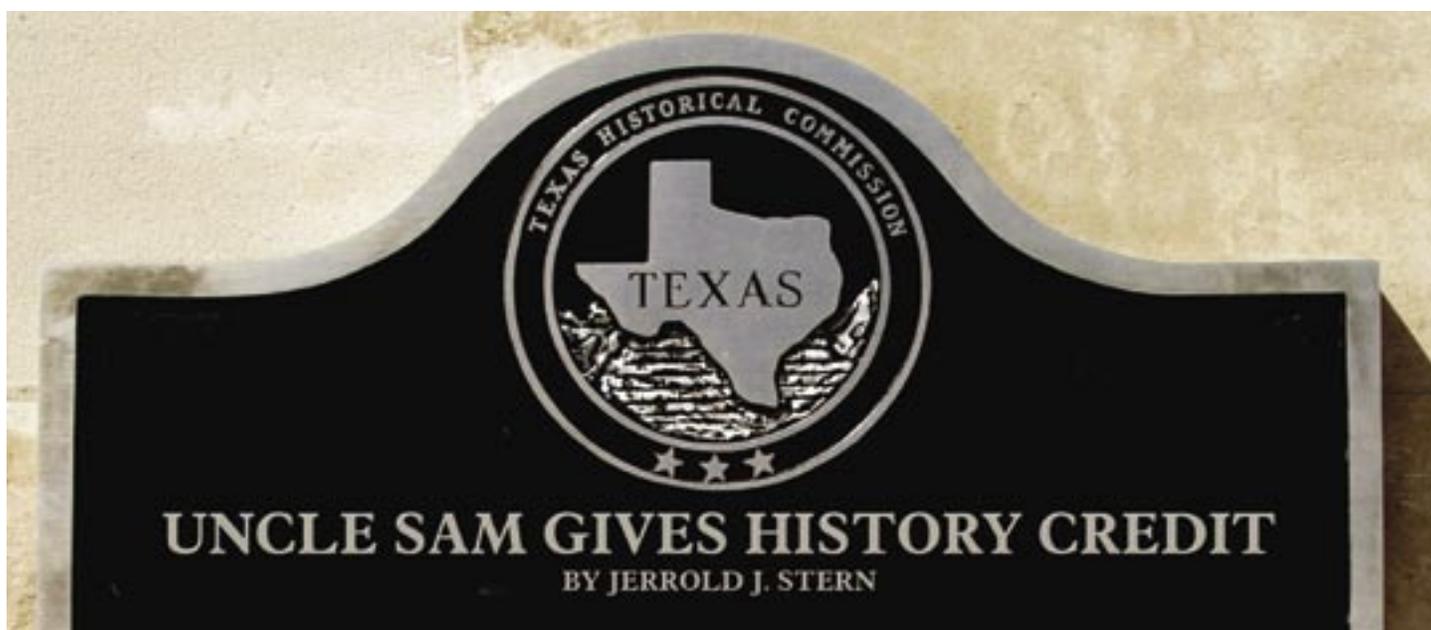


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Congress has declared the rehabilitation and preservation of historic structures and neighborhoods an important national goal. To encourage preservation of historic structures, tax law provides two types of rehabilitation tax credits that reduce tax liability and, in turn, reduce net restoration cost.

20 Percent Credit

To qualify for a 20 percent credit, the structure being restored must fit the tax law's definition of a "certified historic structure." The definition requires that the building be listed in the National Register of Historic Places or located in a registered historic district and certified by the Secretary of the Interior as being of historic significance to the district.

A property is treated as certified by the secretary if the taxpayer believes the building will become certified, files a request for certification and the secretary ultimately certifies the property. This means a property does not have to be certified when the rehabilitation work begins.

Normally, the request for certification must be filed on or before the date the property is placed in service. However, in a 2004 case, the IRS ruled that a request that was filed late would be treated as filed on time because the taxpayer intended to claim the tax credit, tracked the rehabilitation by taking numerous photographs and kept detailed records of the project. Moreover, the taxpayer's management had numerous discussions

about the project and the tax credit with their professional tax consultants.

The portion of the property's cost not treated as a credit can be depreciated straight line for tax purposes — 27½ years for residential rental property and 39 years for nonresidential property.

For example, Larry Chamberlain pays \$600,000 for an apartment building certified as an historic structure because it is located on the town square of Granbury, Texas. Rehabilitation costs \$900,000. Chamberlain receives a \$180,000 tax credit (20 percent of \$900,000) and depreciates \$1,320,000 (\$600,000 plus \$900,000 less \$180,000) over 27½ years.

Another requirement is that the cost of the rehabilitation must exceed the adjusted basis in the entire building (and also exceed \$5,000). This rule is met by the example, but a 1992 tax court case demonstrates how this rule can be elusive (ALEXANDER III, 97 TC 244).

Alexander spent \$69,000 to purchase a certified historic building of which \$22,000 was allocable to the first floor. He paid \$40,000 to rehabilitate the first floor to create an apartment and claimed the \$40,000 expenditure was eligible for the credit because it exceeded the \$22,000 cost of the first floor. Rehabilitation costs for the remainder of the building were \$12,000. The tax court held that no credit was allowable because the \$52,000 total rehabilitation costs (\$40,000 plus \$12,000) did not exceed the \$69,000 total cost of the building.

10 Percent Credit

A 10 percent credit is available for rehabilitation of certain nonhistoric structures. To qualify, the building can be either residential rental or nonresidential as long as it was built before 1936. The building cannot be located in a registered historic district.

To qualify for the 10 percent credit, at least 50 percent of the external walls must remain as external walls, at least 75 percent of the external walls must remain as external or internal walls and at least 75 percent of the "internal structural framework" must remain in place. The internal structural framework includes all load-bearing internal walls and any other internal structural supports.

Also, the building must have been placed in service by the taxpayer before rehabilitation began. These rules do not apply to the 20 percent credit previously discussed.

There are some rules that apply to both the 10 percent and 20 percent credits. Qualified rehabilitation expenditures can be made by either a lessee or a lessor. Costs to enlarge the building do not qualify for the rehabilitation tax credit, although they do qualify for depreciation.

In addition to the rules discussed above, several other technical requirements must be met. Consultation with a tax accountant or tax attorney is recommended. ♣

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