



COMMONWEALTH of VIRGINIA
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REHABILITATION TAX CREDITS
A TAXPAYER'S GUIDE

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The tax codes of the United States and of the Commonwealth of Virginia provide unique incentives for taxpayers who contribute to the preservation of Virginia's old and historic buildings. By rehabilitating eligible buildings, taxpayers can qualify for substantial income tax credits. Historic rehabilitation tax credits have been provided by the federal tax code since 1976. The code was most recently revised by the Tax Reform Act of 1986. The Commonwealth of Virginia established the state tax credit program in 1996.

This *Guide* describes both the State and the Federal tax credit programs. Both programs are administered in Virginia by the Virginia Department of Historic Resources. In some cases, rehabilitation projects may qualify property owners for both state and federal tax credits.

- If you want to apply for the federal tax credits, read pages 4-13 and 23-24 of this *Guide*, and use the federal Historic Preservation Certification Application, form 10-168.
- If you want to apply for the state tax credits, read pages 14-24 of this *Guide*, and use the Commonwealth of Virginia Historic Preservation Certification Application.
- If you want to apply for both the federal and the state tax credits, read this entire *Guide* and use the federal Historic Preservation Certification Application, together with Page 1 of the appropriate Commonwealth of Virginia Historic Preservation Certification Application.

All applications are submitted to John E. Wells at the Department's central office in Richmond. Information on the programs, and assistance with individual projects, may be requested from Virginia E. McConnell, William M. Crosby, or John E. Wells at the Richmond office of DHR.

Assistance may also be requested from the Department's regional offices:

Capitol Region Preservation Office
Jack Zehmer (804) 863-1621

Roanoke Regional Preservation Office
Anne Stuart Beckett (540) 857-7585

Portsmouth Regional Preservation Office
Mary Ruffin Hanbury (757) 396-6707

Winchester Regional Preservation Office
Scott Brooks-Miller (540) 722-3456

Petersburg Office
10 Courthouse Avenue
Petersburg, VA 23803
Tel: (804) 863-1620

Portsmouth Office
612 Court Street, 3rd Floor
Portsmouth, VA 23704
Tel: (757) 396.6707

Roanoke Office
1030 Penmar Avenue, SE
Roanoke, VA 24013
Tel: (540) 857-7585

Winchester Office
107 N. Kent Street, Suite 203
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The State Historic Rehabilitation Tax Credit Program

The state tax credit, which reduces the taxpayer's Virginia Income Tax liability, is calculated as a percentage of the eligible rehabilitation expenses. Effective for taxable years beginning on and after January 1, 1997, any individual, trust or estate, or corporation incurring eligible expenses in the rehabilitation of a certified historic structure shall be entitled to a credit against the tax imposed by Articles 2 (§ 58.1-320 et seq.), 6 (§ 58.1-360 et seq.) and 10 (§ 58.1-400 et seq.) of Chapter 3; Chapter 12 (§ 58.1-1200 et seq.); Article 1 (§ 58.1-2500 et seq.) of Chapter 25; and Article 2 (§ 58.1-2620 et seq.) of Chapter 26 of this title, in accord with the following schedule:

Year	% of Eligible Expenses
1997	10%
1998	15%
1999	20%
2000 and thereafter	25%

Certifications of buildings and rehabilitations, so that property owners can claim the credits, are issued by the Virginia Department of Historic Resources. The Virginia Department of Taxation has full authority to determine tax treatment questions.

INCOME PRODUCING PROPERTIES?

Properties do not need to be income-producing to qualify for the state tax credits. Rehabilitations of owner-occupied residences can qualify for the state tax credits. Rehabilitations of income-producing properties can also qualify for the state tax credits.

CERTIFIED HISTORIC STRUCTURES

"Certified historic structure" means a property listed individually in the Virginia Landmarks Register, or certified by the Director of the Virginia Department of Historic Resources as contributing to the historic significance of a historic district that is listed in the Virginia Landmarks Register or certified by the Director of the Virginia Department of Historic Resources as meeting the criteria for listing in the Virginia Landmarks Register.

Individual properties that have been determined by the Department and by the Historic Resources Board, through the DHR Preliminary Information Request, to be eligible for listing in the Virginia Landmarks Register, are considered "certified historic structures." Properties in historic districts that may be eligible for listing cannot be considered "certified historic structures." The law does not require properties that have been determined eligible to be formally listed in the Virginia Landmarks Register in order to confirm the tax credits.

