

Differences Between the Historic Rehabilitation Tax Credit and Low Income Housing Tax Credit

<i>Historic Rehabilitation Tax Credit</i>	<i>Low Income Housing Tax Credit</i>
<p>Credit Percentage: The historic rehabilitation tax credit is equal to 20% of the amount of qualified rehabilitation expenditures.</p> <p>The credit is 26% for expenditures paid or incurred after August 27, 2005, and before January 1, 2009, with respect to property located in the Gulf Opportunity Zone.</p>	<p>Credit Percentage: The low income housing tax credit is equal to approximately 9% of the amount of a building's qualified basis annually for 10 years, and is designed so that the present value of the credit is no more than 70% of the building's qualified basis. A 4% annual credit is available if the building is constructed or rehabilitated with federal subsidies or an existing building is acquired and substantially rehabilitated, in which case the present value of the credit is designed to be no more than 30% of the building's qualified basis. The exact percentage for the low income housing tax credit generally is based upon the month in which the property is placed in service or, if elected by the taxpayer, the month in which allocation is received.</p>
<p>Substantial Rehabilitation: The rehabilitation tax credit is only available in connection with the qualified rehabilitation of a certified historic structure. A certified historic structure must be listed individually in the National Register of Historic Places or be determined to contribute to a Registered Historic District. The property must be substantially rehabilitated. This means the rehabilitation expenditures incurred during a 24-month period must exceed the greater of \$5,000 or the adjusted basis of the building at the commencement of the 24-month period.</p>	<p>Substantial Rehabilitation: The low income housing tax credit is available for new construction or substantial rehabilitation. In addition, acquisition costs for an existing building may be eligible for the low income housing tax credit in the case of a substantial rehabilitation of the building. For purposes of the low income housing tax credit, substantial rehabilitation is defined as expenditures incurred during a 24-month period which are not less than the greater of (1) \$3,000 of qualified basis per low income unit or (2) 10% of the adjusted basis of the building (determined at the commencement of such 24month period).</p>

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<p>Credit Computation: The rehabilitation tax credit is based upon the amount of qualified rehabilitation expenditures, which generally consist of improvements made to the building structure and interior which have a 27.5 year depreciation period (39 years for nonresidential rental). No rehabilitation tax credit is allowed for land costs, site improvements, enlargement of a building, personal property or for building acquisition costs.</p>	<p>Credit Computation: The low income housing tax credit is computed, in part, by reference to eligible basis, which includes substantially all the depreciable costs of constructing or rehabilitating a building and depreciable costs of property that is used in common areas. No low income housing tax credit is permitted for non-depreciable land costs. The acquisition costs of a building can be included for purposes of the low income housing tax credit, but only for the 4% credit provided that certain requirements are met: e.g., the building has not been placed in service within the last 10 years, the building is acquired from an unrelated party and a substantial rehabilitation is undertaken in connection with the acquisition of the building.</p>
<p>Property Type Restriction: The rehabilitation tax credit is available for any depreciable real property used in a trade or business, whether such use is residential or nonresidential.</p>	<p>Property Type Restriction: The low income housing tax credit is available only with respect to residential rental property, including facilities that are functionally related and subordinate to the rental units. It also includes property used in a common area or provided as a comparable amenity to all residential rental units in the building.</p>
<p>Tax-exempt Use Property Rules: The rehabilitation tax credit is generally not available with respect to tax-exempt use property, which includes property leased to a tax-exempt entity, governmental entity or foreign entity under a disqualified lease. Disqualified leases generally include leases in excess of 20 years, leases with purchase options and sale-lease back arrangements.</p>	<p>Tax-exempt Use Property Rules: The low income housing tax credit is not affected by the tax-exempt use property rules. However, residential units must be leased to qualified low-income tenants and the rents must be restricted.</p>

