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LAW OF THE LAND

REINFORCING REHABS

Historic Tax Credits Sweeten the Pot for Developers

Provide Key Source of Equity for Reuse Projects

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SPECIAL TO BANKER & TRADESMAN

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Developers looking to reposition historic properties have a double advantage in Massachusetts – federal and state income tax credits based on qualifying historic rehabilitation costs.

The federal historic rehabilitation tax credit program is administered through the Internal Revenue Service and the National Park Service. The credit amounts to 20 percent of "qualified rehabilitation expenditures" on a "qualified rehabilitated building," as determined by the National Park Service.

The credit is available for substantial rehabilitations of "certified historic structures," which are buildings listed in the National Register of Historic Places or certified by the National Park Service as contributing to the significance of a registered historic district. In general, a building is considered "substantially rehabilitated" if, during a 24-month measuring period, the qualified rehabilitation expenditures exceed the greater of the adjusted basis of the building and its structural components, or $5,000. The U.S. Department of the Interior publishes detailed standards and guidelines governing rehabilitations that qualify for the tax credit.

Image courtesy of MassHousing

State and federal historic tax credits generated $13.5 million in equity toward the first phase of the Eagle Mill redevelopment in Lee which began construction this spring. Rees-Larkin Development and Berkshire Housing Development Corp. are creating 56 affordable apartments in the complex, which operated as a paper mill from 1808 to 2008.

The federal credit is only available for capital expenditures on existing depreciable buildings that are income-producing. It is not available for personal residences. The federal credit is unavailable for acquisition costs, newly constructed buildings and enlargements or additions to buildings, but it is available for qualified expenditures that increase floor area through interior remodeling. The federal credit cannot be claimed for landscaping, sidewalks or parking lots. Unlike the Massachusetts historic rehabilitation tax credit discussed below, the federal credit generally is not transferable.

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Before 2018, the entire 20-percent federal tax credit could be taken in a lump sum, but now it must be spread out over a 5-year period. The federal rehabilitation credit is one of the general business credits that taxpayers can claim against the income tax. As such, if the available credit exceeds income taxes owed in a given year, taxpayers generally can carry back for one year and carry forward for up to 20 years the unused portions of the federal tax credit.

AHA Expands State Investment

The Massachusetts historic rehabilitation tax credit is available through the Massachusetts Historical Commission. The historic rehabilitation tax credit can offset state income taxes for up to 20 percent of a developer's qualified expenditures to rehabilitate an historic building. Qualified buildings are those listed with the National Register of Historic Places or deemed eligible by the MHC for such listing. Qualifying projects must be certified by the MHC. The credit is earned when the completed project is placed in service.

This state tax incentive program originally was only in effect from 2005 through 2009, with a limit of $10 million in annual tax credits. The program became popular with developers and the state legislature, which amended the statute a few times. The annual limit was soon increased to $15 million, then to $50 million in 2006, and eventually to $55 million in 2018. The sunset provision of the program was steadily extended beyond 2009 to 2027.

Gov. Maura Healey's Affordable Homes Act, enacted in August, significantly increased the commonwealth's financial commitment to this tax incentive program, doubling the annual limit on the tax credit from $55 million to $110 million, and extending its expiration date to 2030. Because of the annual limit on the Massachusetts credit, investors must go through an approval process to qualify, and the MHC has discretion when allocating the available credit.

> **The Affordable Homes Act enacted last August significantly increased the commonwealth's financial commitment to this tax incentive program, doubling the annual limit on the tax credit from $55 million to $110 million, and extending its expiration date to 2030.**

In making this allocation, state regulations require MHC to consider several enumerated factors, such as whether the project will create affordable housing, the historical significance of the building being rehabilitated, the availability of other beneficial funding sources to the taxpayer and the overall economic effect of the project on the surrounding community.

Similar to the federal tax credit, the Massachusetts credit is not available for personal residences, or for acquisition costs. But unlike the federal historic tax credit, taxpayers who qualify for the Massachusetts tax credit can transfer the credit to a different taxpayer without transferring the qualified historic structure itself. This is particularly useful for developers whose taxable income is less than the amount of the credit. Taxpayers can only carry forward unused credits for only up to five years, but taxpayers' ability to transfer tax credits enables those who cannot utilize the full credit, to realize a financial benefit by selling the unused credit to a taxpayer who can use it.

Historic rehabilitation tax credits are attractive for those committed to preserving historic buildings, but taxpayers must use them with caution. There are numerous complexities that cannot be fully explained in a short column. Consultation with tax professionals is advised. ◀

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