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**The Texas Historic Preservation Tax Credit Program**

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**The Texas State Historic Preservation Tax Credit**

**by**

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**Professional Report**

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## **Dedication**

This report might have never been completed if not for the motivation of having my first child, Harper Jane Hudson. It took your arrival for me to have the courage to finish. To my supportive husband, Scott, I am forever grateful for your love and devotion.

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## **Abstract**

### **The Texas State Historic Preservation Tax Credit**

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The University of Texas at Austin, 2014

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Across the country more and more states are taking advantage of the economic value of state historic tax credits that can be used in conjunction with federal rehabilitation tax credits to incentivize significant investment in the rehabilitation of buildings. Texas joined thirty-three other states when it passed a state historic tax credit in 2013. The financial incentives of this new piece of legislation are expected to spur the rehabilitation of historic buildings in large cities and small towns across the state. In order to be a successful statewide program the tax credit must be an attractive financial incentive for not only sophisticated investors, but also for small building owners with no previous tax credit or rehabilitation experience. The tax credit creates a new market of buyers and sellers, drawing the attention of local and national real estate developers and investors. The ability to combine state and federal historic tax credits changes the bottom line in real estate pro formas, leveraging historic buildings as assets. The availability of the tax credit for small preservation projects may have the greatest impact on historic preservation efforts across the states as smaller towns begin to see new investment in downtown commercial districts. This report explains how the tax credit was created,

analyzes the strength of the policy, and makes recommendations for its implementation and use.

This work addresses a series of important questions. Will the Texas Historic Preservation Tax Credit be an effective economic driver as compared to other state historic tax credits? What are the strengths and weaknesses of the Texas tax credit? This report analyzes the new Texas program and gages its potential to incentivize the rehabilitation of historic properties in a range of sizes and locales.

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## **Chapter 1: Historic Tax Credits as Financial Incentives**

One of the most successful redevelopment tools in the country is the Federal Rehabilitation Tax Credit program. Cities and towns across the country have benefited from the investment of capital into historic buildings that bring life back to abandoned and forgotten districts. Texas became the thirty fourth state to take advantage of this economic incentive by creating a state historic tax credit that works with the federal credit to incentivize large redevelopment projects. The new state credit also promotes small redevelopment projects that do not meet the qualifications of the federal program. This piece of legislation, HB 500, will be an effective historic preservation and economic development tool for years to come.

The purpose of my research is to analyze the recently created Texas state historic preservation tax credit, its creation, and anticipated impact on communities across the state. How can the newly enacted Texas Historic Preservation Tax Credit Program be implemented so as to ensure a successful program that incentivizes rehabilitation projects in small town main streets and historic urban cores? Will the differences between the Federal Historic Rehabilitation Tax Credit and the new state tax credit be enough to incentivize small projects? This research compares the strengths of the Texas version of the state historic tax credit to other state historic tax credits. The analysis centers on the actual piece of legislation, H.B. 500 and the rules the Texas Historical Commission will use to approve projects. The findings include recommendations for users of the tax credit at an individual project level and also include recommendations for organizations that have a role to play in promoting the use of the tax credit.

The term "historic preservation" is often used in the pejorative as a term associated with restrictions on property rights and naysayer advocates opposing

demolition of old buildings. Historic preservation is not always associated with economic development or financial incentives. Many property owners resent having to deal with the local preservation boards for approval for alterations to their properties. There is no doubt that historic designation comes with restrictions and more regulation than some care to deal with. However, historic tax credits help offset the restrictions by offering a financial incentive for investing in older buildings. As preservationists and city planners know, historic preservation can be a valuable tool in creating and maintaining sustainable neighborhoods that are walkable, affordable and desirable places to live. Quality rehabilitation work requires a special dedication on the part of owners and investors. Specialized labor and materials are required as well as sophisticated project management. Ultimately a rehabilitation project must make economic sense. Very few property owners can do rehab work just for the sake of doing something that feels right. Rather, financial motivations play an important part in the revitalization of historic districts and main street communities across the state. Tax credits legitimize the cultural and historical value of preservation in financial terms. In most cases, major rehabilitation projects are the result of a real estate venture that makes financial sense for owners and investors. Federal historic tax credits have been impacting the bottom line of such real estate investments for decades; now Texas has a new tool to increase the number and scope of rehabilitation projects.

