

COMMONWEALTH OF VIRGINIA – DEPARTMENT OF HISTORIC RESOURCES
STATE AND FEDERAL HISTORIC REHABILITATION TAX CREDIT PROGRAM
**GUIDANCE FOR CERTIFIED PUBLIC ACCOUNTANTS
GENERATING AUPs OR AUDITS**

This document is intended to assist CPAs with answers to common questions about the Audit and Agreed-Upon Procedures reports created for projects seeking participation in the Virginia Historic Rehabilitation Tax Credit Program.

DHR Staff are not financial professionals, but the below guidance comes from our experience with common questions brought up by both CPAs and their clients during our review of the Part 3 financial materials submitted for projects seeking participation in this Program.

For any questions or concerns not addressed below, or to discuss the specifics of the report/project you are working on, please contact the Tax Credit Program Supervisor, Jessica Ugarte, at Jessica.Ugarte@dhr.virginia.gov or 804-482-6452.

Who can complete an AUP or Audit?

Only Certified Public Accountants working for firms that successfully undergo the peer review process every three years may issue an AUP or Audit to be used with the Virginia Historic Rehabilitation Tax Credit Program.

The CPA completing this report for a rehabilitation project must be independent from the ownership of the project. From the AICPA publication, “Plain English Guide to Independence:”

“Independence of mind is the state of mind that permits a member to perform an attest service without being affected by influences that compromise professional judgement, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism. Independence in appearance is the avoidance of circumstances that would cause a reasonable and informed third party, who has knowledge of all relevant information, including safeguards applied, to reasonably conclude that the integrity, objectivity, or professional skepticism of a firm or member of the attest engagement team is compromised.”

Which report should be prepared for client?

For projects with total project costs \$500,000 or above, an **Audit** must be prepared.

For projects with total project costs under \$500,000, an **Agreed-Upon Procedures Report** must be prepared.

Total project costs include both eligible and ineligible expenditures.

The AICPA has issued a new Independent Accountant’s Report template for AUPs/Audits – do I have to use the provided DHR example?

No. Please use the most current letter templates provided by AICPA for AUPs and Audits.

Do I have to use the other provided templates?

For an AUP, the Procedures starting on page 2 of the Agreed Upon Procedures template document must be included as provided.

For both an AUP and Audit, the Schedule of Eligible Rehabilitation Expenses and the Schedule of Construction Costs templates should be used as provided. Small modifications or additions to the individual line items may be made only if absolutely necessary, though this should be limited.

What costs should be included in the report?

All costs related to the overall rehabilitation project should be included, both eligible and ineligible rehabilitation expenses. Eligible and ineligible costs should be reported in the appropriate columns of the Schedule of Construction Costs and the Schedule of Eligible Rehabilitation Expenses.

NOTE: This does not include acquisition costs for the property, which should not be included in the overall rehabilitation project cost data. Additionally, any costs for the property that were or will be expensed as in-service or operational costs on the client’s tax return are ineligible, and may be excluded from the report or listed as ineligible.

Ineligible costs are often missed in reports; the following are common costs that are mistakenly omitted from an Audit or AUP:

- Additions and other types of new construction on the site.
- Site work and landscaping.
- Work done on non-contributing/ineligible buildings.
- Personal property, such as appliances or window treatments.

What is the “completion date?”

The “completion date” (for un-Phased projects or for the final Phase of a project) is EITHER the date of the Certificate of Occupancy (also accepted is documentation for a Temporary Certificate of Occupancy or the final Building Inspection) OR the date that the final, eligible physical rehabilitation expense was incurred.

The following examples should not be used to establish the “completion date:”

- AIA Certificate of Substantial Completion.
- Rental Certificate of Compliance.
- Bills for soft costs, i.e., CPA or preservation consultant billing.
- Invoices for work that is ineligible for tax credits.

What are the differences when reporting for an initial Phase (not the final Phase) of a Phased project?

If the project is Phased, and the financial report is being submitted for an initial Phase, the project start and end dates should be the dates that the Phase started and ended. For these initial Phases the “completion date” is typically reported as the last expenditure being claimed for that Phase. Phases should not overlap and should agree with the approved Phasing Plan that was submitted with the Part 2 (or as revised by a subsequent Amendment).

Please note that the threshold for whether an AUP or Audit should be completed is for the total project costs, not just for the completed Phase.

Do all costs need to have been incurred by the “completion date?”

No. It is not uncommon for soft costs such as the CPA, preservation consultant, or State and Federal project review fees to be incurred after the identified “completion date.” Or, additional, minor eligible rehabilitation work may be completed after the Certificate of Occupancy is issued; these costs could also be included. In general, any costs for the property that were incurred through the completion date and up until tax year-end are includable. Costs incurred after the tax year-end of the project completion year are not includable.

There was still work being completed when a new year began, but the client wishes to utilize the State credits for the prior year. Can an earlier invoice be used to establish an earlier “completion year?”

No. Per DHR regulations, the “completion year” should be established by either of the methods identified above. Artificially selecting an earlier date to obtain credits in a year other than the actual year that the project was completed is in conflict with this requirement.

Can an owner/applicant/client pay themselves for the labor/time spent working on a project?

An owner/applicant/client can only claim costs for their labor (often known as “sweat equity”) if the labor costs are billed by and paid to another entity with an income tax reporting requirement. Examples of applicable entities are partnerships, Limited Liability Companies (LLCs), Limited Liability Partnerships (LLPs), Corporations, S-Corporations, or Sole Proprietorship. Additionally, 1099s for these costs should be issued when paid to an entity requiring 1099 reporting.

Any relation between the owner/applicant and the developer/contractor/project management/etc. should be disclosed in the notes.

