

COMMONWEALTH OF VIRGINIA – DEPARTMENT OF HISTORIC RESOURCES
STATE AND FEDERAL HISTORIC REHABILITATION TAX CREDIT PROGRAM
FREQUENTLY ASKED QUESTIONS

What are the Rehabilitation Tax Credits?

The State and Federal Historic Rehabilitation Tax Credits (HRTCs) are dollar-for-dollar reductions in income tax liability for taxpayers who rehabilitate historic buildings according to the Secretary of the Interior's *Standards for Rehabilitation (Standards)*, a nationally recognized set of guidelines that aim to revitalize historic sites and structures while preserving the essential historic character they possess.

The amount of the credit is based on a project's eligible rehabilitation expenses, and credits are available from both the Federal government and the State of Virginia. The Federal credit is 20% of the eligible rehabilitation expenses, and the State credit is 25% of the eligible rehabilitation expenses. In some cases, taxpayers can qualify for both the State and Federal Programs, allowing them to claim credits of 45% of their eligible rehabilitation expenses.

What buildings qualify for the State and Federal Tax Credit Programs?

The credits described above are available only for "Certified Historic Structures," which are defined as follows:

- Under the Federal Program, a certified historic structure is one that is either:
 - Individually listed on the National Register of Historic Places, or
 - Certified as Contributing to a Historic District that is so listed.

- Under the State Program, a certified historic structure is one that is:
 - Individually listed on the Virginia Landmarks Register or National Register, or
 - Certified as a contributing structure in a Historic District that is so listed, or
 - Certified as *eligible* for listing.
 - Please note that for the State Program, a final listing on the State or National Registers is not required. A formal finding of eligibility for listing will enable a structure to participate in the Virginia Historic Rehabilitation Tax Credit Program. See the "*Preliminary Information Form*" document for more information on requesting a formal finding of eligibility for a structure that is not currently listed.

With a few exceptions, most Virginia properties that are listed on one of these registers are listed on both. Note, however, that National and Virginia Register historic districts may differ from locally designated historic districts. Certification that a building contributes to a listed district, or, for purposes of the State credit, is eligible for individual listing, is obtained only by submitting the Part 1 application for review.

The proposed use of a building also has an impact on potential eligibility for the State and Federal Programs:

- For the Federal Program, only income-producing properties are eligible for HRTCs.
- For the State Program, both income-producing properties and owner-occupied homes are eligible for HRTCs.

If my building is in a National Register Historic District that is not yet listed, can I start my rehabilitation anyway?

Generally, buildings must be contributing to a historic district that is listed in either the Virginia or National Registers in order to receive the credit. In general, work can begin on a structure before final listing in the National Register; however, there is risk involved. If, for some reason, the historic district is not listed after the project is completed, any awarded credits would be subject to recapture. If possible, it is a good idea to wait until the listing process is nearly complete and appears to be on-track before doing any substantial work.

There are some differences between the State and Federal Programs in this matter:

- State Program: The property must either be determined individually eligible for listing, listed individually, or be in a listed National Register historic district, prior to credits being awarded.
- Federal Program: If you complete your project before the Historic District is listed, the Historic District **must** be listed on the National Register within thirty (30) months of the project's completion date in order to claim/retain Federal credits.

What work qualifies for the credits?

Technically speaking, eligible expenses include any work that is properly chargeable to a building's capital account in connection with a certified rehabilitation. Essentially, this means that all work done to structural components of the building will be eligible, as well as certain soft costs such as architectural and engineering fees, construction period interest and taxes, construction management costs, and reasonable developer fees. Expenses related to new heating, plumbing and electrical systems are eligible, as well as expenses related to updating kitchens and bathrooms, compliance with ADA, and fire suppression systems and fire escapes.

Costs that are not eligible include acquisition costs, any expenses attributable to additions or enlargements of the building (including excavation), personal property such as appliances, and certain soft costs such as legal fees for syndication. Under the Federal program, site work, landscaping elements, solar, and geothermal systems are not eligible expenses. Under the State Program, certain historic, man-made landscape features may be eligible. See the "*Eligible and Ineligible Costs*" document for more information.

Please keep in mind that the overall work completed for the entire project must *Standards*; credits cannot be claimed only on the portions of the work that meet the *Standards*. Therefore, if the overall project does not meet the *Standards*, no part of the credit may be claimed. If the work is certified as meeting the *Standards*, the credit is based on all eligible expenses.

How much money do I have to spend?

The threshold requirements for the State Program are different from the Federal requirements.

For the State Program, the eligible rehabilitation expenses must be:

- For owner-occupied residential buildings, at least 25% of the assessed value of the building for local real estate tax purposes for the year before the rehabilitation work began.
- For commercial and all other buildings, at least 50% of the assessed value of the building for local real estate tax purposes in the year before the rehabilitation work began.

Under the Federal Program, the project must be a "substantial rehabilitation" to qualify for the credit. The Internal Revenue Service defines "substantial" as exceeding the owner's adjusted basis in the building, or \$5000, whichever is greater. The adjusted basis is generally defined as the purchase price, minus the value of the land, minus any depreciation already claimed, plus the value of any earlier capital improvements.

