

Rehabilitation Tax Projects

PROFITABLE PRESERVATION

An abandoned commercial building in Hot Springs, a decrepit bank in Fayetteville, a Little Rock fraternal hall with a massive hole in the roof: each of these once seemed to be a candidate for the wrecking ball, but each now houses a thriving business. How? The owners were able to offset the expense of restoring their structure by taking advantage of tax incentives available for rehabilitating historic buildings.

PRESERVATION TAX CREDITS

A community's historic buildings are the tangible links with its unique character. The tax reform act of 1986 encourages the preservation of these irreplaceable resources by establishing:

- * A 20% tax credit for the substantial rehabilitation of certified historic buildings for commercial, industrial and rental residential purposes.
- * A 10% tax credit for the substantial rehabilitation for nonresidential purposes of buildings built before 1936 that are determined to be ineligible for listing on the National Register of Historic Places.
- * A straight-line depreciation period of 27.5 years for residential property and 31.5 years for nonresidential property for the depreciable basis of the rehabilitated building reduced by the amount of the tax credit claimed.

20% Tax Credit

The 20% tax credit is the incentive that interests most owners of historic structures. To qualify to take the 20% credit the following criteria must be met:

- 1) The structure must be listed or determined eligible for listing in the National Register of Historic Places either individually or as a contributing structure within a National Register historic district.
- 2) The structure must be rehabilitated for an income-producing purpose (ie: office space, rental/residential, bed-and-breakfast, commercial, industrial, agricultural, etc.; not a private, owner-occupied residence).
- 3) The project **must** meet the Secretary of the Interior's Standards for Rehabilitation and must be approved by both the Arkansas Historic Preservation Program (AHPP) and the National Park Service (NPS) **before** work is initiated.

4) The project must meet the substantial rehabilitation test in that the cost of the rehabilitation must exceed the adjusted basis of the structure being rehabilitated, or if the structure has been depreciated to its fullest extent, a minimum of \$5,000.

The owner of a historic structure who is considering a rehabilitation project and wishing to take advantage of the 20% tax credit should contact the Arkansas Historic Preservation Program before work begins. Not only do the AHPP and the National Park Service have to approve the proposed project, but the AHPP will provide the forms necessary for taking the credit.

CERTIFICATION APPLICATION

The application consists of three separate historic preservation certification forms:

Part 1 - Evaluation of Significance

Part 2 - Description of Rehabilitation

Part 3 - Request for Certification of Completed Work

In Part 1, the Evaluation of Significance, the applicant must describe the physical appearance of the structure (architectural style; type of construction, such as brick, wood frame, or stone; defining features, such as gables, decorative moldings, window hoods, shingle work, bays, towers, or windows; important landscape features and outbuildings; etc.). The applicant must also describe the significance of the structure. Why is it noteworthy enough to be historically significant? Is it of a particularly fine architectural style? Is it associated with a famous person or event?

In addition to the Part 1 form, the applicant must submit photographs, both interior and exterior, of the structure before any work is done and a map showing the location of the structure. All information must be submitted in duplicate (one set for the AHPP and one set for the National Park Service).

Note: If the structure being rehabilitated is listed individually on the National Register, then Part 1 can be omitted from the application.

Part 2, the Description of Rehabilitation, is just that. On this form, the applicant describes the work to be done to the structure. The form is designed so that each area of work can be individually itemized. The applicant first describes the existing condition and age of the item and then describes the proposed work to be done.

(EXAMPLE:)

Existing: Existing composition shingle roof ca. 1940. Shingles are of a reddish brown color, badly deteriorated and missing in places. Roof decking is also rotted in places. Both decking and shingles need to be replaced.

Proposed: Deteriorated decking and shingles will be removed. New decking will be installed and new shingles matching the original in color and style will be applied.

In addition to the Part 2 form, the applicant must include photographs (before any work is done) of both the interior and exterior. The photos should correspond to the individual items of work to be done. The applicant must also include a floor plan of the structure as it exists and a revised floor plan if any changes are to be made to the interior. Remember, all information must be submitted in duplicate.

Part 3, the Request for Certification of Completed Work, is submitted when the project is finished. In addition to the form, photographs of the completed project must be included, again in duplicate.

10% Tax Credit

The 10% credit can be taken in some cases as an alternative to the 20% credit if the following criteria are met:

- 1) The structure to be rehabilitated is determined ineligible for listing on the National Register or as not contributing to a historic district.
- 2) The structure was built before 1936.
- 3) The rehabilitation will be income-producing but for nonresidential usage (no apartments, rental houses, bed-and-breakfasts, or private residences).
- 4) The structure meets the substantial rehabilitation requirements as described in Number 4 of the 20% rehabilitation tax credit requirements.

To take the 10% credit, both the AHPP and the National Park Service must certify that the structure in question is not eligible for listing on the National Register of Historic Places. Therefore, a Part 1 form must be submitted for review. Once the structure is determined ineligible, the project can continue with no further review. When filing the tax return to take the credit, a copy of the certified Part 1 form should be included. If, however, the structure is determined to be eligible for National Register listing, it does not qualify for the 10% credit -- only the 20% credit.

