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Final Regulation Agency Background Document

Agency name	Department of Historic Resources
Virginia Administrative Code (VAC) citation(s)	17 VAC 10-30
Regulation title(s)	Historic Rehabilitation Tax Credit
Action title	Revisions to the rehabilitation tax credit regulations
Date this document prepared	September 1, 2015

This information is required for executive branch review and the Virginia Registrar of Regulations, pursuant to the Virginia Administrative Process Act (APA), Executive Orders 17 (2014) and 58 (1999), and the *Virginia Register Form, Style, and Procedure Manual*.

Brief summary

Please provide a brief summary of the proposed new regulation, proposed amendments to the existing regulation, or the regulation proposed to be repealed. Alert the reader to all substantive matters or changes. If applicable, generally describe the existing regulation.

The purpose of this regulatory action is to clarify existing language, strengthen the requirements and standards for reporting by the applicant, and revise the existing fee structure for review of applications.

Acronyms and Definitions

Please define all acronyms used in the Agency Background Document. Also, please define any technical terms that are used in the document that are not also defined in the "Definition" section of the regulations.

DHR: Virginia Department of Historic Resources
VAC: Virginia Annotated Code

Owner: The owner of the property that is the subject of the rehabilitation tax credit project
Rehabilitation: The process of returning a building or buildings to a state of utility, through repair or alteration, which makes possible an efficient use of the building and its site and environment which are significant to its historic, architectural, and cultural values as determined by the Department of Historic Resources.
MSA: Metropolitan Statistical Area
Certification: Approval by the Department of Historic Resources
CPA: Certified Public Accountant

Statement of final agency action

Please provide a statement of the final action taken by the agency including: 1) the date the action was taken; 2) the name of the agency taking the action; and 3) the title of the regulation.

On December 8, 2015, the Director of the Department of Historic Resources approved the promulgation of 17VAC10-30, Historic Rehabilitation Tax Credits.

Legal basis

Please identify the state and/or federal legal authority to promulgate this proposed regulation, including: 1) the most relevant citations to the Code of Virginia or General Assembly chapter number(s), if applicable; and 2) promulgating entity, i.e., agency, board, or person. Your citation should include a specific provision authorizing the promulgating entity to regulate this specific subject or program, as well as a reference to the agency/board/person's overall regulatory authority.

The Department of Historic Resources (DHR) has specific statutory authority under Va. Code § 58.1-339.2 to promulgate regulations necessary to implement the program. The regulation is mandated in whole by the state statute. The statute provides that the Director of the Department of Historic Resources shall establish by regulation the requirements needed for the program, including the fees to defray the necessary expenses and the extent to which the availability of the credit is coextensive with the availability of the federal rehabilitation tax credit.

Purpose

Please explain the need for the new or amended regulation. Describe the rationale or justification of the proposed regulatory action. Describe the specific reasons the regulation is essential to protect the health, safety or welfare of citizens. Discuss the goals of the proposal and the problems the proposal is intended to solve.

Amendment and clarification of the existing program regulations is necessary to enhance the ease of use for applicants; more clearly set out the application requirements and standards of review for both applicants and DHR staff; and establish stricter reporting requirements to prevent abuse of the program. Additionally, the amendments will revise the existing fee

structure to more accurately reflect the time and professional expertise necessary for DHR’s review of projects.

By clarifying existing language, this amendment will make the application process and requirements easier to understand for property owners, and promote the wide use of the program, which has demonstrated direct environmental, economic, and social benefits resulting from reinvestment in existing buildings and historic communities.

Enhancing the reporting and attestation requirements on the part of the applicant, both in the description and documentation of proposed and completed rehabilitation work and in the eligible rehabilitation expenses reported as being incurred through the project, is intended to prevent abuse of the program and increase the reliability and certainty of the information presented to DHR for certification.

Substance

Please briefly identify and explain the new substantive provisions, the substantive changes to existing sections, or both.

10 VAC 10-10-10 Definitions: This section has been revised to add and define four new terms.

10 VAC 10-30-30 Certifications of Historic Significance: This section is amended to explain the application requirements for properties that are individually listed in the Virginia Landmarks Register and to clarify the procedure for Certifications of Historic Significance for moved buildings.