Do all costs need to have been fully paid by the time the AUP/Audit is completed?

Generally, all costs related to the rehabilitation of the project – except for the limited situations noted below – should be fully paid by the time the Part 3 – Request for Certification of Completed Work is submitted.

- End-of-Project Soft Costs: For certain costs such as the CPA, preservation consultant, or project review fees it is not uncommon for these costs to be outstanding at the time that the AUP or Audit is completed. A note indicating that these costs are outstanding but are expected to be paid within a typical billing cycle, is sufficient.
- Deferred Developer Fees may be outstanding at the time the AUP or Audit is completed. A note indicating these outstanding costs and the specific repayment terms identified in the Developer Agreement must be included in the financial report.
 - o **IMPORTANT**: Deferred Developer Fees may not have a repayment term of more than ten (10) years post project completion.
- Retainage Fees may also be outstanding at the time the AUP or Audit is completed. A note indicating these outstanding costs, who they are owed to, and the repayment terms should be included in the financial report.
- Limited Other Outstanding Costs: All unpaid costs related to the rehabilitation of the project must be reasonable for a project at or nearing completion, and must be demonstrated as being able to be fully paid through remaining financial assumptions of the project. In any event, payment should be made in full not later than the receipt of the remaining syndication funding from both the Federal and State tax credits. These costs should be disclosed in the notes, and include who they are owed to and the terms for repayment.

Related to the above, per DHR regulations 17VAC10-30-110 D(12), the following are ineligible costs:

“Deferred fees or unpaid costs for which there is no charge to a capital account with a corresponding recorded entry to a liability account and either proof of subsequent payment thereof or an appropriate documentation evidencing the liability.”

The contractor did not separate different work scope items in their invoices – can I lump multiple types of work in a new catchall line item on the schedules?

While we understand that sometimes invoices are not as clear or organized as might be hoped, it is the responsibility of the client to ensure that it is possible for the different types of work to be appropriately classified on the required schedules. If costs are not broken out in the information

provided to you, the client should contact the contractor/business to obtain a breakdown of work done for each line item.

NOTE: Allocation is not permitted between different projects/properties.

How do I know whether to calculate 25% or 50% for the “Material Rehabilitation” test?

The 25% threshold is only available for owner-occupied structures. An owner-occupied structure is any building, at least 75% of which is used as a personal residence by the owner, or which is available for occupancy by the owner for at least 75% of the year.

All other projects must meet the 50% threshold.

COMMON QUESTIONS ON ELIGIBLE/INELIGIBLE COSTS:

A part of the work included the demolition and reconstruction of an exterior stair, porch, etc.; is the new construction a qualified expense?

No. If the existing feature outside of the footprint of the building was demolished and re-built, this is new construction, and so is considered an ineligible cost. This is applicable even for missing historic features – such as a porch – that are being reconstructed to match the historic condition.

A part of the work included the construction of a new exterior ramp, excavation for a new exterior egress path from a sub-grade level, or other types of work; is this exterior construction a qualified expense?

Not necessarily.

New work completed outside of the existing building envelope to suit a new use is generally an ineligible cost, as this is considered to be new construction.

ADA ramps, lifts, other accessibility features, and fire escapes are generally considered to be eligible costs.

I understand that for the State Program some man-made landscape features may qualify for credits. Which ones do?

Only work done to historic, man-made landscape features that are specifically listed as “contributing” in the National Register of Historic Places nomination may be considered as eligible costs.

Are solar panels, wind turbines, and geothermal systems eligible for tax credits?

For the State Program, yes. The only limitation is that the power generated should only be used for the historic property.

NOTE: For the Federal Program the IRS has provided guidance that solar panels, wind turbines, and geothermal systems are 5-year property under section 168. Because costs are not included in the basis of the building, therefore, they should not qualify for the rehabilitation credit. Please see <https://www.irs.gov/pub/irs-utl/qualified-rehabilitation-expenditures.pdf> for more information on IRS guidance on eligible/ineligible costs.

The client needed to excavate the basement by one (or more) foot in order for the space to meet code for occupancy – is this an eligible cost?

No. Any excavation to enlarge the volume of the existing space is an ineligible cost. Please also be aware that in addition to the actual excavation costs being ineligible for rehabilitation tax credits, the work in the expanded volume of the space is similarly not eligible for credits. Finish work in the newly enlarged space or systems work for that expanded interior volume should be classified as ineligible for credits.

In cases where only part of the work is attributable to an expansion of volume, the following guidance on apportionment can be found in DHR regulations 17VAC10-30-110 D(4)(b):

“If expenditures only partially qualify because some of the expenditures are attributable to the enlargement of the building, the expenditures must be apportioned between the original portion of the building and the enlargement. The expenditures must be specifically allocated between the original portion of the building and the enlargement to the extent possible. If it is not possible to make a specific allocation of the expenditures, the expenditures must be allocated to each portion on a reasonable basis. The determination of a reasonable basis for an allocation depends of factors such as the type of improvement and how the improvement relates functionally to the building.”

We understand that there may be unique circumstances for these sorts of situations, so please contact the DHR Reviewer assigned to the project if you would like to speak further about the details of the project and what costs should be classified as eligible or ineligible.

Are Feasibility Studies, Market Studies, or LEED certification costs eligible?

No. These should be listed as ineligible for credits.

The client had a legal dispute with a contractor/vendor over work done at the property for the Historic Rehabilitation Tax Credit Program project – are the costs for this eligible?

No. Legal costs associated with contractor/vendor disputes, even those related to the tax credit project, are ineligible for credits. Furthermore, any such disputed costs are not qualified until the dispute is settled and costs are paid.