The Department of Historic Resources has records of all properties in Virginia which are listed in the Virginia Landmarks Register, and of all registered historic districts. Property owners may consult Calder C. Loth, ed., *The Virginia Landmarks Register*, Fourth Edition (Charlottesville: University Press of Virginia, 1999), which has listings complete through March 19, 1997; or, for more recent listings, contact Suzanne Durham, Archivist, Department of Historic Resources, (804) 367-2386. Applicants may also visit the Department at 2801 Kensington Avenue, Richmond, 23221 to consult with the archives.

CERTIFIED HISTORIC REHABILITATIONS

Rehabilitations of certified historic structures must be certified by the Virginia Department of Historic Resources for the applicants to qualify for the state tax credit. All rehabilitation work must be consistent with *The Secretary of the Interior's Standards for Rehabilitation* for a project to be certified; all such projects will be designated "certified historic rehabilitations." If a rehabilitation project is determined **not** to be consistent with the *Standards*, certification will be denied, and the investors will not be eligible to claim a tax credit.

MATERIAL REHABILITATION

"Material rehabilitation" means improvements or reconstruction consistent with "The Secretary of the Interior's Standards for Rehabilitation," the cost of which amounts to at least fifty percent of the assessed value of the buildings for local real estate tax purposes for the year before such rehabilitation expenses were incurred. Rehabilitation projects costing less than 50% of a building's assessed value will not qualify for the state rehabilitation tax credits.

In March 2000, the General Assembly passed a bill that lowers the "material rehabilitation" minimum-expenditure threshold to 25% of a property's assessed value. This new definition applies to owner-occupied residences only; the threshold for income-producing properties will remain at 50%. It is anticipated that this change will become effective for projects completed in the year 2001.

ELIGIBLE REHABILITATION EXPENSES

The rehabilitation tax credit is calculated as a percentage of the eligible rehabilitation expenses. Eligible rehabilitation expenses are expenses incurred in the material rehabilitation of a certified historic structure and added to the property's capital account.

Rehabilitation expenses must be capital in nature and depreciable as real property. Acquisition is not considered a rehabilitation expense. The costs of new construction beyond the "shell" of the existing building, and the costs of landscaping, parking lots, and site work, are not considered rehabilitation expenses. The costs of personal property and furnishings are not considered rehabilitation expenses. Costs incurred before January 1, 1997, are not eligible rehabilitation expenses.

CLAIMING THE CREDITS

The tax credit is available to the owners of a qualified rehabilitated building. Generally, the credits are claimed for the tax year in which the rehabilitation is completed and the building is placed in service. An approved Historic Preservation Certification Application, Part 3, "Request for Certification of Completed Work" should be filed with the tax return claiming the credit

The credit is calculated as a percentage of the eligible rehabilitation expenses. For projects completed in calendar year 1997, the credit is 10% of the rehabilitation expenses. For projects completed in calendar year 1998, the credit is 15% of the rehabilitation expenses. For projects completed in calendar year 1999, the credit is 20% of the rehabilitation expenses. For projects completed in calendar year 2000 or in subsequent years, the credit is 25% of the rehabilitation expenses.

If the amount of such credit exceeds the taxpayer's tax liability for such taxable year, the amount that exceeds the tax liability may be carried over for credit against the income taxes of such taxpayer in the next five taxable years or until the full credit is used, whichever occurs first. Credits granted to a partnership or electing small business corporation (S corporation) shall be passed through to the partners or shareholders, respectively.

Pending legislation will extend the carry-forward period to ten years. This legislation is expected to take effect in the year 2001.

TRANSFER OF CREDITS

For projects completed before the enactment of the state regulations (anticipated late in the year 2000), the Department of Historic Resources is authorized to provide taxpayers the election of making a special one time transfer of their credits earned pursuant to §58.1-339.2 of the Code of Virginia. Any such transfer is irrevocable. Taxpayers requesting such authorization shall make written request to the Department, including the following information:

1. The Request for Certification of Completed Work for the project;
2. The name(s), mailing address(es), and taxpayer I.D. number(s) of the taxpayers who completed the rehabilitation;
3. The name(s), mailing address(es), and taxpayer I.D. number(s) of the taxpayers to whom the credits are to be transferred.

State regulations governing the transfer of tax credits have not been completed as of January 2000.

TRANSITION RULES FOR PROJECTS BEGUN BEFORE 1997

In general, rehabilitation expenses incurred before January 1, 1997, shall not qualify a property owner for a rehabilitation tax credit. Property owners whose rehabilitation projects commenced before 1997, but not completed until after January 1, 1997, may apply for certification of their properties and of their rehabilitation work. All of the rehabilitation work must be consistent with the *Secretary's Standards*, and the tax credit is calculated as the appropriate percentage of expenses incurred after January 1, 1997. The "material rehabilitation" test is determined by the entire project, rather than by those project components completed after January 1, 1997.