17 VAC 10-30-50 Certifications of Rehabilitation: The language in this section is amended to describe in greater detail the process for obtaining Certifications of Rehabilitation, clarify the information that must be disclosed by the applicant and submitted to DHR for review, enhance the attestation requirements of the property owner, and amend the requirements for CPA review of eligible rehabilitation expenses and subsequent reporting by the property owner.

17 VAC 10-30-80 Fees for processing Rehabilitation certification requests: The fee structure for review of applications as set out in this section is revised to refine the categories based on project costs, and raise the review fees.

17 VAC 10-30-100 Definition of Rehabilitation project: The language of this section is amended to more clearly define what constitutes a Rehabilitation project.

17 VAC 10-30-110 Eligible Rehabilitation Expenses: The language in this section is amended to provide a more detailed description of expenses that are not eligible for the rehabilitation tax credit.

17 VAC 10-30-140 Entitlement to credit: This section is revised to stipulate that expenses incurred before 2003 are not eligible for the rehabilitation tax credits.

17 VAC 10-30-150 Projects begun before 2003: This section is revised to stipulate that expenses incurred before 2003 are not eligible for the rehabilitation tax credits.

Issues

Please identify the issues associated with the proposed regulatory action, including: 1) the primary advantages and disadvantages to the public, such as individual private citizens or businesses, of implementing the new or amended provisions; 2) the primary advantages and disadvantages to the agency or the Commonwealth; and 3) other pertinent matters of interest to the regulated community, government officials, and the public. If there are no disadvantages to the public or the Commonwealth, please indicate.

Amending the existing regulations to clarify the application process and reporting requirements will benefit all users of the program. The application process, necessary documentation, and reporting requirements will be more clearly described for property owners applying for the rehabilitation tax credit. This will also aid DHR in the review of rehabilitation projects, as the information submitted will be more complete, and DHR staff will be better able to review the information submitted and respond to the applicant.

Strengthening the attestation and reporting requirements by the owner, particularly the requirements for determining the eligible rehabilitation expenditures, will provide greater assurance to DHR and the Commonwealth that the information submitted is reliable and that subsequent certification of the application by DHR has a factual basis.

According to the existing regulations, property owners/applicants must obtain CPA certification of the eligible rehabilitation expenses for projects with expenses exceeding \$100,000. The proposed amendment would require that all projects have CPA review of expenses, according to the format proscribed by DHR policy. Thus, there will be a new requirement and associated cost for projects under the \$100,000 threshold. However, this important change is proposed to ensure that all expenses upon which tax credits are granted are valid and eligible for the credits. It should be noted that the CPA certification of rehabilitation expenses also provides assurance to the property owner, and their investors, that the statement of eligible rehabilitation expenses is reliable. This change, therefore, will be beneficial to the property owners/applicants, DHR, and the Commonwealth.

The revised fee structure increases the fees charged by DHR for review of the applications. The existing fee structure, which has been in place since the inception of the program, no longer reflects the extensive amount of time and expertise required of DHR to review the applications and administer the program. The revised fee schedule includes more refined cost categories, and the fees charged for review of an application will not exceed 1% of project costs. While this will be an increased cost to the applicant, DHR believes that it is a fair and necessary change. Again, the increased fees will more accurately reflect the investment of resources required of DHR in review of projects, and will allow DHR to maintain and perhaps expand its program capacity.

The proposed revisions have been carefully drafted to enhance the usability of the rehabilitation tax credit program, while ensuring its integrity for property owners, DHR, and the Commonwealth.



Requirements more restrictive than federal

Please identify and describe any requirement of the proposal which is more restrictive than applicable federal requirements. Include a rationale for the need for the more restrictive requirements. If there are no applicable federal requirements or no requirements that exceed applicable federal requirements, include a statement to that effect.

There are no requirements that are more restrictive than applicable federal requirements.

Localities particularly affected

Please identify any locality particularly affected by the proposed regulation. Locality particularly affected means any locality which bears any identified disproportionate material impact which would not be experienced by other localities.

The proposed amendments and revisions will apply equally to all projects, regardless of the locality in which the property that is subject of the historic rehabilitation tax credit project is located.