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<p>Use Commitment: A building which is entitled to the rehabilitation tax credit is not subject to any extended use commitment beyond the 5-year credit recapture period.</p>	<p>Use Commitment: The owner of a qualified low income housing building is required to enter into an extended use agreement requiring the building to be maintained as affordable housing for a period of not less than 30 years.</p>
<p>Pass-through Election: The owner of rehabilitation tax credit property can elect, under certain circumstances, to pass-through the credit to a lessee.</p>	<p>Pass-through Election: The owner of low income housing tax credit property cannot elect to pass through the credit to the tenants.</p>
<p>Property Location: The rehabilitation tax credit is equal to 20% of the qualified rehabilitation expenditures without regard to where the building is located</p>	<p>Property Location: If a qualified low income housing building is located in either a qualified census tract (e.g., a designated tract in which 50% or more of the households have an income that is less than 60% of the area median gross income) or in a difficult development area (a designated area which has high construction, land, or utility costs relative to area median gross income), the construction or rehabilitation expenditures for purposes of the credit may be increased by up to 130% of the amount of such expenditures.</p>
<p>Adjustments When Combining Credits: The amount of rehabilitation tax credit is not affected by the low income housing tax credit</p>	<p>Adjustments When Combining Credits: The eligible basis for purposes of computing the low income housing tax credit must be reduced by the amount of the rehabilitation tax credit.</p>

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<p>Federal Grants: The rehabilitation tax credit is not necessarily reduced by the amount of federal grants. Federal grants which are received to finance construction may or may not be included in basis. Inclusion in basis is dependent upon whether the grant proceeds are included in income. Grants utilized to subsidize operations would not cause a reduction in the amount of basis.</p>	<p>Federal Grants: The eligible basis of a low income housing tax credit property must be reduced by the amount of any federal grant which is used for the building (or for its operation), regardless of whether the amount of such grant has been taken into income or when the grant is received during the 15-year compliance period.</p>
<p>Federal Subsidies: The receipt of a federal subsidy in the form of a below-market interest rate loan or the use of tax-exempt bonds does not reduce the amount of the rehabilitation tax credit.</p>	<p>Federal Subsidies: The receipt of a federal subsidy in the form of a below-market interest rate loan or the use of tax-exempt bonds requires use of the 4% (instead of the 9%) low income housing tax credit unless the taxpayer elects to reduce the eligible basis of the building by the amount of federally subsidized financing.</p>
<p>When Credit is Claimed: The full amount of the rehabilitation tax credit is claimed in the year in which the qualified rehabilitation expenditures are placed in service, or earlier if the taxpayer is eligible for and elects treatment under the qualified progress expenditure rules. The credit may be claimed even if the building or a portion of the building is vacant, so long as it is ready and available for occupancy.</p>	<p>When Credit is Claimed: The low income housing tax credit generally may be claimed over a 10-year credit period starting with the year the building meets the elected minimum set-aside requirement for occupancy by qualified tenants, but not later than 1 year after the year the building is placed in service. There are special rules for multi-building or phased projects. The credit is not available for a dwelling unit until such dwelling unit is occupied by a qualified tenant.</p>

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<p>Placed in Service: Qualified rehabilitation expenditures are placed in service at the time that they are ready and available for their assigned use. This typically means that placement of service occurs when a certificate of occupancy is obtained for the building.</p>	<p>Placed in Service: A new low income housing building is placed in service when it is ready and available for its specifically assigned function, e.g., when the first unit in the building is certified as being suitable for occupancy in accordance with state law, and rehabilitation expenditures are treated as placed in service at the end of the 24-month period for aggregating these expenditures, or may be treated as placed in service on completion of the rehabilitation if the completion is before the end of the 24-month period, provided that on such date the taxpayer has met the test set forth above for qualifying the building as a substantially rehabilitated building.</p>
<p>Basis Adjustment: The taxpayer must reduce the depreciable basis of the building by the amount of the rehabilitation tax credit. A partner in a partnership must reduce his capital account in a partnership owning such a building by his ratable share of the rehabilitation tax credit.</p>	<p>Basis Adjustment: No adjustment to basis or capital accounts is required in the case of the low income housing tax credit.</p>
<p>At Risk Rules: The rehabilitation tax credit is subject to at-risk rules. In particular, the amount of non-recourse financing with respect to qualified rehabilitation expenditures (even if the financing otherwise constitutes qualified commercial financing) cannot exceed 80% of the credit base of the qualified rehabilitation expenditures.</p>	<p>At Risk Rules: The low income housing tax credit is subject to the at-risk rules, but unlike the rehabilitation tax credit there is no percentage requirement tied to nonrecourse financing.</p>

