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Regulatory
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Final Regulation Agency Background Document

Agency name	Department of Historic Resources
Virginia Administrative Code (VAC) citation	17 VAC 10-30
Regulation title	Historic Rehabilitation Tax Credit
Action title	Final Regulations
Document preparation date	10-27-05

This information is required for executive branch review and the Virginia Registrar of Regulations, pursuant to the Virginia Administrative Process Act (APA), Executive Orders 21 (2002) and 58 (1999), and the *Virginia Register Form, Style, and Procedure Manual*.

Brief summary

Please provide a brief summary (no more than 2 short paragraphs) of the proposed new regulation, proposed amendments to the existing regulation, or the regulation proposed to be repealed.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.

Since the passage of the enabling legislation for the Virginia Historic Rehabilitation Tax Credit program in 1996, the Department of Historic Resources has been operating the program under draft regulations. The final regulations will formally implement the program. They provide clear guidance to Virginia taxpayers about eligibility for the program, application requirements and procedures, review standards, appeal procedures, and coordination with the federal Certified Historic Rehabilitation program. The only substantial change from the draft regulations is to specifically disallow the credit for expenditures which are made by government agencies or are financed by an obligation of the Commonwealth.

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.

- (1) Draft regulations published were by the Department in 1997; Proposed regulations were issued in 2002.
- (2) Department of Historic Resources
- (3) Historic Rehabilitation Tax Credit

Legal basis

Please identify the state and/or federal legal authority to promulgate this proposed regulation, including (1) the most relevant law and/or regulation, including Code of Virginia citation and General Assembly chapter numbers, if applicable, and (2) promulgating entity, i.e., agency, board, or person. Describe the legal authority and the extent to which the authority is mandatory or discretionary.

The Department of Historic Resources has specific statutory authority, and is mandated, under Va. Code §58.1-339.2 to promulgate regulations necessary to implement its review and certification of historic rehabilitation projects in order for those projects to receive state tax credits. 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. The Office of the Attorney General has certified that the agency has the statutory authority to promulgate the final regulations, and that they comport with applicable state law.

The statute is located at <http://leg1.state.va.us/cgi-bin/legp504.exe?000+cod+58.1-339.2>

Purpose

Please explain the need for the new or amended regulation. Describe the rationale or justification of the proposed regulatory action. Detail the specific reasons it 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.

These regulations are mandated by state law, and will protect the health, safety, and welfare of the citizens of Virginia by providing a clear and understandable process for qualifying for and claiming historic rehabilitation tax credits, while also assuring that those credits are issued for projects that meet high criteria for historic significance, quality rehabilitation and public benefit. The rehabilitation of historic buildings benefits not only individual property owners, developers, and investors, but entire communities. Through the tax credit program, private dollars are invested in preservation, resulting in enormous public advantage. This money represents costs paid into the construction industry to architects, contractors, craftsmen, and suppliers, as well as to professionals in related fields such as banking, legal services, private consulting, and real estate. The capital improvement to the buildings can result in dramatic increases in local property taxes, enhanced commercial activity, and community revitalization. The rehabilitated buildings provide needed housing (in many cases, low- and moderate-income housing), and office, retail,

and other commercial space. Communities benefit from property improvement, blight removal, and increased occupancy of buildings in historic core neighborhoods.

Substance

Please identify and explain the new substantive provisions, the substantive changes to existing sections, or both where appropriate. A more detailed discussion is required under the "All changes made in this regulatory action" section.

The proposed regulations set forth the requirements and procedures for obtaining the tax credit authorized by section 58.1-339.2 of the Virginia Code. The regulations address the following areas:

- Definitions
- Introduction to certifications of significance and rehabilitation
- Certifications of historic significance
- Standards for evaluating significance within registered historic districts
- Certifications of rehabilitation
- Standards for rehabilitation
- Appeals
- Fees for processing certification of rehabilitation requests
- Forms
- Definition of rehabilitation project
- Eligible rehabilitation expenses
- Qualification for credit
- Amount and timing of credit
- Entitlement to credit
- Transition rules for projects begun before 1977
- Coordination with the federal Certified Historic Rehabilitation program

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.

1) The proposed state regulations parallel the well-established corresponding federal rehabilitation tax credit regulations to a large extent. Where they differ, it is primarily in ways that are advantageous to Virginia taxpayers. Advantages to the public include the following:

- The state credit, unlike the federal credit, is available to homeowners.