How long do I have to complete the rehabilitation?

The rehabilitation does not have to be completed within any particular period of time. However, the "substantial rehabilitation" test (for the Federal Program) and the "material rehabilitation" test (for the State Program) must be met within a consecutive 24-month period that ends sometime during the year in which the credits are claimed. Essentially, this means that for most projects the greatest expenditures must be made within a 2-year period, ending in the year in which the project ends. For phased projects, the time limit is extended to 60 months. See the "*Measuring Test*" document for more information.

NOTE: Per Virginia Program regulations, only costs incurred on or after January 1, 2003 may be considered eligible for the Virginia Historic Rehabilitation Tax Credit Program.

My project has taken longer than I expected, and although I have spent more than my adjusted basis in the building, I have not spent it within a 24-month period. Can I decide to Phase my project now in order to take advantage of the 60-month measuring period?

For the State Program, yes. As long as the project is still ongoing it may be Phased at any time before the project has been completed. A Phasing Plan must be submitted for review and approval as soon as possible.

For the Federal Program, no. In order to use the 60-month measuring period for a Phased project, the taxpayer must choose to Phase the project from the beginning. This means that a Phasing Plan, showing what work will be completed during each phase of the project, must be submitted before work begins. For some projects, it may be a good idea to submit a Phasing Plan at the start of the project, even if there is a possibility the project can be completed within two years. This will "hold open" the 60-month time period but does not obligate the taxpayer to take that long to complete the project.

See the "*Project Phasing*" document for more information.

When can I claim the credit?

The credit is claimed for the year the rehabilitation (or Phase) is completed, as identified by the "completion date."

Per State Program regulations, the "completion date" is EITHER the date of the Certificate of Occupancy OR the date that the final, eligible, physical rehabilitation expenditure was incurred; soft costs incurred after the rehabilitation work is completed, such as the CPA or review fees, are not used to determine the completion date.

The State credit may be carried forward for up to ten years. There is no carryback for the State credit. As of January 1, 2017, there is a \$5 million dollar cap on the amount of credits a single taxpayer can claim in a single taxable year.

The Federal credit may be carried forward for up to twenty years, and back for one year. Additionally, under the Federal Program the credit cannot all be claimed during the year of project completion; it must be claimed over at least the first five years in increments of 20% of the total credit.

Can I sell the building after I complete the rehabilitation?

Under the State Program there is no continuing ownership requirement following completion of the rehabilitation. That said, it is strongly recommended that owners participating in the Virginia HRTC Program do not sell the building before a final certification letter is issued. In some instances, remediation of inappropriate or unapproved completed work is required to certify the project for tax credits. If the previous owner/tax credit applicant no longer owns the building, it may not be possible to complete the required work and so the overall project may be denied. Maintaining ownership of the building until the final certification is issued protects against this.

Please note that per Program regulations, the Virginia Department of Historic Resources reserves the right to inspect a rehabilitated property at any time during the first three years after completion, and to revoke certification if work was not undertaken as presented in the Part 3 application. Please see 17VAC10-30-50 (F) for more information.

Under the Federal Program, if the building is disposed of, or if it loses its income-producing status, within five years after the rehabilitation is completed, the taxpayer will face recapture of the credit. The amount of recapture is reduced by 20% in each succeeding year after the year the rehabilitation is completed. In other words, if the building is sold after one year, there will be recapture of 80% of the credit; if it is sold after two years, there will be recapture of 60% of the credit; and so forth.

The National Park Service reserves the right to inspect a rehabilitated property any time during first five years after completion, and to revoke certification if work was not undertaken as presented in the application, or if further unapproved alterations have been made since the tax credit project's completion. The recapture rates discussed previously would then apply.

Can I sell the tax credits?

Technically speaking, no. Credits may be syndicated through the use of limited partnerships, but they may not be directly sold. Syndication is a common tool for bringing investors into a rehabilitation project, but it must be carefully thought out at the beginning of the project. The legal structure for the syndication of credits should be set up early in the project, and must be in place before project completion. Please consult with a knowledgeable tax attorney to discuss your options.

Federal credits may be allocated according to percentage of ownership. The State credit, however, may be allocated by agreement among partners. The Virginia Department of Historic Resources does not provide advice on these types of ownership structures. Please consult with an experienced tax credit attorney to determine if this is an option for you.

How can a nonprofit organization, church, or local government take advantage of rehabilitation tax credits?

By taking on taxpayers under a limited partnership arrangement and maintaining a minority ownership interest as a general partner, nonprofit organizations and other entities that do not have a Virginia income tax liability have been able to benefit from the State Historic Rehabilitation Tax Credit Program. The Virginia Department of Historic Resources does not provide advice on these types of ownership structures. Please consult with an experienced tax credit attorney to determine if this is an option for you.

How do I apply for the credit?

Applying for the State or Federal HRTC Program is a three-part process. See the *"Detailed Application Process"* document for more details.