In 2013, the State of Texas took a big step in helping to incentivize historic rehabilitation by creating the State Historic Tax Credit as part of House Bill 500, amending Section 14. (a) Chapter 171, Tax Code by adding Subchapter S. Tax Credit for Certified Rehabilitation of Certified Historic Structures. This piece of legislation is intended to increase the number of historic rehabilitation projects across the state by means of a financial incentive worth 25% of the value of eligible costs and expenses.

## **THE FEDERAL HISTORIC REHABILITATION TAX CREDIT**

A tax credit creates a dollar-for-dollar reduction in the taxes owed to the government. The Rehabilitation Investment Tax Credit was created by Congress in 1978 with the passage of the Tax Act (Tyler, 2009, p. 249). The tax credit program (began as a 10% credit) is worth a 20% credit against federal income tax liabilities. The Historic Rehabilitation Tax Credit (HRTC) is the federal government's most significant financial investment in historic preservation. During its 30 plus years, the HRTC has created more than 2.35 million jobs, leveraged over \$106 billion in private investments all by putting more than 38,700 buildings back into productive use (National Trust Community Investment Corporation, 2013). Across the country the federal incentive, worth 20% of qualified rehabilitation expenses, is seen as an economic development driver, not just a preservation tool (Yots, 2014).

Credits are taken the year the building is placed in service, and owners must retain the property for five years once the credit is claimed. When a building owner cannot directly use the full value of a tax credit they use a process called "syndication". Syndication requires bringing an investor into the ownership structure, thus allowing the investor to claim the tax benefits in exchange for financing the project. The Internal Revenue Code makes it difficult for individuals to use the tax credits and so investors are most often third-party corporate investors. As part of the syndication process the investor becomes a limited partner or a member of Limited Liability Company. The tax credits are not sold directly to the investor; rather the investor redeems the credits against its federal income tax liability in exchange for putting equity into the project. Such investors are typically banks, publicly held corporations, and other institutional investors that are not subject to passive loss rules by the Internal Revenue Service (IRS). Syndication is a complex and expensive process, and due to the complexity and high costs of syndication,

it is only considered a viable option for projects that generate substantial tax credits. Non-profits looking to complete a tax credit project must syndicate the tax credit. Further complicating the syndication process was the 2012 Historic Boardwalk Hall case that invalidated a common Historic Rehabilitation Tax Credit (HRTC) syndication structure. The federal appeals court ruling made experienced tax credit investors leery of taking on new projects due to the uncertainty regarding the legality of commonly used syndication structuring. The IRS came out with new guidance for syndication structuring on December 30, 2013, called Revenue Procedure 2014-12 (Yots, 2014). The seventeen page document describes the way in which HRTC projects can have a “safe harbor” from future IRS challenges.

For major rehabilitation projects HRTC’s alone may not be enough financial incentive to make projects feasible. Developers must use a combination of tax credits and other incentives to help fill the financial gap. Working with historic properties can incur higher costs than greenfield development and often require creative partnerships and multiple tax credits (Wood, 2013). According to the 2013 Historic Rehabilitation Tax Credit Recapture Survey commissioned by the National Trust for Historic Preservation, all of the survey respondents used other federal tax credit programs such as Low Income Housing Tax Credits (LIHTC), New Markets Tax Credits (NMTC) along with HRTC’s (Novogradac & Co. 2012). It should be noted that LIHTC and NMTCs are used more often than HTCs (Listoken and Lahr, 2011 p.3). Many projects also rely on state and local incentives. The respondents to this survey were sophisticated investors that take on multi-million dollar projects where HRTC’s can be worth over \$1 million. Through phone interviews with experienced developers it became clear that in order to be willing to take on a major rehabilitation project there would need to be a substantial credit available. For many experienced developers “substantial” means \$1 million in tax credits.

Several interviewed developers said that they have to weigh the value of the tax credit against the headache of dealing with the regulatory process that comes with tax credit projects. The Recapture Survey validates this sentiment.

