

Rev. Rul. 89-90

1989-2 C.B. 3, 1989-30 I.R.B. 4.

Internal Revenue Service

Revenue Ruling

RECAPTURE UNDER SECTION 47 OF THE CODE

Published: July 24, 1989

SECTION 47. -- CERTAIN DISPOSITIONS, ETC. OF SECTION 38 PROPERTY, 26 CFR 1.47- 2: 'Disposition' and 'cessation'.

(Also Section 170; 1.170A-14.)

Recapture under section 47 of the Code. There is recapture of a portion of the rehabilitation tax credit upon the conveyance of a facade easement, by means of either a sale or a gift.

ISSUES

(1) If a taxpayer creates and sells a facade easement for a building for which the taxpayer has already claimed an investment credit for the rehabilitation of an historic structure, is there recapture of the investment credit under section 47 of the Internal Revenue Code?

(2) If a taxpayer creates and donates to an historical society a facade easement for a building for which the taxpayer has already claimed an investment credit for the rehabilitation of an historic structure, is there recapture of the investment credit under section 47 of the Internal Revenue Code?

FACTS

(1) Taxpayer purchased a building that was certified as historic and rehabilitated it pursuant to a plan that was approved by the Department of the Interior. The expenditures for rehabilitating the building qualified for an investment credit under section 48(g) of the Code. Subsequent to the rehabilitation of the building, Taxpayer created and sold a facade easement to the local historical society. The facade easement sold meets the definition of a qualified real property interest under section 170(h)(2) of the Code.

(2) The facts are the same as in (1) above, except that Taxpayer created and donated the facade easement to the local historical society and claimed a corresponding charitable deduction.

LAW AND ANALYSIS

Section 47(a) of the Code provides the general rule that, if during any tax year property is disposed of before the close of the useful life that was taken into account in computing the credit under section 38, then the tax for such year shall be increased by an amount equal to the aggregate decrease in the credits allowed under section 38 for all prior tax years that would have

resulted solely from substituting, in determining qualified investment, for such useful life the period beginning with the time such property was placed in service by the taxpayer and ending with the time such property ceased to be section 38 property.

Section 48(g) of the Code sets forth the rules relating to the credit for qualified rehabilitations.

Section 170(h) of the Code sets forth the rules relating to a qualified conservation contribution.

Section 1.47-2(a) of the Income Tax Regulations provides the general rule that the term 'disposition' includes a sale in a sale- and-leaseback transaction, a transfer upon the foreclosure of a security interest, and a gift, but such term does not include a mere transfer of title to a creditor upon creation of a security interest.

Section 1.47-2(c) of the regulations provides that if, in the credit year or in any tax year subsequent to the credit year, the basis (or cost) of section 38 property is reduced, then such section 38 property shall be treated as having ceased to be section 38 property with respect to the taxpayer to the extent of the amount of such reduction in basis (or cost) on the date the refund which results in such reduction in basis (or cost) is received or accrued.

Section 1.47-3(a) of the regulations provides that the provisions relating to the 'disposition' of section 38 property shall not apply to transfers by reason of death, to property destroyed by casualty, to reselection of used section 38 property, to transactions to which section 381(a) applies, to mere changes in form of conducting a trade or business, or to certain sale- and-leaseback transactions.

Section 1.170A-14 of the regulations provides the rules under which a qualified conservation contribution may be allowed as a charitable contribution deduction. A qualified conservation contribution is the contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes and such purpose must be protected in perpetuity.

Section 1.170A-14(h)(3)(iii) of the regulations provides that in the case of the donation of a qualified real property interest for conservation purposes, the basis of the property retained by the donor must be adjusted by the elimination of that part of total basis of the property that is properly allocable to the qualified real property interest granted. The amount of the basis that is allocable to the qualified real property interest shall bear the same ratio to the total basis of the property as the fair market value of the qualified real property interest bears to the fair market value of the property before the granting of the qualified real property interest. When a taxpayer donates to a qualifying conservation organization an easement on a structure with respect to which deductions are taken for depreciation, the reduction in the basis of the property retained by the taxpayer must be allocated between the structure and the underlying land.

An easement is an ownership interest in real property rather than a mere license. When an easement is sold, basis in the property is reduced in determining taxable gain. See *Hort v. Commissioner*, 313 U.S. 28 (1940). In contrast, when a mere license is sold, there is no basis reduction, and all of the proceeds are ordinary income. The treatment of the gift of an easement is consistent with the treatment of the sale of an easement. If a taxpayer donates an easement, the taxpayer must reduce the basis of the underlying property. Section 1.170A-14(h)(4). Example (12).

There are no grounds for treating a facade easement any differently than any other easement. A facade easement is treated for tax

purposes like any other easement. Thus, its conveyance is a partial disposition of the underlying real property under section 47(a). As such, it triggers recapture.

Congress wanted to encourage both the rehabilitation of historic structures and the granting of facade easements and provided tax incentives to encourage both. However, nothing in the statute or legislative history suggests that the granting of an easement is exempt from recapture or that there is an exception to the general rule that the conveyance of an easement is a disposition of an interest in real property. Because there is no exception, the general rules apply, and there is a ratable recapture of the rehabilitation tax credit to the extent that basis in the rehabilitation is reduced as a result of the conveyance of the easement.

HOLDINGS

(1) There is recapture under section 47 of the Code of a portion of the investment credit for the rehabilitation of an historic structure upon the sale of a facade easement.

(2) There is recapture under section 47 of the Code of a portion of the investment credit for the rehabilitation of an historic structure upon the gift of a facade easement.

DRAFTING INFORMATION

The principal author of this revenue ruling is Michael J. Hahn of the Corporation Tax Division. For further information regarding this revenue ruling contact Mr. Hahn on (202) 566-6511 (not a toll-free call).

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