Certain localities, however, see greater historic rehabilitation tax credit activity due to the local real estate and construction market and available historic building stock. Historically, the localities with the greatest number of projects are Richmond City, the Hampton Roads MSA (projects primarily in Norfolk, Suffolk, and Portsmouth), Roanoke City, and Winchester.

Thus, the increased review fees and enhanced requirement for review of eligible rehabilitation expenses by a CPA will affect more property owners/applicants in these localities. As participation in the program is voluntary, the review fee and expense associated with the CPA review are only incurred when seeking the historic rehabilitation tax credits. So too, these expenses are eligible for the tax credit and are prorated according to the size of the project.

All applicants will be positively affected by the revisions to the regulations to clarify the application process and standards for review. Again, such changes will be experienced more frequently in those localities where rehabilitation tax credit projects are widespread.

Family impact

Please assess the impact of this regulatory action on the institution of the family and family stability including to what extent the regulatory action will: 1) strengthen or erode the authority and rights of parents in the education, nurturing, and supervision of their children; 2) encourage or discourage economic self-sufficiency, self-pride, and the assumption of responsibility for oneself, one's spouse, and one's children and/or elderly parents; 3) strengthen or erode the marital commitment; and 4) increase or decrease disposable family income.

The proposed amendments and revisions will not have an impact on families or family stability.

Changes made since the proposed stage

Please list all changes that made to the text of the proposed regulation and the rationale for the changes; explain the new requirements and what they mean rather than merely quoting the proposed text of the regulation. *Please put an asterisk next to any substantive changes.

Section number	Requirement at proposed stage	What has changed	Rationale for change
10-30-50	<p>A(2)(f): Change the requirements for CPA review of rehabilitation expenses: When rehabilitation expenses exceed \$100,000, certification For a project with (i) rehabilitation expenses of \$250,000 or greater, a report of an audit of the rehabilitation expenses by a an independent certified public accountant or equivalent of the actual costs attributed to the rehabilitation of the historic structure in accordance with the department's Rehabilitation Tax Credit Program Certification Requirements, dated January 2015; and or (ii) less than \$250,000 in rehabilitation expenses, an agreed-upon procedures engagement report of the rehabilitation expenses by an independent certified public accountant in accordance with the department's Rehabilitation Tax Credit Program Certification Requirements, dated January 2015;</p> <p>A(2)(g): The proposed revisions state that <u>submission of false information or falsification of anything in communication with DHR may result in denial of certification and is punishable under Virginia or federal law.</u></p>	<p>A(2)(f): The requirement would be revised so that a project with rehabilitation expenses of \$500,000 or more would be required to submit an audit report of the rehabilitation expenses, whereas a project with rehabilitation expenses of less than \$500,000 would submit an agreed-upon procedures engagement report of the rehabilitation expenses: When rehabilitation expenses exceed \$100,000, certification For a project with (i) rehabilitation expenses of \$500,000 or greater, a report of an audit of the rehabilitation expenses by a an independent certified public accountant or equivalent of the actual costs attributed to the rehabilitation of the historic structure in accordance with the department's Rehabilitation Tax Credit Program Certification Requirements, dated January 2015; and or (ii) less than \$500,000 in rehabilitation expenses, an agreed-upon procedures engagement report of the rehabilitation expenses by an independent certified public accountant in accordance with the department's Rehabilitation Tax Credit Program Certification Requirements, dated January 2015;</p> <p>A(2)(g): The regulations should state that such offenses would be punishable under Virginia <i>and</i> federal law: <u>Signature of the applicant owner. By signing the application, the owner declares that the information stated is correct to the best of the owner's knowledge. Submission of false records or falsification of anything in</u></p>	<p>A(2)(f): After further consideration and consultation with the public and program participants, DHR believes that the cost of an audit of rehabilitation expenses by a CPA is more appropriate in projects with a higher level of rehabilitation costs and budget. Therefore, we propose to revise the language to require an audit for projects with \$500,000 of rehabilitation expenses and an agreed-upon procedures for projects with less than \$500,000 in expenses.</p> <p>A(2)(g): DHR also seeks to correct a scrivener's error; the regulations should state that submission of false information or falsification of anything in communication with DHR may result in denial of certification and is punishable under Virginia <u>and</u> federal law, in order to more accurately describe the</p>