As this report is being written, Congress is conducting a complete review of the Internal Revenue Code. Congressional desire for tax reform means that all government expenditures and revenue sources are being closely examined. Tax expenditures such as tax credits and deductions are being evaluated. In February 2014, House Ways & Means Chairman Dave Camp released a discussion piece that included the elimination of the Federal HRTC. The Historic Tax Credit Coalition and the National Trust have started a campaign to save the HRTC. As research has shown, state historic tax credit programs leverage the use of the Federal HRTC. Despite some uncertainty, this paper will assume that the federal HRTC will stay in place.

### **HRTC PROJECTS IN TEXAS**

Compared to states with state historic tax credits, Texas has lagged behind in the number of Federal Historic Rehabilitation Tax Credit projects. From 2001 to 2012 Texas had only 111 HRTC projects. These projects created 12,678 jobs, leveraging \$142,453,245 in tax credits to \$858,152,079 in development expenditures (National Trust Community Investment Corporation, 2013). During the same time period, Ohio saw 697 projects completed. Ohio has had a strong state tax credit program since 2007. In 2013 it claimed the most HRTC project submissions in the country. Like Texas, the Ohio tax credit is worth 25% of qualified rehabilitation expenses (Heritage Ohio and National Trust for Historic Preservation, 2013. pg. 2). Texas has more than double the population of Ohio and is in the midst of a real estate boom compared to Ohio. So why has Ohio had



so many more rehabilitation projects than Texas? National Park Service reports show that states with strong state tax credit programs have the highest numbers of federal HRTC projects. In 2011 the National Trust Community Trust Corporation released its Second Annual Report on the Economic Impact of the Federal Historic Tax Credit detailing the impact that the Kansas state HTC had on the state's economy. Kansas had 50 HRTC projects in the 21 years before the creation of the state program in 2002 and in the eight years since there were 542 HRTC projects (Daffern, Lahr, Listokin, & Stanek, 2010, p.3). Like Texas, the Kansas state credit is transferable, worth 25% of qualified rehabilitation expenses of commercial projects, and has no per-project cap. If the Kansas program is any indicator of the increase in federal HRTC projects that Texas can expect to see, then it might be time to prepare for a rehabilitation boom.

In Texas not all cities are created equal in terms of their historic assets and preservation ethic. San Antonio has very strong local protections for historic assets while Houston struggles to protect historic assets because of its lack of zoning. One would guess that San Antonio would have the most HRTC projects in the state given the sheer number of designated properties, but designation does not equal restoration. Houston, which is not known as a preservation friendly city, and has struggled to create local historic districts, has in fact made as much use of the HRTC as San Antonio, which has the oldest preservation ordinance in the state, and the first and largest National Register Districts in the state. By using data from the National Trust for Historic Preservation for the number of projects completed in each state we see that 39% of all HRTC projects in Texas from 2001-2012 were concentrated to the state's three largest cities, Houston, Dallas and San Antonio. Dallas' Fidelity Union Life Tower project is the most expensive at \$86,000,000 in total development costs (National Trust Community Investment Corporation, 2013). In a phone interview with Hal Fairbanks (personal communication,

February 13, 2014) of Historic Restorations Inc. (HRI), one of the leading adaptive reuse real estate companies in the country, Fairbanks noted how the new state tax credit is already having an impact on real estate prices in downtown Dallas. “Low hanging fruit” projects, large buildings in active real estate markets, can easily be adapted to a new use, are and will be subject to bidding wars. Large buildings that are easily converted into housing and retail uses have the potential to create millions of dollars in tax credits are readily sought out by developers from across the country. Most of the “low hanging fruit” projects in the Dallas area have already been completed. The state tax credit should make more projects financially viable that would not have been feasible if not for the state credit.

Major preservation projects are usually shaped more by financial feasibility and less by preservation ethics. Savvy developers look for large projects in growing cities with robust economic development incentives. Federal and state HTCs are not always enough to incentivize major rehabilitation projects. Municipalities are expected to put together a package of incentives including property tax abatement, public infrastructure funding, and other incentives to entice private developers to take on large projects (sometimes viewed as “white elephants”) that have the potential to revitalize a neighborhood. As experienced HRTC investors and developers become aware of the new Texas program they will seek out large projects and “low hanging fruit” such as National Register (NR) designated warehouses and large office buildings that can be adaptively reused for housing or commercial activities. Cities that have robust local incentives will likely see the first state HTC projects completed and may find themselves vying for investments from experienced historic property developers.

