

**FOCUS**

## *Giving history some credit: Tax treatment spurs rehabs*

Federal tax credit is like a grant for 20 percent of costs

Preservation of historic buildings gained momentum following the regrettable demolition of New York's historic Pennsylvania Station in the mid-'60s.

The cry that went out was answered, most significantly by an array of tax provisions that have evolved over time but still offer significant benefits to aid the restoration and preservation of historic properties.

Foremost among these benefits is the federal rehabilitation tax credit. The current form allows a tax credit equal to 20 percent of the "qualified rehabilitation expenditures" incurred in connection with a "certified rehabilitation" of a "certified historic structure." A 10 percent credit is available for rehabilitation of older, nonhistoric buildings constructed prior to 1936.

A tax credit is the most attractive type of tax benefit, as it offers a dollar-for-dollar reduction against tax liability. In essence, for a historic building, it is as if the federal government is making a grant to cover 20 percent of the rehabilitation costs. The credit is allowed up front when the building is placed in service, thus aiding in the equity formation for the redevelopment.

To qualify, you must start with a certified historic structure. This is a building that is either listed on the National Register of Historic Places or is located in a registered historic district and certified by the secretary of the interior as being of historic significance to the district. Some bit of history lurks in many older buildings, so that even somewhat nondescript structures have a shot at receiving listing on the National Register.

The rehabilitation plan for the building also must be certified by the National Park Service as being consistent with the historic character of the building or the district. The certification process is done in conjunction with the Oregon Historic Preservation Office. Plans must be submitted for initial approval, the rehabilitation must be carried out in conformance with the approved plans, and a final sign-off from the National Park Service is required. Generally, the



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state office will want to ensure the preservation and renovation of original architectural elements, such as façade details, windows and interior elements of special interest. Roof-top additions likely will be limited to one story that is stepped back from the existing façade.

Finally, the tax credit is calculated based upon the "qualified rehabilitation expenditures" that are incurred. To

qualify, the developer's total expenditures must at least equal the developer's tax basis (depreciated cost) in the building (exclusive of land).

Expenditures at this level must be incurred during a 24-month period ending with or within the year the credit is claimed, although this measuring period can be stretched to 60 months if plans exist at the commencement of the rehabilitation establishing a phased rehabilitation period of this length.

If this threshold is met, all expenditures that are added to the depreciable basis of the building qualify for the credit. This includes all soft costs that are capitalized during the construction period, such as construction period interest and architect and developer fees.

A number of restrictions apply. To qualify, the property must be depreciable nonresidential real property or rental real property. Personal residences and residential condominiums held for sale to customers will not qualify.

The costs of additions to the building are also excluded. If portions of the building are leased to tax-exempt entities (including governmental entities) under certain disqualifying leases, the credit is proportionately reduced.

If the property is disposed of within five years after completion, the credit is subject to recapture at 20 percent for each year of early disposition. Also, the tax basis of the property is reduced by the amount of the credit. Thus, there will be depreciation and potentially some capital gain tradeoffs. Accordingly, the credit is most ideal for a long-term hold.

Besides the rehabilitation tax credit, the Internal Revenue Code permits a charitable deduction if a conservation easement is placed on a certified historic structure and donated to a qualifying nonprofit organization. Generally, this easement obligates the owner to maintain the existing historic façade of the building and restricts the owner from developing to full potential the air space above the building. The air space restriction generally has demonstrable value and is the basis for the charitable deduction.

For example, if two additional stories could be constructed on the rooftop of a building and the developer restricts construction to one story or even a partial story, the potential value of the lost square footage can be appraised and form the basis of the charitable deduction. The deduction can provide another significant up-front financial benefit, again aiding equity formation.

Finally, the Oregon Legislature has enacted a 15-year tax freeze for historic properties. It essentially freezes the value of the property for assessment purposes and, if timed correctly, will exclude the rehabilitation expenditures from assessed value, thereby preventing the increase in value resulting from the new improvements from being taxed.

A second 15-year period can be obtained if the owner submits a preservation plan and commits to make substantial improvements for seismic upgrades, compliance with the Americans with Disabilities Act or energy conservation.

The tax freeze is scheduled to sunset in 2010. Hopefully, the Legislature will recognize this program's importance and will extend it.

As with most tax matters, the devil is in the details, and there are many details when it comes to these historic property tax benefits. However, with careful planning, they can all be wielded as useful tools to reclaim the glory of older buildings and maintain them as important contributors to our architectural landscape.

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