		<u>communications with the department is grounds for denial of the certification of completed work and is punishable under Virginia law and federal law. The department shall submit any relevant information in its possession to the appropriate law-enforcement officials or governmental agencies as necessary; and</u>	
10-30-140	No change proposed to existing language: 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 tax in the manner and amount set forth in these regulations.	The date in section 10-30-140 should have been revised in the proposed changes to be consistent with the dates in section 10-30-150 as they are proposed to be revised: Effective for taxable years beginning on or after <u>January 1, 2003</u> , 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 tax in the manner and amount set forth in these regulations.	In the changes to these regulations, DHR proposes to revise the regulations to state that expenses incurred prior to January 1, 2003 are not eligible for the tax credits. The language in section 10-30-140 was inadvertently not revised accordingly in the proposed changes; DHR now proposes to revise the language accordingly.

Public comment

Please summarize all comments received during the public comment period following the publication of the proposed stage, and provide the agency response. If no comment was received, please so indicate. Please distinguish between comments received on Town Hall versus those made in a public hearing or submitted directly to the agency or board.

Commenter	Comment	Agency response
Marc Hirth	In support of proposed changes; recommend CPA audit of rehabilitation expenses would apply to projects of \$500,000 in rehabilitation expenses or greater; comment made directly to DHR by email.	DHR is making the change as recommended
Chris Johnson	In support of proposed changes; comment made directly to DHR email and at public hearing.	
Mark McConnel	In support of proposed changes; comment made directly to DHR by email.	

<p>Felicity Blundon</p>	<p>Language in section 10-30-110(D)(4)(b), pertaining to allocation of expenses between existing and new sections of a building is redundant.</p> <p>Language in section 10-30-140, Entitlement to credit, should be made consistent with dates in section 10-30-150.</p> <p>Comments made directly to DHR by email.</p>	<p>The language exists as the regulation was originally promulgated, and DHR had not proposed to change it, as the language is not repetitive.</p> <p>DHR proposes to revise the date in section 10-30-140 to be consistent with the date specified in section 10-30-150, January 1, 2003.</p>
<p>Bill Roach</p>	<p>CPA audit report harder to accomplish for projects with less rehabilitation expenses; comment made in public hearing.</p>	<p>DHR proposes to revise the changes so that the CPA audit report would apply to projects with rehabilitation expenses of \$500,000 or greater</p>
<p>Enoch Pou</p>	<p>Concern about proposed requirement for agreed-upon procedures engagement for projects with low rehabilitation expenses; comment made directly to DHR.</p>	<p>DHR feels strongly that all tax credit projects submitted for certification have a standardized review by an independent CPA. The lack of this review by a CPA, regardless of the level of rehabilitation expenses, opens the program to abuse.</p>
<p>David White</p>	<p>Requests that definition of “start of rehabilitation” be changed to include the earliest project expenses, such as architectural or engineering studies necessary to develop the scope of rehabilitation; comment made directly to DHR by email.</p>	<p>DHR does not believe this change is necessary or prudent. The term “start of rehabilitation” is defined as either the date the “taxpayer applies for the building permit for the work contemplated by the plan of rehabilitation, or the date upon which the actual work contemplated by the plan of rehabilitation begins.” This addresses the commencement of the actual, physical rehabilitation work, and differs from the beginning of the project planning.</p> <p>As currently defined, “start of rehabilitation” is integral to the function of the substantial rehabilitation test, and altering the definition would change how a project meets the required financial thresholds.</p> <p>Consequently, changing the definition of “start of rehabilitation” would have a profound impact on the operation of the program and structure of tax credit projects, and would further require changing the definition of “material rehabilitation,” as well as the definition of a rehabilitation project and qualification for credit.</p> <p>Regulations do allow for initial project expenses to be captured, i.e. expenses associated with the planning and development of the project, once the substantial rehabilitation test is met.</p>

All changes made in this regulatory action

Please list all changes that are being proposed and the consequences of the proposed changes. Describe new provisions and/or all changes to existing sections. Explain the new requirements and what they mean rather than merely quoting the proposed text of the regulation