## **THE STATE FRANCHISE TAX**

Other successful state historic tax credit programs are designed to align with the Federal Historic Rehabilitation Tax Credit. The Texas program matches the federal program in many aspects except for the tax to which the credit is given. Texas is one of six states that do not have a state income tax. Texas is the first state to create a state historic tax credit that is tied to the state franchise tax. In 2012, the State of Texas collected \$4.6 billion in franchise tax revenue. The state franchise tax is the second largest source of tax revenue for the state and is the primary tax on businesses ("The Texas Economy," 2013). As the second largest source of income for the state, the assumption can be made that there will be plenty of tax credit buyers for this newly created credit. Since the Texas market is new and based on a different tax source than other states, it is difficult to compare to other states as the value of the purchase price of the rehab tax credits has not yet been set by the market. As this market is formed and matures there will be more confidence in the price that rehab tax credits can be sold. Companies such as Stonehenge Capital have a vested interest in the sophistication of the state franchise tax market. As a company that buys and sells state tax credits, they depend on a demand for the credits from entities that have franchise tax credit liabilities and supply from tax credit projects as created by H.B. 500. The historic preservation tax credit created by this piece of legislation was one way of reducing a franchise tax liability.

According to the Comptroller's Window on State Government website, taxable entities subject to the franchise tax include: corporations, limited liability companies, partnerships (with exceptions), professional associations, joint ventures, business trusts, and other legal entities. Since 2008 the tax rate has been: 1.0% (.01) for most entities, 0.5% (.005) for qualifying wholesalers and retailers, and 0.575% for those entities with

\$10 million or less in Total Revenue (annualized per 12 month period on which the report is based). The tax is based on a taxable entity's margin. The taxable margin can be calculated in several ways. It can be based on total revenue minus cost of goods sold or; total revenue minus \$1 million. Certain small businesses may be eligible to file a No Tax Due Report, and an EZ filing option is available for those with \$10 million or less in annual total revenue. Entities that elect to use the EZ filing option are not eligible to use tax credits. Entities that have annualized total revenue of less than \$1,080,000 (current no-tax-due threshold) or those with a tax due of less than \$1,000, owe no franchise tax (Combs, 2014).

To date there are four franchise tax credit options available including: Franchise Tax Credit for Clean Energy Projects; Temporary Credit for Business Loss Carryforwards; Research and Development Activities Credit; and Certified Historic Structures Rehabilitation Credit (effective for reports originally due on or after Jan. 1, 2015). The advantage of the Historic Rehabilitation Credit is that it can be transferred unlike the other three credits which must be used directly by the taxable entity undertaking the work qualifying for the credit.

## **Chapter 2: How the Texas Historic Tax Credit came to be**

The Texas Legislature meets every other year (odd years) and each legislative session Preservation Texas (PT), the statewide nonprofit for historic preservation, creates an agenda of preservation issues that constitute its legislative agenda. During the 2011 legislative session the biggest preservation advocacy issues focused around the status of the Texas Historical Commission (THC), the state's historic preservation office. 2011 was a difficult year for the THC. Despite strong grassroots advocacy, the agency's 2012-2013 budget was drastically cut resulting in a loss of staff and programming. The agency lost 21 full time employees as the budget was cut from \$100,157,115 to \$52,644,819 (Legislative Budget Board, 2013, p.129).

As the 2013 legislature geared up, the staff of THC prepared its Legislative Appropriation Request calling for stable funding from the previous year at \$62,014,818. As a state agency the THC is unable to advocate for itself and must rely on engaged preservationists and groups like PT and the Texas Downtown Association (TDA) to advocate on its behalf. As part of its 2013 adopted Advocacy Program, PT highlighted the important role of the THC and requested funding increase from the 2011 levels. A particular focus was the THC's Historic Courthouse Preservation Program. PT worked closely with the National Trust for Historic Preservation on the "I Love Texas Courthouse" campaign to help bring attention to the underfunded program. As an overarching theme PT used their Advocacy Program to call attention to the general economic benefits of historic preservation. During legislative years PT hosts "Preservation Day" in order to gather preservationists from around the state to present their advocacy agenda, train attendees on how to talk to their elected state representatives, and release their yearly list of Most Endangered Places. Preservation Day

was held February 20, 2013. At the time of the event the possibility of a state historic tax credit had not yet been presented.