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<p>Passive Activity Loss Rules: Individuals that invest in rehabilitation tax credit property are subject to passive activity loss rules if they are not materially participating in the real estate activity (e.g. limited partners). An individual can utilize the rehabilitation tax credit to offset up to the tax equivalent of a \$25,000 loss subject to a phase-out as the individual's adjusted gross income increases from \$200,000 to \$250,000. No credit can be claimed if adjusted gross income is greater than \$250,000 and the activity is passive.</p>	<p>Passive Activity Loss Rules: Individuals that invest in low income housing tax credit property are subject to passive activity loss rules if they are not materially participating in the real estate activity (e.g., limited partners). An individual can use the low income housing tax credit to offset up to the tax equivalent of a \$25,000 loss, without regard to the adjusted gross income of the individual.</p>
<p>Ownership Requirement: The rehabilitation tax credit is available only to the owner of the building (or partners in a partnership which is the owner of the building) at the time the qualified rehabilitation expenditures are placed in service. Once the property has been placed in service, the credits can not be transferred to a subsequent buyer or investor partner.</p>	<p>Ownership Requirement: The low income housing tax credit is available to the building owner(s) beginning in the year that the building meets the minimum set aside requirements, but not later than the year after the year the building is placed in service. Section 42(d)(7) permits the disposition of a building and continuation of the credits once the credit has been allocated. However, the former owners must either recapture the accelerated portion of the credits they have claimed or post bonds or U. S. Treasury securities as collateral to ensure that the property will be maintained as low income housing throughout the 15-year compliance period. The accelerated portion of the credit is the excess of the amount of credit claimed over the amount that would have been allowable for the relevant years if the aggregate credit had been allowable ratably over a 15-year period.</p>

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<p>Partnership Allocation Rules: The rehabilitation tax credit is allocated among partners of a partnership based on their shares of general profits.</p>	<p>Partnership Allocation Rules: The low income housing tax credit is allocated among partners in a partnership based upon their shares of depreciation deductions attributable to the expenditures producing the low income housing tax credit.</p>
<p>Profit Motive: The IRS has not specifically ruled on whether a participant in a rehabilitation tax credit transaction must have a profit motive.</p>	<p>Profit Motive: The Treasury Regulations specifically provide that a profit motive is not required in order to claim the low income housing tax credit. The transaction, however, must not be a “sham” and the person or entity claiming the low income housing tax credit must have a bona fide ownership interest in the property.</p>
<p>Tax Credit Recapture: The rehabilitation tax credit is subject to recapture if the building is disposed of or is otherwise converted to improper use during the five-year period commencing on the date it is placed in service, or if the ownership interest of a partner in a partnership owning the building is reduced during that period by more than one-third. The percentage of recapture is reduced by 20% for each full year elapsing before the recapture event occurs.</p>	<p>Tax Credit Recapture: The low income housing tax credit is subject to recapture over a 15-year period in the event of noncompliance with the low income housing tax credit rules.</p>

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<p>Governmental Approval/Allocation: The rehabilitation tax credit is available without any governmental allocation or approval process except approvals are required from the Department of Interior with regard to the historic quality and character of the building and the rehabilitation of the building.</p>	<p>Governmental Approval/Allocation: In general, the low income housing tax credit is available through a competitive allocation process conducted by state housing credit agencies. Projects are ranked based on the state's identified housing priorities and criteria appropriate to local conditions. The annual credit available to each state generally is based on the state's population multiplied by a specific amount (currently \$1.25). These tax credits are also separately available to projects financed more than 50% by tax-exempt bonds issued under the private activity bond volume cap of Internal Revenue Code Section 146.</p>

This comparison presentation was prepared by Mark Primoli, Internal Revenue Service, from a memorandum authored by Kenneth A. Alperin, P.C., Nixon Peabody LLP, Boston, MA. Its purpose is to present an overview of the issues set forth, and should not be relied upon as definitive tax advice, but merely as a starting point for the analysis of these issues.

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