Historic Preservation Tax Credits Webinar

Types of Tax Credits

- Federal Historic Rehabilitation Tax Credit
- Ohio Historic Rehabilitation Tax Credit

Federal Historic Rehabilitation Tax Credit Basics

General

- 20% credit available for certified historic structures
- 10% credit available for non-certified structures built before 1936 (Non-residential uses only)
- Credit based on Qualified Rehabilitation Expenditures ("QREs")
- Credits can usually only be claimed by non-closely held C-corporations (2008 Amendments may benefit certain other users)

Historic Rehabilitation Tax Credit Basics

Process

- Certification: National Park Service and State Preservation Office
  - Listing property on National Register
  - Parts I, II and III
- Form for-profit tax credit entity controlled by developer
- Transfer property to for-profit tax credit entity
- Initial designs by architect and historic consultant
- Construction
- Admission of tax credit member prior to placement in service (i.e. first use)

Historic Rehabilitation Tax Credit Basics

QREs – What Qualifies?

- Interior demolition
- All façade construction
- All interior construction
- Soft costs
  (Architect, historic consultant and legal fees)
- Construction period interest
- Developer fee

Historic Rehabilitation Tax Credit Basics

What is Not a QRE?

- Land and interest carry on land
- Building acquisition and interest carry on acquisition
- Acquisition related costs
- Site improvements and landscaping (parking lot)
- Enlargements and demolition
- Personal property
- Portion of share improvements (*i.e.*, HVAC) allocable to enlargement

Historic Rehabilitation Tax Credit Basics

Developer Fees

- Portion of fee attributable to rehabilitation of building is eligible and included as a QRE.
- Care needed in drafting agreement
- If the developer fee is paid to a related party, care must be taken so that the fee is considered "reasonable"
- Deferred fees – must prove ability to repay in 10 years

Historic Rehabilitation Tax Credit Basics

Discussion on Enlargements

- Any expenditure attributable to the enlargement of an existing building does not qualify as includable in HTC basis.

- It is important to differentiate between *additions*, which are includable in HTC basis and *enlargements*, which are not.

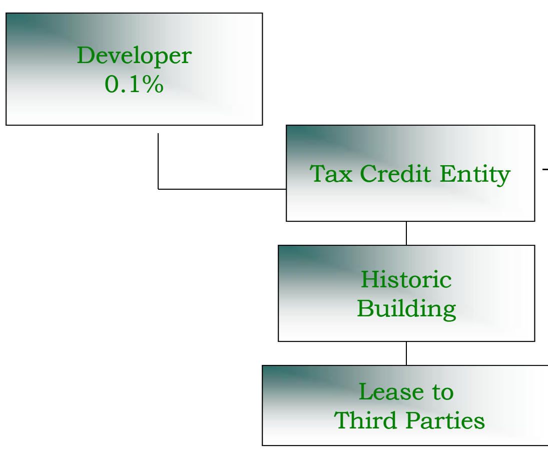
- Neither term is defined in the IRC, however, *enlargement* is defined in the IRS Regulations. Therefore, any *addition* that does not meet this definition can be classified as qualifying.

Historic Rehabilitation Tax Credit Basics

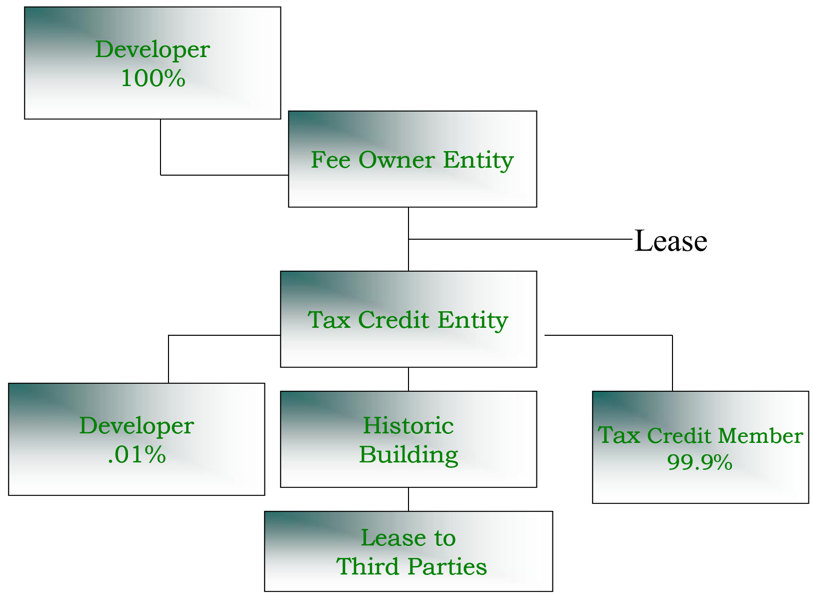
Discussion on Enlargements (C0nt'd)

- In general a building is enlarged to the extent that the total volume of the building is increased.
  1. An increase in floor space resulting from interior remodeling is **not** considered an enlargement.
  2. The total volume of a building is generally equal to the product of the floor area of the base of the building and the height from the underside of the lowest floor (including a basement) to the average height of the finished roof (as it exists or existed).
  3. For purposes of the HTC rules, "addition" refers to additional rehabilitation that does not go beyond the physical planes of the original building, while "enlargement" refers to construction that occurs outside the physical planes of the original building.

Typical Direct Investment Structure



Typical Leasehold Investment Structure



Historic Rehabilitation Tax Credit Basics

Does the Rehab Qualify?