#### **INTRODUCTION OF THE BILL**

The concept for a state historic tax credit was presented to Representative Harvey Hilderbran of Kerrville by representatives of Stonehenge Capital of Baton Rouge, Louisiana. Stonehenge Capital is a specialty finance company with a presence in twenty states. They have experience in a variety of types of structured tax credit financing including renewable energy, affordable housing, film production, and also historic rehabilitation. For projects that generate a tax credit, Stonehenge provides monetization and financing options (Stonehenge). By convincing the state legislature to create a state historic tax credit that is transferable they were able to create a brand new market for them to buy and sell franchise tax credits. The concept of creating a historic state tax credit during the 2013 legislative session was the idea of Stonehenge Capital. It was Stonehenge that paid for lobbyists and helped to create the Consortium for Quality Redevelopment. Stonehenge reached out to the THC, PT, TDA, and other interested parties regarding the proposed legislation.

The first draft of the legislation was filed on March 7, 2013, as HB 3111 by Hilderbran. It was sent to the House Ways & Means Committee, of which Hilderbran was the chair, on March 19, 2013. Public testimony was given in support of the creation of the state historic tax credit by representatives from PT( the author of this report), Stonehenge Capital and the San Antonio Conservation Society. Letters of support were also submitted on behalf of several downtown associations, Texas Association of Realtors and the Texas Society of Architects. Downtown associations noted the economic impact

historic rehabilitations have in downtown areas and noted that many of the easy projects have already been completed and that the more complicated projects require more financial incentives. The initial draft tied the tax credit to the state franchise tax and the state insurance tax. HB 3111 became part of a larger franchise tax reform bill, HB 500, as Section 14 subsection S on May 7, 2013, when it was offered as an amendment to the bill (Texas Legislature Online).

Governor Rick Perry had threatened to call a special session if he did not see "significant tax relief" during the regular session (Ramshaw & Batheja, 2013). HB 500 was the tax relief he was looking for and was passed by the House of Representatives on May 8, 2013, and sent to the Senate on May 9. The Senate and House both agreed that changes to the franchise tax were needed, but had different opinions on how to reduce the tax liability for businesses. According to the *Texas Tribune* there were more than 90 bills filed during the 83rd legislative session dealing with the franchise tax. In the same article the *Tribune* cites the comptroller's office estimates that in 2014-2015 budget cycle there would be a \$627 million cut in House version of the bill and \$648 million cut in the tax in the Senate version of the bill (Aaronson, 2013). As one component of a much larger tax relief bill it is still unclear how long it will take for end users (businesses who owe franchise taxes) to find out about the availability of the credit and begin to utilize historic tax credits to reduce their franchise tax liability as compared to other franchise tax credit programs and reductions.

HB 500 was signed by the Governor on June 14, 2013. The Texas Historical Commission was charged with evaluating properties that would qualify for credits. Some of the language in the bill was not completely clear and left a few areas open for interpretation. There were multiple dates referenced in the bill that caused uncertainty for the state agency tasked with implementing the new tax credit program. HB 500 became

generally effective on January 1, 2014; however Subchapter S does not become effective until January 1, 2015. A third date, September 1, 2013, is the date to determine qualification for the tax credit. The THC submitted a request for an opinion by the Attorney General (AG) of Texas regarding the multiple dates and two other questions regarding the ability of an applicant to appeal a denied certificate and the ability to sell or assign the tax credit. The THC submitted a request for an opinion on August 30, 2013, and received an answer on March 3, 2014.