COORDINATION WITH THE FEDERAL CERTIFIED HISTORIC REHABILITATION PROGRAM

Certifications of properties and rehabilitation projects by the National Park Service, U.S. Department of the Interior, under Federal Law 36 CFR Part 67, are not equivalent to certification of properties and rehabilitation projects by the Virginia Department of Historic Resources under State Law § 58.1-339.2, except under the following conditions.

1. Certifications of historic significance of properties (Part 1, Historic Preservation Certification Application) by the National Park Service, U.S. Department of the Interior, dated after January 1, 1995, shall be accepted as equivalent of certification of historic significance by the Virginia Department of Historic Resources.

2. Property owners with eligible projects may apply for certification under Federal Law, 36 CFR Part 67, and under State Law, § 58.1-339.2, with a single application to the Virginia Department of Historic Resources.

PHASED REHABILITATIONS

Normally, rehabilitations must be completed within a consecutive 24-month period. In some cases, where a rehabilitation project consists of two or more distinct stages of development, it may reasonably be expected to be completed in phases, and it may be carried out over a consecutive 60-month period. Part 2 of the Historic Preservation Certification Application should include architectural plans and specifications, completed before the physical work on the rehabilitation begins, describing the overall project. These plans should describe generally all phases of the project; they are not required to contain detailed working drawings or detailed specifications.

It is not necessary for each phase to exceed in cost one-half of the building's assessed value; but the overall project must exceed one-half the building's assessed value, as determined from the beginning of the first phase.

The Department of Historic Resources can review each phase as it is completed, and confirm whether each phase complies with the *Standards*, but phased rehabilitations can not be given

final certification until all phases are completed. For phased rehabilitations, credits may be claimed as each phase of the project is completed.

FORMS

The U.S. Department of the Interior's Historic Preservation Certification Application, Forms 10-168, 10-168a, 10-168b, and 10-168c (Rev. 12/90), is used to apply for the federal tax credits. The Commonwealth of Virginia Historic Preservation Certification Application, a similar form, is used to apply for the state tax credits. Property owners may apply for both the federal and the state tax credits with a single application, using the federal form and the cover sheet from the appropriate Virginia form.

APPLICATION AND REVIEW PROCEDURES

The Historic Preservation Certification Application is submitted to the main office of the Virginia Department of Historic Resources in Richmond. The Department reviews the application for completeness, identifies potential conflicts with the *Standards*, and, if indicated, negotiates controversial aspects of projects with the applicant. Review of an application is generally completed within 30 days of receipt of complete information. Complex or controversial projects may require longer review periods. All decisions are issued in writing.

In some cases, revisions to rehabilitation proposals are necessary to bring a project into compliance with the *Standards*. Such revisions are easier and less costly if the application is submitted to the Department prior to beginning construction.

GUIDELINES FOR COMPLETING THE HISTORIC PRESERVATION CERTIFICATION APPLICATION

Complete, coherent, and legible applications allow for much faster review by the Department of Historic Resources. Attention to the instructions included with the application forms, and to the following guidelines, will be in the best interest of every applicant.

Part I: Evaluation of Significance

Part 1 of the application must be completed for any building to be rehabilitated within a historic district. The Part 1 application requests that a building be evaluated for its contribution to the significance of the historic district through its location, design, setting, materials, workmanship, feeling, and association. Certifications will be made based on the appearance and conditions of the building before its rehabilitation.

The Part 1 application is not required when a building to be rehabilitated is listed individually in the Virginia Landmarks Register.

Part 1 applications must include all of the following:

1. Completed application with owner's original signature on current forms.
2. Map locating the property within the boundaries of its historic district (Maps of all historic districts in Virginia are available from the Department of Historic Resources.)
3. Labeled photographs (keyed to a floorplan) depicting streetscapes, all sides of the building, major interior spaces, and specific character-defining features.

The following requirements refer to special cases where the Part 1 application is also used.

1. Preliminary Determinations. When buildings to be rehabilitated are not yet listed in the Virginia Landmarks Register, the significance of the property cannot be certified until the nomination process has been initiated. A copy of the Virginia Landmarks Register nomination report, or t.b" Department of Historic Resources "Preliminary Information Form," used to apply for Virginia Landmarks Register listing, should be included with these Part 1 applications. The Department's action on the Preliminary Information Form takes precedent

2. Buildings outside the period or area of significance. When a building in a district is not consistent with the district's designated periods or areas of significance, as defined in its Virginia Landmarks Register nomination report, it may not be possible to certify the building without revisions to the nomination report. Applications for certification for such buildings should provide documentation to argue for expanded areas or periods of significance for the district, with special regard to the subject building.