- The state credit is triggered by a different spending threshold than the federal credit. In order to qualify for the federal credit, rehabilitation expenditures must exceed the owner's adjusted basis in the building. In order to qualify for the state credit, rehabilitation expenditures for an income-producing building must be at least 50% of the locally assessed value of the building. This is usually a lower threshold, thus allowing property owners undertaking smaller rehabilitation projects to participate in the state program even if they are ineligible for the federal program.
- The federal credit is available only for properties that are individually listed on the historic register or are contributing structures in listed historic districts. The state program expands eligibility by allowing the credit for properties that are certified by the Director of the Department of Historic Resources as eligible for individual listing, even if they are not actually listed.
- The proposed state regulations, unlike the federal regulations, allow for disproportionate allocation of the credit among partners. This flexibility in the use of the credit attracts out-of-state investors and allows for more creative and innovative financing of projects. It also results in nonprofit organizations being able to make use of the state credit by forming partnerships with investors.
- The submission requirements for state applications are somewhat less stringent than the submission requirements for federal applications. Most notably, the federal program requires that Part 1 of the application, the Request for Certification of Significance, be submitted prior to completion of the rehabilitation. This sometimes precludes owners whose rehabilitation work would otherwise qualify them for the credit from applying at all. The proposed state regulations require that all parts of the application be submitted within one year of completion of the rehabilitation work, thereby preventing denial of the credit for a technicality in the paperwork.

2) The primary advantage of this program to the agency is the opportunity to provide an incentive for the use of private investment to further the agency's mission to protect historic resources. Through this program property owners and developers are encouraged to do appropriate work on historic buildings so that they can remain in, or be returned to, useful service. Since 1977, over 1,400 historic Virginia buildings have been rehabilitated using the federal credit, representing private investment of over \$1 billion. The state program has already resulted in over \$125 million in economic activity independent of the federal credit.

Another advantage to the agency is the opportunity to create an income stream through the use of fees for review and processing of projects. Details of the fee structure are listed below in the agency's statement on the fiscal impact of the program.

3) Because the state tax credit could not be granted without clear and precise regulations governing eligibility of projects, and because participation in the program is limited to property owners who voluntarily choose to seek the credit, these regulations will not result in any disadvantage to the public or the Commonwealth.

Changes made since the proposed stage

Please describe all changes made to the text of the proposed regulation since the publication of the proposed stage. For the Registrar’s office, please put an asterisk next to any substantive changes.

Section number	Requirement at proposed stage	What has changed	Rationale for change
10-30-50		4. F. An authorized representative of the Department may inspect projects to determine if the work meets the <i>Standards for Rehabilitation</i> . The Department reserves the right to make inspections at any time up to three years after completion of the rehabilitation and to revoke a certification, after giving the applicant 30 days to comment on the matter, if it is determined that the rehabilitation project was not undertaken as represented in the application and supporting documentation. The tax consequences of a revocation of certification will be determined by the Department of Taxation. <u>However, certification shall not be revoked for changes which are determined to have been made following good-faith completion of the project.</u>	Responds to public comment described below. This change is not considered substantive, as it merely clarifies standing procedure.
*10-30-110.		A. Eligible rehabilitation expenses are those expenses incurred <u>by a taxpayer</u> in connection with a plan of rehabilitation on or after January 1, 1997, in the material rehabilitation of a certified historic structure and added to the property’s capital account.	The statutory authority for the program requires that eligible expenditures be incurred by a taxpayer. Because governmental entities are not taxpayers, expenditures made by such entities should not qualify for

		<p>D. Certain expenses are not eligible rehabilitation expenses. These expenses are:</p> <p>5. <u>Any expense not incurred by a taxpayer, including expenses incurred by a local government or any agency thereof, or by any agency, unit, or instrumentality of the Commonwealth.</u></p> <p>6. <u>Any rehabilitation expense financed, directly or indirectly, by an obligation of the Commonwealth of Virginia.</u></p>	<p>credits. However, in transactions where governmental entities enter into appropriate arrangements with bona fide private investors, tax credits should not be precluded. These changes clarify that expenses not incurred by taxpayers, as well as expenses financed through bond issues, are not eligible for the credit. However, projects which are appropriately financed with private investment remain eligible.</p>
<p>10-30-110</p>		<p>C. Amounts are properly chargeable to capital account if they are properly includible in computing the basis of real property under U.S. Department of the Treasury, Internal Revenue Code, Reg. §1.46-3(c). Amounts treated as an expense and deducted in the year paid or incurred or amounts that are otherwise not added to the basis of real property do not qualify. Amounts incurred for <u>historic preservation consultant fees</u>, architectural and engineering fees, site fees and other construction related costs that are added to the basis of real property satisfy this requirement.</p>	<p>Responds to public comment described below. This change is not considered substantive as it merely clarifies standing procedure.</p>
<p>*10-30-140</p>		<p>A. . . . Credits granted to a partnership, electing small business corporation (S corporation), or limited liability company shall be allocated among partners or shareholders, respectively, either in proportion</p>	<p>The rationale for this decision is that (a) the regulations provide for allocation of the credits at the end of the relevant taxable year, not necessarily at</p>

		<p>to their ownership interest in such entity or as the partners or shareholders mutually agree as provided in an executed document. The document shall be signed by all members, partners or shareholders of the owning, partnership, corporation, or limited liability company and shall be attached to the Request for Certification of Completed work. The following form may be used:</p> <p>The state historic rehabilitation tax credits shall be allocated among the [members, partners or shareholders, as applicable] as follows:</p> <p>Member, partner or shareholder 1 _____ x% Member, partner or shareholder 2 _____ y% Member, partner or shareholder 3 _____ z% and so on through 100%</p> <p>This document shall be executed by all necessary parties prior to the Request for Certification of Completed Work. The members, partners or shareholders at the end of the taxable year in which there is an entitlement to credit shall be allocated the state rehabilitation tax credits for which a project is certified, as defined in this document.</p>	<p>the time the documents are submitted to the Department, and (b) this information is appropriately filed with the Department of Taxation, not with the Department of Historic Resources.</p>
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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.