#### **IMPLEMENTING A NEW PROGRAM**

According to the opinion of the Attorney General's office, the THC cannot implement or enforce the statute until January 1, 2015. However the agency is authorized to adopt rules to implement. The THC publicly posted a draft of rules on May 6, 2014, in the *Texas Register*, which triggered a mandatory thirty day public input period. Texas law requires that when an agency takes public comments that they must comment on the responses they received during the public input period when they create the final version of the rule. During the public comment period the THC received comments from interested parties including: Stonehenge Capital Company LLC, Ramp Development, Cohn Reznick, Tax Incentive Capital LLC, and MacRostie Historic Advisors LLC, SWCA Consultants, Commerce Bank, and the City of Fort Worth (*Texas Register*, 2014, pg.4). The final rules for the tax credit program were adopted by the Texas Historical Commission at the July 2014 meeting in Alpine. Generally speaking, the rules are designed to make the state tax credit similar to the federal credit. One of the main differences between the two programs is that a property must be designated by the time the credit is claimed for the state program, unlike the federal which allows 30 months



after completion of the project for designation to be confirmed. The rules do not provide a timeframe for the commission to review submitted applications. This could be problematic for applicants if the THC becomes inundated with requests and project review times start to increase.

The AG's opinion states that a building that is "placed in service" between September 1, 2013, and January 1, 2015, is eligible for tax credits, but those credits cannot be taken until 2015 (Attorney General p.2). This interpretation allows projects currently underway to qualify for the program, however the THC cannot take any administrative action before January 1, 2015. This time frame between September 1, 2013 and January 1, 2015, creates a dilemma for building owners and developers. It means that if they have a project underway that they think would qualify for tax credits, they should be in contact with the THC for some basic guidance, but the THC cannot take any official action.

As of spring 2014, the tax credit program is still relatively unknown among the development community and the public. The THC has not promoted the availability of the program, presumably since the rules have just been adopted. However, it is important for eligible projects to take advantage of the program. Waiting until January 1, 2015, to promote the program could mean that some eligible projects are left out. The THC cannot be expected to handle promotion of the program alone. Preservation organizations such as Preservation Texas and the National Trust for Historic Preservation also have an important role to play in spreading information on the availability of the tax credit as do local preservation organizations, downtown associations, city preservation offices, county historical commissions, and professionals such as preservation architects and preservation consultants.

## **POLICY ANALYSIS OF TEXAS STATE CREDIT**

Evaluating the economic impact of the tax credit will not be possible until there are completed projects to analyze. However, it is possible to analyze the program at the policy level based on other state historic tax credit programs. Harry Schwartz is a longtime advocate for both the federal HTC and state HTC's. He worked for and with the National Trust for Historic Preservation (NTHP) for decades and is considered an expert on tax credit policy. In late 2013 he produced a policy report for the NTHP on State Tax Credits for Historic Preservation. He describes the criteria that make for a good program and why some state programs perform better than others. Another important report has recently come out completed by fiscal analysts Jeffrey Oakman and Marvin Ward in which they define "success" of a program based on its ability to leverage federal HTC resources (Oakman & Ward p. 1).

When a state is looking to create an HTC program as a means of economic development, policy makers need to know that the creation of the state HTC will make projects feasible that the federal HTC alone could not do (Oakman & Ward, 2013). The design of the HTC is important to the success of the program. Both the Schwartz and the Oakman & Ward reports show that transferability of a state HTC program is paramount. The complexity of transferring federal credits through syndication is a deterrent for many small and medium sized projects.

In assessing the potential success of the new Texas Historic Tax Credit, many of the same program criteria were used as Schwartz and Oakman & Ward. Based upon these criteria, the Texas program can be rated as a generally strong program. Many states' HTC programs have been around for many years, allowing time for multiple reports and analysis. The most used state credit programs have a few commonalities including: transferability, lack of project cap, and lack of program cap. As mentioned earlier, Ohio's

state credit has increased the number of federal HRTC projects even though it has a project cap of \$5 million and a program cap of \$60 million annually. Texas may very well benefit from being late to the game. With thirty-three state programs created before Texas' program the authors of the legislation had the ability to research and understand what makes a successful statewide historic tax credit program. HB500 was written in such a way that the Texas program has the three most important characteristics of a strong program: the credit to be transferred, there is not a cap on the overall program, nor on individual project cap. For now, we can expect that the well thought out design of the program will incentivize new rehabilitation projects of all sizes.