Part 2: Description of Rehabilitation

Part 2 of the application is required for all applications. The Part 2 application describes the proposed rehabilitation work in detail. Part 2 applications should include all of the following:

1. Completed application with owner's original signature.
2. Complete written description of the rehabilitation work to be performed, describing the existing features of the building and the impact of the proposed work on these features. A sample Part 2 narrative description, describing a hypothetical rehabilitation project, is amended to this guide.
3. Labeled photographs (keyed to a floorplan) showing the condition of the property prior to commencement of its rehabilitation. The photographs submitted with the Part 1 application may be sufficient to cover all aspects of the building; if not, they should be supplemented for the Part 2. Photographs of all areas where significant work is proposed should be included.

4. Rehabilitation drawings clearly showing any changes to existing plan features.
5. Where applicable, architectural blueprints and specifications describing the rehabilitation.

Part 3: Request For Certification of Completed Work

Department of Historic Resources approval of the third part of the Historic Preservation Certification Application officially certifies that a completed rehabilitation project meets *The Secretary of the Interior's Standards for "Rehabilitation"*. The property owners are not eligible to claim the rehabilitation tax credits until this Part 3 application is approved. The Request for Certification of Completed Work should include the following information:

1. Completed application with the DHR project number, the final rehabilitation costs, the date the project was completed, and the owner's original signature on current forms.
2. After-rehabilitation photographs of the building, showing all exterior elevations, all significant interior spaces, significant exterior and interior features, major alterations, and new construction. Ideally, the post-rehabilitation photographs should be taken from the same locations and same angles that the pre-rehabilitation photographs were taken from.
3. For projects costing more than \$100,000 in rehabilitation expenses, a statement from a certified public accountant verifying the amount of rehabilitation expenses.

PROCESSING FEES

Fees are charged for reviewing rehabilitation certification requests in accordance with the schedule below. Payment shall be made to the Department of Historic Resources, using the "Billing Statement" included with the Historic Preservation Certification Application. A certification decision will not be issued until the appropriate remittance is received. Fees are nonrefundable. The fee shall be sent to the address indicated on the Billing Statement

The fee schedule is based on the dollar amount of the costs attributed solely to the rehabilitation of the certified historic structure, as follows:

FEE	COST OF REHABILITATION
\$100	less than \$50,000
\$250	\$50,000 to \$99,999
\$400	\$100,000 to \$499,999
\$750	\$500,000 to \$999,999
\$1,500	\$1 million or more

In general, each rehabilitation of a separate certified historic structure will be considered a separate project for purposes of computing the size of the fee.

FOR PROJECTS ALREADY COMPLETED

Property owners are strongly encouraged to submit Parts 1 and 2 of their applications before beginning rehabilitation work. For purposes of the federal rehabilitation tax credits, the Internal Revenue Service requires that the Part 1 be submitted before rehabilitation work is completed. If a property owner waits until after completion of a project to submit Part 2, the projects can be evaluated if the owner has sufficient photographic documentation of the building prior to its rehabilitation. Where photographic documentation is lacking, it may be impossible to evaluate a completed rehabilitation; and the Department of Historic Resources may have to deny certification for want of adequate information. In some cases, it may be possible to determine the scope of a rehabilitation without pre-rehabilitation photographs, especially if a property owner can show with post-rehabilitation photographs that a property's character-defining features and spaces have been preserved intact

Projects completed prior to 1997 will not qualify for the state tax credits.

APPEALS

If a project is denied certification by the Department of Historic Resources, an appeal hearing can be requested. The appeals procedure insures that projects are not denied certification without due consideration of all relevant information. Details of the appeals process are not complete as of March 2000.

REGULATIONS

The certification of historic buildings and rehabilitations is governed by the Department of Historic Resources regulations. We expect that final regulations will not be completed until late 2000.

THE SECRETARY OF THE INTERIOR'S STANDARDS FOR REHABILITATION

The *Standards*, written by W. Brown Morton III and Gary Hume, were first codified in 1979 in response to a Federal mandate requiring the establishment of policies for all programs under the authority of the Department of the Interior. The *Standards* enable the Department of the Interior to direct work undertaken on historic buildings. They are used in review of all Federal projects involving historic properties listed on or eligible for listing in the National Register of Historic Places. Compliance with die *Standards* provides for the preservation of me historic and architectural integrity of buildings being rehabilitated. The *Standards* were most recently revised in 1992. Department of the Interior regulations (36 CFR 67.7(b) state that the *Standards axe* to be applied to specific rehabilitation projects in a reasonable manner, taking into consideration economic and technical feasibility.