Current section number	Proposed new section number, if applicable	Current requirement	Proposed change and rationale
10		This section contains the terms and definitions used in the chapter.	This section is amended by adding defined terms for Commonwealth, Completion Date, Program, and Work.
30		This section describes the process for determining whether a property is a certified historic structure.	<p>This section is amended to require that a Part 1 application, "Evaluation of Significance," must be submitted for properties that are individually listed in the Virginia Landmarks Register and that contain more than one building or structure. This change reflects the practice by DHR of requiring that a Part 1 application be submitted when multiple buildings or structures exist on an individually-listed property, so that DHR has a documented record of all structures present and can confirm their condition both before and after completion of the rehabilitation project to ensure that any and all changes at the property are consistent with program requirements.</p> <p>The language of this section is amended to state that any Certified Historic Structure present at a property that is the subject of a rehabilitation project must meet the definition of a rehabilitation project, as described in Section 100 of this regulation, and to state that not all buildings or structures present on a property must be rehabilitated. This language is proposed to clarify the existing language and reflect DHR's policy and administration of the program.</p> <p>The section is amended to state that the Director of DHR may determine a property's eligibility for listing in the Virginia Landmarks Register at his or her sole discretion. This language reflects the existing authority of the Director to make such determinations.</p> <p>Because relocation of a historic structure is not a recommended approach, and may</p>

			<p>result in denial of certification of a tax credit application, language is proposed to be inserted that recommends that property owners receive approval from DHR for a relocation plan prior to undertaking such an effort. The language is also amended to require that the owner submit a Part 1 application, "Evaluation of Significance," following relocation of the structure but prior to its rehabilitation in order to determine whether it continues to be a Certified Historic Structure and therefore eligible for the program. These amendments are proposed in order to delineate the requirements for documentation and consultation with DHR when a property, for which rehabilitation tax credits are sought, is to be relocated. This additional language will provide greater clarity and guidance to property owners.</p>
<p>50</p>		<p>This section details the process and reporting requirements for obtaining DHR's review of a proposed project and certification of a completed rehabilitation project.</p>	<p>DHR seeks to amend this section to state that if a property owner begins rehabilitation work prior to submitting a Part 2, "Description of Rehabilitation," and receiving DHR approval for the proposed scope of work, the owner proceeds at their own risk, as the work may not be approved by DHR. This language is intended to make clear to property owners that work conducted prior to DHR review may not consistent with the program requirements and therefore may not be approved, and to encourage property owners to submit the Part 2 application prior to beginning work. This language reflects the guidance already provided by DHR to applicants, and is intended to avoid problems stemming from inappropriate work conducted before consultation with DHR.</p> <p>This section is amended by providing additional examples of the kind of documentation that should be submitted with the Part 2 application to assist DHR in its review of the proposed rehabilitation.</p> <p>This section is amended to state that the program application form as completed by the property owner takes precedence, should there be any discrepancy between the description of work or reporting of costs in the application and the supporting documentation submitted with it. The addition of this language is intended to clarify which document to use in the case of</p>