#### Transferability

Since the Texas HTC is applied to the state franchise tax it would have limited availability if eligible building owners had to have a franchise tax liability to qualify for the credit. Fortunately, program eligibility has more to do with the building than the entity undertaking the work. The franchise tax is the state's business tax. Many businesses do not actually have to pay the franchise tax or their liability is very low and so the universe of entities that can directly benefit from the tax credit is less than it might appear at first glance. When the legislation was first passed, the issue of transferability was one of the primary questions raised by the Texas Historical Commission before State Attorney General's office. The Attorney General's office confirmed the transferability of the credit in his official opinion dated March 3, 2014. The entity undertaking the certified historic rehabilitation “need not have a franchise tax liability.” The value of the credit can be sold or transferred to an entity as long as the final recipient of the credit does in fact have franchise tax liability (Attorney General P.5).

The transferability of the tax credit makes it useful to more property owners by giving the credit a cash value; however, there are two drawbacks that reduce the value of

the tax credit. First, in order to have value to the entity that purchases the credit must be sold at a discount. What initially appears to be a 25% tax credit can quickly become reduced once sold or transferred. If the building owner that is accruing the credit does not have the ability to sell the credit directly they will need the services of a third-party, such as Stonehenge Capital. The credit is sold to the third-party presumably at a lower price than if sold directly to the end user. The value of the credit is further reduced since the entity purchasing the credit will need to have room for a markup before they sell it to the entity that will ultimately use the credit. The Texas tax credit market is not mature enough to evaluate at this point and prices have not be set for state HTCs. Assumptions can be made that as the market matures the tax credit may be bought for 70 cents on the dollar and sold for 85 cents on the dollar, for example. A building owner that undertakes a certified rehabilitation worth \$100,000 in qualified rehabilitation expenses will accrue \$25,000 in state franchise tax credits, but if they are not able to take the credits directly and must sell the credits they may only see \$17,500 in cash. This difference of \$7,500 is ultimately what drives the market. In order for entities to want to buy credits they must be able to do so at a discount. It is the delta that creates the market. Without a market for third party entities, the state of Texas might very well not have a HTC to begin with. It was in fact a third party tax credit financing company that brought the piece of legislation to Texas.

The second downside to transferring the tax credit is that once the state tax credit is sold it is viewed as a short-term capital gain by the IRS. Schwartz refers to this as the "Federal Penalty." A short-term capital gain could be taxed as high as 43.4%, depending on the tax bracket of the person claiming the gain. If we use that same \$25,000 tax credit that is sold for \$17,500 and then taxed at 43.4% the seller now only has \$9,905 in state tax credit value to show for \$100,000 in qualified rehabilitation expenses. So while

transferability of the tax credit will make many more projects eligible for use, it also has substantial financial implications for the building owner/investor. One could argue that the ability to get cash at the completion of the project has value, which is true, but ultimately the owner needs to understand how the tax credit will be devalued as it is sold or transferred.

### Credit Value

Texas' 25% tax credit value is considered an appropriate rate. Most state programs are either 20% or 25%. Anything less is not a strong enough incentive. States that allow the tax credit for owner occupied structures often have rates of 30%, but those projects do not qualify for the federal program and so a higher rate is needed to be a true incentive. For Texas projects that qualify for both state and federal tax credits investors can anticipate upwards of 45% of qualified expenses back in tax credits, assuming they take the credit directly and do not transfer the credit. As described in the above paragraph, while 25% seems substantial it can quickly become a reduced rate if the credit is sold.

### Annual budget cap

With a state as large and diverse as Texas it is advantageous not to have an annual budget cap on the amount of tax credits available. Such budget caps can cause uncertainty in the availability in the credit, which can make the incentive less attractive. States with budget caps create scarcity and uncertainty in the market. By not having a budget cap small and large projects have equal footing and are not in competition for the same tax credit dollars.

### Per project cap

A per project cap could render a credit value based on percentage as meaningless. Large projects could quickly surpass a per project limit. Sophisticated investors know

that every dollar counts. A project cap would disincentivize larger projects. By not having a per project cap Texas has a strong financial incentive for small and large projects alike.