QREs during a 24-month period selected by the tax credit entity must exceed the greater of $5,000 or the adjusted basis of the building as of the beginning of the 24-month period. (60 months for a phased project).

Historic Rehabilitation Tax Credit Basics

When Can The Credit Be Claimed?

- The year the project is placed in service –100% of the credit can be claimed
- Carry back one year
- Carry forward 20 years

Historic Rehabilitation Tax Credit Basics

When Must The QREs Be Incurred To Qualify?

- Since beginning of the rehab project
- During the 24-month period (60 month if phased)
- Through the end of the year placed in service

Historic Rehabilitation Tax Credit Basics

What Is The Risk Of Recapture?

- Triggering recapture
  - Disposition of the property
  - Disposition of a least 1/3 of the interest in tax credit entity
  - Noncompliance with IRS requirements
- Amount of recapture
  - 100% in the first 12 months from date placed in service
  - Declines 20% every 12 months thereafter from placed in service date

Historic Rehabilitation Tax Credit Basics

Why Use The Tax Credits?

- Assuming the project's QREs are $5,000,000:
  - Tax credit of $1,000,000 available
  - Tax credit investors pay $0.80 to $0.90 per $1.00 of Credit
- After the recapture period, Developer buys out tax credit investor for nominal sum

Historic Rehabilitation Tax Credit Basics

Investor Motivation

- Reducing tax liability
- Increased earnings
- Meeting community investment obligations (Community Reinvestment Act - Banks)
- Good corporate citizen
- Favorable press coverage

Historic Rehabilitation Tax Credit Basics

Investor Guarantees

- Provided by Developer
- At a minimum:
  - Operating deficit guaranty
  - Recapture protection
- If Developer needs contribution earlier will include:
  - Construction guaranty
  - Lease-up guaranty
  - And others

Historic Rehabilitation Tax Credit Basics

Eligible Users of Credits

For property placed in service after 1/1/2008, HTC able to be used against alternative minimum tax for individual and corporate taxpayers

1. Changes made by the Housing and Economic Recovery Act of 2008, individuals can use credit against AMT tax
2. HTC still subject to the passive activity regulations and is considered a passive activity credit. The passive activity credit can only be used against tax liability resulting from passive activities. All rental activities, whether residential or commercial are passive activities.
3. If an individual fits the IRS's definition of a real estate professional, he or she may qualify for the real estate professional exemption. This enables the taxpayer to apply the tax credit to non-passive income.

Historic Rehabilitation Tax Credit Basics

Eligible Users of Credits

4. Widely-held C-Corporations not subject to passive activity rules

- Federal HTC is a non-refundable tax credit, thus taxpayer must have federal income tax liability to fully utilize the credit. Unused credits can be carried back one year and forward 20 years.
- Even on small HTC projects, credits may exceed tax liabilities of project owners that can utilize credits given various restrictions.
- Compared to State of Ohio Historic Tax Credits which are refundable credits so even if property owner has insufficient tax liability, taxpayer will receive excess as a cash refund.

Historic Rehabilitation Tax Credit Basics

Tax-Exempt Entity Issues

A non-profit entity:

- Cannot claim credits directly

- Cannot lease or otherwise occupy the property from the for-profit entity:

  - If owned and/or occupied the property prior to rehabilitation
  - If lease term is longer that 20 years
  - If has option to purchase
  - If participant in issuing tax exempt bonds for the project
  - Note 50% deminimis rule

Historic Rehabilitation Tax Credit Basics

Tax-Exempt Entity Issues (Cont'd)

- Special rules apply to partnerships with tax-exempt partners if the partnership agreement provides for allocations of partnership items that are not considered a "qualified allocation." IRC applies highest % of any allocated item to determine tax-exempt use portion.
- Can be a non-profit owner of the for-profit tax credit entity if non-profit elects to be taxed as a for-profit entity to avoid portion of property considered as tax-exempt use property
- The IRC provides that the portion of any expenditure that is allocable to tax-exempt use property is not included in calculating QREs and, therefore, is not included in HTC basis.
- Portion of property considered as Non-tax exempt use property still available to earn HTCs.

Ohio Rehabilitation Tax Credit Basics

General

- Similar to Federal Historic Rehabilitation Tax Credit
- Credit amount is 25% of QREs
- Can be used in combination with the Federal HTC
- Credit is refundable (with limits)
- Program is funded at $60 million per fiscal year
- Two competitive application rounds per year
- Applications due September 30 and March 31 of each year

Ohio Rehabilitation Tax Credit Basics

Differences from Federal

- Must apply and get project approved by Ohio Department of Development
- Credits awarded based on 100 point scoring criteria – competitive process
- Only costs incurred in the 24 month (or 60 month, if phased) period can be included (Period selected by taxpayer)
- Refundable, with limit of $3 million
- Note refund is taxable on federal return

Ohio Rehabilitation Tax Credit Basics

Differences from Federal (Cont.)

- Property must be on the National Register of Historic Places, Contributor to a National Register District or Local Landmark at time of application
- Much more competitive process
- Longer application process
- Maximum amount of credit is capped at time of approval, if your costs are higher, only get the awarded amount
- Must get any change approved by ODD, including timeline

Historic Rehabilitation and New Market Tax Credits Basics

QUESTIONS?

Contact us:

Donald E. Longwell, Jr.
Longwell Legal, LLC
40163 Banks Road
Grafton, Ohio 44044
Mobile: 440-669-0876
Facsimile: 888-342-2651
Email: dlongwell@longwelllegal.com