The *Standards for Rehabilitation* are:

1. ¹ property shall be used for its historic purpose or be placed in a new use that requires minimal change to the defining characteristics of die 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 mat create a false sense of historical development, such as adding conjectural features or architectural elements from older buildings, shall not be undertaken.
4. Most properties change over time; those changes that have acquired historic significance in deir own right shall be retained and preserved.
5. Distinctive features, finishes, and construction techniques or examples of craftsmanship that characterize a historic property shall be preserved.
6. Deteriorated architectural features shall be repaired rather man replaced. Where me severity of deterioration requires replacement of a distinctive feature, the new feature should match the old in design, color, texture, and other visual qualities and, where possible, materials. Replacement of missing architectural features shall be substantiated by documentary, physical, or pictorial evidence.
7. Chemical or physical treatments, such as sandblasting, mat cause damage to historic materials shall not be used. The surface cleaning of structures, if appropriate, shall be undertaken using die gentlest means possible.
8. Significant archaeological 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 differentiated from the old and shall be compatible with the massing, size, scale, and architectural features to protect the historic integrity of the property and its environment.

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.

The Department of the Interior publishes the *Standards* in bound format, with extensive guidelines for the application of the *Standards* to general and specific rehabilitation issues. The *Standards* and a wide range of related publications are available from the Superintendent of Documents, Government Printing Office, P.O. Box 371954, Pittsburg, PA 15250-7954; (202) 512-1800. Both the plain and illustrated editions are bargains!

The Secretary of the Interior's Standards for 'Rehabilitation and Guidelines for Rehabilitating Historic Buildings. 1990. 59 pages. GPO stock number 024-005-01061-1. \$2.00 per copy.

The Secretary of the Interior's Standards/or Rehabilitation with Illustrated Guidelines/or Rehabilitating Historic Buildings. 1992. 160 pages, 230 illustrations. GPO stock number 024-005-01091-2. \$12.00 per copy.

WHY SOME PROJECTS ARE DENIED CERTIFICATION

Some 95% of the federal rehabilitation tax credit applications filed for Virginia projects have been evaluated as consistent with *The Secretary of the Interior's Standards for Rehabilitation*, and have accordingly been granted certification by the National Park Service. When certification is denied, though, the property owners do not qualify for any tax credits. Understanding of the recurring problems associated with projects denied certification may help other property owners avoid the same mistakes. Submission of the Historic Preservation Certification Application, Part 2, prior to commencing rehabilitation work, can help avoid problems that could result in denial of certification.

The following rehabilitation treatments are the most common issues in projects denied certification:

1. Inappropriate masonry repairs or cleaning. Repairs to historic brickwork using incompatible mortars, especially mortars with high Portland Cement content, or with workmanship that does not match that of the historic masonry, can cause aesthetic and structural problems. Cleaning of historic masonry with abrasive cleaners can similarly cause aesthetic and structural problems. In addition to sandblasting and gritblasting, high pressure water and some chemical cleaning procedures can act as abrasives on historic masonry. In nearly every case, such treatments

will lead to denial of certification.

2. Inappropriate window replacement Historic windows are primary diameter-defining features of most buildings. The *Standards* recommend repair of historic window frames and sash rather than replacement with new materials that could diminish the significance of the building. Should an owner unnecessarily replace historic windows as part of a rehabilitation, certification of the entire project could be denied.

3. Radical alterations to significant interior spaces. Introduction of new partitions, ceilings, or finishes in character-defining interior spaces, such as parlors, stairhalls, banquet balls, auditoriums, or other carefully-delineated spaces, even if the historic materials are preserved in place, can compromise the integrity of a historic property. Similarly, wholesale removal of historic interior materials, especially materials with distinctive craftsmanship, will diminish a property's character. Removal of interior finishes to expose the underlying brick or frame structure will almost always result in denial of certification. Introduction of modern mechanical systems can involve disruptive treatments such as lowered ceilings or furred-out wall surfaces. When the character of significant interior spaces is lost, denial of certification will follow.

4. Incompatible new additions. The *Standards* do not discourage new additions; but if new additions are built so as to require demolition, obscuring, or overwhelming of significant historic elements, a property's character can be diminished, and denial of certification may result. New construction should be compatible with the size, scale, materials, colors, and character of a historic building and its district. Projects involving additions on primary elevations, rooftop additions, or additions which compete with the historic definition of the building are regularly denied certification.