			<p>differing information, and reflects current DHR policy and practice.</p> <p>The reporting requirements are revised to require CPA review of rehabilitation expenses for all projects, according to the format proscribed by DHR. This is a new requirement for projects with rehabilitation expenses less than \$100,000, which are not currently subject to any CPA review. This change is proposed to ensure that the expenses upon which tax credits are granted are valid and eligible for the tax credits and to prevent abuse of the program. This will mean an additional requirement for projects with less than \$100,000 in rehabilitation expenses. The cost of the CPA review depends on the sufficiency of the property owner's records; the cost of the CPA review is an eligible for the tax credit. DHR believes that tightening this requirement is necessary to preserve the integrity of the program.</p> <p>This section is amended by adding language to state that by signing the application documents, the owner attests to the accuracy of the information, and that submission of false information or falsification of anything in communication with DHR may result in denial of certification and is punishable under Virginia and/or federal law. This amendment is intended to make property owners aware of their responsibility to present accurate information to DHR, and the ramifications for presenting false information. This language is also intended to prevent abuse of the program.</p> <p>Additional information may be requested by DHR in order to determine whether the rehabilitation project meets the requirements of the program, which may include a physical inspection of the project by DHR.</p> <p>Remediation of inappropriate work may be required by DHR in order to certify the rehabilitation project.</p> <p>Explanatory language is inserted to state that a property owner is not responsible for work done by a prior owner, or for work done by the current owner more than five years prior to submission of a tax credit application, so long as that work was not done to circumvent the program</p>
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			<p>requirements. This language is intended to clarify existing language and to provide guidance to property owners.</p> <p>DHR seeks to add the requirement that if the legal property boundaries change after submission of the Part 1 application, "Evaluation of Significance," the property owner must disclose this information. Such information determines the scope of DHR's review of proposed and completed work.</p> <p>Language is proposed to more fully explain when to submit an Amendment to the Part 2, "Description of Rehabilitation," or Part 3, "Request for Certification of Completed Work," applications. This is intended to clarify the application process and the information required by DHR for review and certification of the project.</p> <p>This section is revised to clarify DHR's existing right to conduct a physical inspection of the rehabilitation project to determine if the project meets the program requirements and whether the completed work is consistent with the information submitted to DHR.</p> <p>In this section, additional language is added to clarify what would occur in the case that DHR determines that a project was not conducted according to program requirements or that there is misrepresentation or material error of fact in the information submitted to DHR. It also states that DHR may investigate any project in which it suspects fraud or misrepresentation, regardless of the time which may have passed since certification of the project. This change is intended to prevent fraud and misuse of the program, and to set out the enforcement action that would be taken by DHR.</p>
80		<p>This section sets out the fees charged by DHR for review of the applications.</p>	<p>The fees charged for review of applications are increased and the fee structure is changed by refining the cost categories.</p> <p>DHR seeks to require that phased projects incur a separate Part 3 review fee for each phase, as each phase requires a separate and complete review.</p> <p>The current fee structure has not been changed since inception of the program, and</p>

			the increased fees more accurately reflect the extensive resources required of DHR for review of the applications and administration of the program. This change will mean an increased cost to the property owner, however the increased application fees are not excessive and are in line with what is charged in other similar state rehabilitation tax credit program.
100		This section sets out the definition of a rehabilitation project.	DHR proposes to add language to state that in properties containing more than one Certified Historic Structure, the work at each structure must meet the requirements of the program. Buildings that are physically connected, but that were not historically or functionally related, are separate properties for the purpose of the program. This language clarifies the requirements of the program and reflects current practice and guidance by DHR.
110		This section establishes what qualifies as eligible rehabilitation expenses.	DHR proposes to amend this section with additional language to clarify those expenses that are eligible for the rehabilitation tax credits and those that are not. Language is added to confirm that insurance proceeds, personal property, syndication costs, and deferred fees or unpaid expenses (for which there is not a charge to a capital account with a corresponding entry to a liability account) are not eligible for the tax credits. This will help property owners to understand more fully what expenses serve as the basis for the tax credits.
120		This section establishes the financial thresholds that a property owner must meet in order to qualify for the credit.	Dates in the examples provided in this section are revised to be more current.
130		This section sets out the percentage of tax credits granted and the timing requirements for seeking certification.	Language is struck in this section which is no longer necessary with the definition of "Completion Date" in section 10 of this regulation
140		This section sets out the date upon which tax credits are available.	DHR proposes to revise this section such that only costs incurred January 1, 2003 and later are eligible for the credit. This change would affect very few, if any, potential applications.
150		This section establishes the transition rules for projects	DHR seeks to revise this section to require that only costs incurred January 1, 2003 and

		<p>started before 1997.</p>	<p>later are eligible for the tax credit. This change would preclude a property owner from claiming tax credits for expenses incurred between 1997 and December 31, 2002. DHR proposes this change because rehabilitation work conducted more than ten years ago is difficult for property owners to document and for DHR to evaluate.</p> <p>This change would affect very few, if any, potential applications.</p>
<p>160</p>		<p>This section describes the interaction between Virginia’s rehabilitation tax credit program, and the federal historic tax credit program, administered by the National Park Service.</p>	<p>The section is proposed to be amended by a statement that approval under either the state or federal tax credit program does not mean approval by the other agency.</p> <p>This section is revised to capitalize defined terms.</p>