- The Part 1 application requests certification that the building is historic and that it is eligible for the Program. For properties that are individually listed, with no outbuildings or other structures, it is not necessary to submit a Part 1. For all other properties – i.e., those seeking certification that they are contributing structures in a listed historic district, are individually listed but have multiple buildings, or have been found to be individually eligible for listing (State-only) – a Part 1 is required. Photographs showing the property in its pre-rehabilitation state must be submitted with the Part 1.
- The Part 2 application requests certification that the proposed rehabilitation work appears to be consistent with the *Standards*. The Part 2 is the most complex part of the application. It requires a description of each significant architectural feature of the property and detailed information on the specific work that will be done in the rehabilitation on each architectural feature. Many property owners choose to complete the Part 2 themselves using the available *"Sample Narrative Description of Work"* document as a guide. Others hire a professional consultant to assist them with completing the required forms. A list of consultants is available from the Virginia Department of Historic Resources upon request.

Please note that additional pre-rehabilitation photographs are often necessary to include with the Part 2 application if the photographs submitted with the Part 1 application are not sufficient for a comprehensive review of the existing conditions and proposed work.

- The Part 3 application requests certification that the completed work is consistent with the Secretary's *Standards*. Photographs showing the completed work must accompany Part 3. All Part 3 applications must have an independent Certified Public Accountant review the expenses incurred for the specific project and submit the required financial report. Projects with below \$500,000 in total project expenses should follow the "Agreed-Upon Procedures Report" example; projects with total project expenses of \$500,000 or greater should follow the "Illustrative Audit Report" example. The appropriate financial report must be submitted concurrently with the Part 3 application - see the "*Financial Certification Requirements*" document.

What are the standards for photographic documentation for the application?

The size and clarity of the photographic images must adequately document the before and after conditions of the building. 24 to 36 photographs are generally sufficient for the average, single-family/small building project. However, it is better to have more photographs than too few. For the State program, photos must be a minimum of 4"x6" in size and may be printed as singles or two to a page. For the Federal Program, the electronic photos must follow their guidance which can be found at their website. Photographs should be labeled with the following information: building name and/or address, view (e.g., north side), and description (e.g., plaster damage in dining room, north wall). Photographs must be numbered and keyed to the Part 2 narrative descriptions of the scope of work as well as a photo key.

If photographs are judged to be insufficient due to poor lighting, poor resolution, or insufficient coverage of the exterior and interior spaces, the reviewer may place your application on hold and request additional photographs, which could delay your project's progress.

See the "*Photographic Standards*" document for more information.

I began rehabilitating a historic building last year, but I have just learned about this program. Can I still qualify for the credits?

It is much more difficult to qualify for the credits if you don't submit the Part 1 and 2 applications before beginning work, but it may be possible. You must have good photographs showing the building before the rehabilitation work began, as described in the preceding section. If you do not have this documentation, it will not be possible to evaluate the proposed and completed project. Additionally, all work which you have already completed must meet the *Standards* – any work that does not meet the *Standards* would need to be remediated in order for the overall project to be approved.

Failure to submit the Part 1 application before completing work is not necessarily fatal to the State Program, provided that all other requirements of the program are met. However, the deadline for application for participation the State Program is one year after your completion date, which is either the date of the Certificate of Occupancy **-or-** the date of the final eligible physical rehabilitation expenditure. You *must* submit a complete, fully documented Part 1, Part 2, and Part 3 application by this date in order to qualify for the State credit.

If you have already completed your rehabilitation work and your building is not individually listed on the National Register, you cannot qualify for the Federal credit. The IRS has taken a strong position that if the Part 1 application has not been submitted before the building is placed in service, it is not a "Certified Historic Building", and the Federal credit is not available. NOTE: A Part 1 application is required for all properties that are individually listed on the National Register except in cases where there is only one building on the property and there are no other resources.

How do I claim the credit?

To claim the State credit, the taxpayer must complete the State Schedule CR and attach a copy of the certification of completed work letter provided by the Department of Historic Resources.

The Federal credit is claimed on IRS Form 3468. The IRS requires information related to the substantial rehabilitation test and a copy of the certification of the completed work by the Secretary of the Interior.

Where can I find the regulations governing these programs?

The Virginia legislation authorizing the State Historic Rehabilitation Tax Credit is found at *Va. Code. §10.1-2202* and *§58.1-339.2* of the Code of Virginia. The section of the Administrative Code is *17VAC10-30*. The regulations for the State Program are final as of February 10th, 2016.

The Federal regulations governing the National Park Service's review of tax credit applications are found at *36 CFR 67*. The regulations governing the use of the tax credit itself (the IRS regulations) are found at *26 CFR 1.48-12*.

How can I get additional information?

For additional information about the State rehabilitation tax credit program, check out the Virginia Department of Historic Resources website at <https://www.dhr.virginia.gov/tax-credits/>.

For additional information on the Federal program, check out the National Park Service's website at <https://www.nps.gov/subjects/taxincentives/index.htm>, or its IRS Connection at <https://www.nps.gov/subjects/taxincentives/irs-information.htm>.