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Historic Rehabilitation Tax Credits Update

With the help of legislators at the state and federal levels, the historic rehabilitation tax credit (HTC) is poised to receive significant upgrades in 2021. The HTC program under Section 47 of the Internal Revenue Code and corresponding state HTC programs have been a highly effective public policy carrot for historic building owners, developers, investors and local governments aiming to revitalize historic structures and stimulate local economies. As the United States recovers from the economic devastation of 2020, the improvement of HTC laws has the potential to encourage development, stimulate job growth, and provide greater access to affordable housing.

Federal Update

On April 1, 2021, Representatives Earl Blumenauer (D-OR), Brian Higgins (D-NY), Terri Sewell (R-AL), and Darin LaHood (R-IL) introduced a new version of the Historic Tax Credit Growth and Opportunity Act in the House of Representatives. The bipartisan bill is designed to boost community revitalization efforts and affordable housing development, following significant market disruption in the wake of the COVID-19 pandemic, through both temporary and permanent changes to the way HTCs are allocated.

Temporary changes are aimed at supporting historic development projects that were stalled or slowed significantly in 2020. Those changes include:

- Increasing the HTC percentage from 20% to 30% until 2024; and then
- Decreasing the HTC percentage incrementally to 26% in 2025, 23% in 2026, and back down to 20% in 2027.

Permanent changes are aimed at stimulating revitalization and affordable housing development in smaller, rural, or midsized communities. Specifically, those changes include:

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- Increasing the HTC percentage from 20% to 30% on the first $2.5 million in qualified rehabilitation expenditures, but only if the total qualified rehabilitation expenditures for the project do not exceed $3.75 million.
- Reducing the substantial rehabilitation test threshold from 100% to 50% of adjusted basis, which will allow more historic projects to qualify for HTC benefits.
- Eliminating the HTC basis adjustment for projects that are placed in service after the date of enactment. This would allow HTCs to be paired with low-income housing tax credits more easily.
- Eliminating the bulk of the disqualified lease rules and making it applicable only to government entities—meaning more tax-exempt use property can qualify as a qualified rehabilitation expenditure.

Kentucky Update

Before the 2021 Kentucky legislative session ended, the General Assembly passed legislation increasing the state-wide HTC cap for certified historic structures to $100 million for applications received on or after April 30, 2022. Of that amount, 25% will be awarded to owner-occupied residential property, and 75% will be awarded to non-owner occupied (aka, commercial) properties. There is also a special provision in the legislation for a one-time "major certified rehabilitation" project to be awarded prior to December 31, 2021. To be considered a major certified rehabilitation, the project must meet specific and limited criteria, which include an intended use as a hotel, tourism destination, or other use supporting or relating to the promotion of tourism.

While the overall cap increase should help more projects maximize the state HTC benefits, there are a few technical issues that may affect how the state HTC program is implemented in the coming months. These issues should be explored with counsel for current, pending or future projects. Application dates must be considered, and it is important to note that the *per project* credit cap of $400,000 for a commercial project was not increased. Also, there is an outstanding issue in the state HTC program that affects the

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transferability of the state HTC, which was not corrected despite various advocacy efforts during the session. Currently, where an election to transfer the state HTC is made, KRS 171.317(8) only permits credits to be transferred or assigned to an entity subject to the bank franchise tax. However, recent legislation repealed the bank franchise tax effective January 1, 2021, and the transfer of the credit is no longer permitted because there is no qualifying transferee.

Frost Brown Todd counsels clients across the country on ways to utilize federal and state historic tax credits in their development projects. We stay at the forefront of all legislative efforts affecting the HTC program, and we are ready to assist clients with current and future projects or HTC applications that may be affected by these changes. We will provide further updates as the Historic Tax Credit Growth and Opportunity Act moves through Congress and as other legislation takes effect and plays out in the industry.

For more information, please contact the authors or any other attorney on Frost Brown Todd's Real Estate or Multifamily Housing teams.

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