially participate in the activity in order for the corporation to meet the material participation standard.

## Q8. Can a taxpayer's involvement be non-passive in one year and passive in the next year?

Yes, passive activity rules are applied on a year-by-year basis. A taxpayer could materially participate in a business generating a rehabilitation tax credit in one year, use the rehabilitation tax credit and have a passive interest in the business operation the following year.

Back to top

## Special Circumstances

### Q1. How is the rehabilitation credit computed when a portion of the property is not used for business? (updated June 9, 2021)

The amount of the rehabilitation credit is equal to 20 percent of the qualified rehabilitation expenditures with respect to a qualified rehabilitated building.

A qualified rehabilitation expenditure must be "properly chargeable to a capital account." In addition, the rehabilitated property must be depreciable and the depreciation for such property must be determined under I.R.C. § 168. If the rehabilitated property is used for both business and non-business (personal) use, an allocation of the rehabilitation expenditures must be made. The allocation is generally made based on a square footage percentage. The only expenditures eligible for the tax credit would be those associated with the business use portion of the rehabilitated property. When a personal residence is used also for business, the business use portion of the home (e.g., home office) would be eligible. Expenditures associated with common living areas, such as a kitchen, bedroom, living room, bathroom, etc., would not be eligible because they are not used **exclusively** for business. If the owners of a Bed & Breakfast live on the premises, the business use portion would only be those areas that are used **exclusively** for business.

To be eligible for the rehabilitation tax credit, the property must be substantially rehabilitated. This means that the qualified rehabilitation expenses must exceed the entire building's adjusted basis. If property is used for both business and personal use, the adjusted basis would include both the business and personal use portions.

### Q2. How is the rehabilitation credit computed when a property is used as a rental property some of the time and as a personal vacation home at other times? (added June 9, 2021)

The amount of the rehabilitation credit is equal to 20 percent of the qualified rehabilitation expenditures with respect to a qualified rehabilitated building.

A qualified rehabilitation expenditure must be "properly chargeable to a capital account". In addition, the rehabilitated property must be depreciable and the depreciation of such property must be determined under I.R.C. § 168. If a structure is used for both rental and personal use, an allocation of the rehabilitation expenditures must be made. The allocation is generally made based on percent of the time that the property is rented at fair rental value, compared to the total number of days the property is used. See I.R.C. § 280A(e). However, if the property is used as a rental property for less than 15 days during the taxable year, it would not be eligible. See I.R.C. § 280A(g).

## Q3. Can the rehabilitation credit be used in conjunction with the low-income housing tax credit? (updated June 9, 2021)

Yes, there is no prohibition within the Internal Revenue Code, but care should be taken to make sure all requirements of each section are met, and any appropriate adjustments (such as adjustments to basis as required under I.R.C. § 50(c)) are made.

For additional information concerning the Low-Income Housing Credit visit the Business Tax Credits page.

## Q4. Can the rehabilitation credit be used in conjunction with a façade easement contribution? (updated June 9, 2021)

Yes. Once the building and rehabilitation are "certified" by the Department of Interior, the owner of the building can donate the façade easement. Generally, these donations are made to qualified organizations under I.R.C. § 170 and must be donated in perpetuity.
By donating the façade easement after the building rehabilitation is complete, the taxpayer may be allowed a charitable contribution deduction pursuant to I.R.C. § 170(h) and Treasury Regulation § 1.170A-14. The allowable amount of that deduction, however, may be reduced by an amount relative to the building's fair market value and the sum of any rehabilitation credits allowed for the 5 preceding taxable years. I.R.C. § 170(f)(14).

Additionally, after donating a façade easement, the rehabilitation credit and depreciable basis of the property retained by the donor are reduced and no credit or depreciation can be taken on that portion of the building. If the donation occurs after the building is placed in service, the credit recapture provisions of I.R.C. § 50(a) apply. See Rome I Ltd. v. Commissioner, 96 T.C. 697 (1991).

A donation can be made by a subsequent owner of a certified historic structure façade easement if the façade easement was not donated by the previous owner.

See the Conservation Easement Audit Techniques Guide for additional information.

## Q5. What is the tax effect of grant or insurance proceeds on rehabilitation credit projects? (added June 9, 2021)

A taxpayer must determine whether amounts related to grant or insurance proceeds are qualified rehabilitation expenditures for purposes of calculating a rehabilitation credit. Pursuant to section 47(c)(2), "qualified rehabilitation expenditure" means any amount properly chargeable to capital account for property for which depreciation is allowable under section 168 and which is nonresidential real property, residential rental property, real property which has a class life of more than 12.5 years, or an addition or improvement to such property. In the case of grant or insurance proceeds received by the taxpayer, the taxpayer must determine, under all the facts and circumstances, if any or all of the grant or insurance proceeds result in an addition to the basis of the property. As part of this determination, whether the grant or insurance proceeds are includible in gross income may be relevant. Any amount that is not added to the basis of such property does not qualify as a qualified rehabilitation expenditure, which may be the case for amounts related to certain grant or insurance proceeds depending on all of the facts and circumstances.

For additional information on basis and qualified rehabilitation expenditures, see Treasury Regulation § 1.46-3(c) and § 1.48-12(c).

Back to top