Claiming the Tax Credit

The property owner can take a 20% tax credit for the rehabilitation expenses incurred within a twenty-four (24) month period unless it is a phased project, which is allowed sixty (60) months for completion. The tax credit must be claimed for the tax year in which the rehabilitated building is placed in service. For phased projects, a percentage of the tax credit may be claimed before completion of the entire project on the basis of qualified progress expenditures if construction is planned for two or more years. When

filing the tax return, include a copy of the certified Part 3 form (signed and dated by the National Park Service) or, for phased projects, a copy of the certified Part 2 form.

Recapture of the Credit

Generally, if a certified rehabilitated building is kept in service by the person who claimed the credit for more than five years after the work is completed, there is no recapture of the credit. If the owner disposes of the building less than a year after claiming the credit, then 100% of the credit can be recaptured. For properties held between one and five years, the recapture amount is reduced by 20% per year.

Processing Fees

Application processing fees are charged by the National Park Service for reviews of requests for Certification of Rehabilitation except for projects under \$20,000. Payment should not be sent until requested by the NPS; applicants will be notified of the amount to be paid. Applications will not be reviewed until payment is received and the fees are not refundable. The fee for review of completed rehabilitation work is based on the dollar amount spent on the project.

<u>Fee</u>	<u>Cost of Rehabilitation</u>
-0-	\$5000 - \$19,999
\$500	\$20,000 - \$99,999
\$800	\$100,000 - \$499,999
\$1,500	\$500,000 - \$999,999
\$2,500	\$1,000,000 - and up

Secretary of the Interior's Standards for Rehabilitation

Although rehabilitation assumes that some repair or alteration of the historic building will occur to provide for an efficient use, the project must not damage or destroy the material and features, both interior and exterior, that are important in defining the building's historic character. The entire project - including demolition or new construction - is reviewed and is certified only if the over all rehabilitation meets the following standards:

Secretary of the Interior's Standards

- 1.** A property shall be used for its historic purpose or be placed in a new use that requires minimal change to the defining characteristics of the building and its site and environment.
- 2.** The historic character of a property shall be retained and preserved. The removal of historic materials or alteration of features and spaces that characterize a property shall be avoided.

3. Each property shall be recognized as a physical record of its time, place and use. Changes that create a false sense of historical development, such as adding conjectural features or architectural elements from other buildings, shall not be undertaken.
4. Most properties change over time; those changes that have acquired historic significance in their own right shall be retained and preserved.
5. Distinctive features, finishes, and construction techniques or examples of craftsmanship that characterize a property shall be preserved.
6. Deteriorated historic features shall be repaired rather than replaced. Where the severity of deterioration requires replacement of a distinctive feature, the new feature shall match the old in design, color, texture, and other visual qualities and, where possible, materials. Replacement of missing features shall be substantiated by documentary, physical, or pictorial evidence.
7. Chemical or physical treatments, such as sandblasting, that cause damage to historic materials shall not be used. The surface cleaning of structures, if appropriate, shall be undertaken using the gentlest means possible.
8. Significant archeological resources affected by a project shall be protected and preserved. If such resources must be disturbed, mitigation measures shall be undertaken.
9. New additions, exterior alterations, or related new construction shall not destroy historic materials that characterize the property. The new work shall be comparable with the massing, size, scale, and architectural features to protect the historic integrity of the property and its environment, but must not give the impression of being historic.
10. New additions and adjacent or related new construction shall be undertaken in such a manner that if removed in the future, the essential form and integrity of the historic property and its environment would be unimpaired.

Do's and Don'ts for taking the 20%

Do's

1. Do contact the Arkansas Historic Preservation Program BEFORE starting construction or clean-up on a potential tax rehabilitation project.
2. Do follow the Secretary of the Interior's Standards for work to be done.
3. Do take lots of photographs (interior and exterior) before, during, and after work is completed.
4. Do try to locate historic photographs of the structure to aid in the rehabilitation.

5. Do respect the integrity and character of the structure.

Don'ts

1. Do Not replace original existing historic windows with inappropriate modern windows.
2. Do Not expose brick walls on the interior of buildings that were plastered originally (another violation that will cost a project its tax credit).
3. Do Not try to get approval on a project that was completed with no review or contact with the AHPP.
4. Do Not add non-original decorative elements to interiors or exteriors of the structure to make a building “prettier.”

The descriptions contained in this brochure are provided for general informational purposes only and should not be construed as tax advice. Anyone interested in pursuing the rehabilitation tax credit should consult a tax attorney or a Certified Public Accountant for guidance.

This brochure was developed by the Arkansas Historic Preservation Program with the invaluable assistance and guidance of H. Lawrence Yancey and John T. Root, Jr., attorneys with Catlett, Yancey, & Stodola, 1800 Tower Building, 323 Center Street, Little Rock, AR 72201, (501) 372-2121.

For more information on the rehabilitation tax credit program, contact the Arkansas Historic Preservation Program, 1500 Tower Building, 323 Center Street, Little Rock, AR 72201; phone (501) 324-9880, (FAX (501) 324-9184), (TDD (501) 324-9811); or send e-mail to info@arkansaspreservation.org.