Commenter	Comment	Agency response
Mary Harding Sadler	Requested that the one-time transfer option be continued for nonprofit organizations after the final regulations are published.	The one-time transfer option was conceived as a temporary measure and implemented under Acts of Assembly. It is not included in the authorizing legislation and cannot be continued without further legislative action.
Mary Harding Sadler	Pointed out that the proposed regulations include a provision allowing the Department to inspect projects for up to three years following completion of the project (17 VAC 10-30-50.F). Noted that this creates a “ticking time bomb” for project applicants whose certification could be revoked pursuant to such inspections and requested that the provision be either eliminated or limited to a six-month period.	The final regulations will provide that final certification cannot be revoked for changes which are determined to have been made following good-faith completion of the project, as detailed above.
Daniel Pezzoni	Recommended that the phrase “at their own risk” be clarified in 17 VAC 10-30-30.G and 17 VAC 10-30-30 J.1 to indicate what the applicant risks in the situations described in those sections of the regulations. Suggested that the regulations specify “at the risk that the project will be denied certification” or similar language.	In 17 VAC 10-30-30.G the language, “Applicants proceed with rehabilitation projects at their own risk; if the historic district is not listed in the Virginia Landmarks Register, the preliminary certification will not become final” seems sufficiently clear to convey that the applicant is risking that the project will not receive final certification. Similarly, in 10-30-30.J.1 the language “In certain special cases, when there is adequate documentation about the building before its relocation and about the moving process, it may be possible to certify historic rehabilitation projects involving moved buildings when participation of the Department prior to the move did not occur. However, this approach is not

		recommended, and owners pursue it at their own risk” seems sufficiently clear to convey what specific risk the applicant is taking.
Daniel Pezzoni	Recommended that fees charged by “preservation consultants,” “preservation professionals,” or “preservationists” be specifically included as eligible expenditures in 17 VAC 10-30-110.C, similarly to architectural or engineering fees.	The language “historic preservation consultant fees” has been added to the specified section of the regulation, as detailed above.
Daniel Gecker	Recommended that 17 VAC 10-30-130 be amended to allow credits to be taken in the year certification is issued in cases where Part 3 of the application is not submitted within three months of the project’s completion date. The rationale for this change is to reduce the need for the filing of amended tax returns and to facilitate the tracking of credits on an annual basis.	This suggestion has not been implemented in the final regulations because the Department of Historic Resources has determined that it would create ambiguity in determining the credit year.
Daniel Gecker	Recommended that the requirement in 17 VAC 10-30-140 that all members, partners, or shareholders of a pass-through ownership entity sign documents submitted to the Department be eliminated. The rationale for this recommendation is that (a) the regulations provide for allocation of the credits at the end of the relevant taxable year, not	This suggestion has been implemented, as detailed above.

	necessarily at the time the documents are submitted to the Department, and (b) this information is appropriately filed with the Department of Taxation, not with the Department of Historic Resources.	
Daniel Gecker	Recommended that the issue of allowing tax credits to be claimed for rehabilitation of governmental use property be examined. Suggested that the issues be clarified and guidelines for such transactions produced.	This recommendation has been implemented in 10-30-110, as detailed above.

Enter any other statement here

All changes made in this regulatory action

Please detail all changes that are being proposed and the consequences of the proposed changes. Detail new provisions and/or all changes to existing sections.

Please see above, under “Changes made since the proposed stage.” No new provisions are being added except through changes described above.

Family impact

Please assess the impact of the proposed regulatory action on the institution of the family and family stability.

Rehabilitation of historic buildings results in, among other benefits, improved housing stock, preservation of neighborhoods, and enhanced property values. In many cases, the historic rehabilitation tax credits are combined with low-income housing tax credits, resulting in increased housing for low and moderate income families. The Virginia credit, unlike the corresponding federal rehabilitation tax credit, is available for owner-occupied buildings. This creates a financial incentive for homeowners to improve their property, resulting in a positive influence for families.

1. This program will not directly affect the authority and rights of parents with regard to the education, nurturing, or supervision of their children.
2. This program will encourage economic self-sufficiency, self-pride, and the assumption of responsibility for oneself and one's family by providing a financial incentive to homeowners to rehabilitate and improve their property and the community in which they live.
3. This program will not directly affect marital commitments.
4. This program will have a positive effect on disposable family income, not only by allowing homeowners to take advantage of the credits, but also by enhancing economic activity in general through money paid into the construction industry and related fields such as real estate, law, and banking, and by enhancing retail and business activity.