#### Substantial rehabilitation

The Texas program was intentionally designed to encourage small rehab projects. By having only a \$5,000 threshold to qualify as a substantial rehabilitation there will be many projects that will qualify for the state tax credit that would not be able to meet the adjusted basis test required for the federal program.

#### Carry forward

The term carry forward means that tax credits can be used against future tax liabilities. Texas allows the HTC to be spread out over five years.

#### Geographic targeting

Targeting rural areas or limiting funding amount in metro areas is a strategy that has been implemented in other states, but this type of geographic targeting can limit the usefulness of a tax credit program. Texas has some of the largest metro areas in the country along with some of the least populated counties. A lack of geographic targeting in the Texas program is a strength when compared to other state programs.

#### Availability to homeowners

The Texas program is not available for homeowners. In order to be eligible the property must be income-producing and depreciable by IRS standards. The limitation on income-producing buildings is in line with the federal HTC.

**Table 2.1 Historic Tax Credit Program Design Measures**

<b>Program Design Measure</b>	<b>Description</b>	<b>Federal HRTC</b>	<b>Texas HTC</b>
<b>Transferability to 3rd Party</b>	Complexity in transferring credit	Complex (syndication required)	Easy
<b>Annual budget cap</b>	Overall funding available to program on annual basis	Unlimited	No cap
<b>Per project cap</b>	Limit on the amount an individual project can receive	No cap	No cap
<b>Credit Value</b>	Amount of tax credit based on certified rehab expenses	20%	25%
<b>Substantial Rehabilitation</b>	Minimum financial investment required to qualify for program	Adjusted basis test or \$5,000 (whichever is greater)	\$5,000
<b>Carry Forward</b>	Number of years credits can be amortized	20 years	5 years
<b>Geographic Targeting</b>	Does the program target specific geographic areas	No	No
<b>Availability to Homeowners</b>	Credit available for owner-occupied residences	No	No

### **Chapter 3: Understanding the rules of the program and choosing projects**

The state program will be handled in much the same way as the federal HRTC. Like the federal program the state program has a three part application process: A) Evaluation of Significance, B) Description of Rehabilitation, and C) Request for Certification of Completed Work. The THC charges a fee for review of part B and C based on the eligible costs and expenses of the project.

**Table 3.1 Texas State Historic Preservation Tax Credit Application Review Fees**

Eligible costs and expenses	Part B review fee	Part C review fee
\$5,000 to \$50,000	\$150	\$150
\$50,001 to \$100,000	\$250	\$250
\$100,001 to \$250,000	\$375	\$375
\$250,001 to \$500,000	\$500	\$500
\$500,001 to \$6,000,000	0.15% of estimated eligible costs and expenses	0.15% of final eligible costs and expenses
Over \$6,000,000	\$9,000	\$9,000

Source: Texas Historical Commission

The National Park Service’s application review fees under the federal program are similarly based on project costs as well. There is no fee for projects under \$80,000. For projects between \$80,000 and \$3,850,000 the fee is \$845 plus 0.15% of costs over \$80,000. For projects more than \$3,850,000 the fee is a flat \$6,500.



## **1ST STEP: DETERMINING ELIGIBILITY**

Any entity can undertake the rehabilitation work to acquire the state historic tax credit as long as all eligibility requirements are met. Eligibility criteria can be broken down into two categories, requirements for the building and requirements for the project. The building must: (1) have proper designation, (2) be depreciable by IRS standards meaning it must be income producing and not owner-occupied, (3) placed in service after September 1, 2013. The following designations must be obtained by the time the building is placed in services: listed individually in the National Register of Historic Places, contributing to a National Register District, deemed a Recorded Texas Historic Landmark (RTHL) or a State Archaeological Landmark (SAL), or contributing to a local district certified by the US Department of the Interior. It should be noted that Texas has no local districts certified by the US Department of the Interior and so local designation is not sufficient to meet the designation criteria (Office of Secretary of State, 2014, pg.1). Project requirements include: (1) rehabilitation work must meet the Secretary of the Interior's Standards for Rehabilitation and (2) eligible costs must exceed \$5,000.

By only requiring state level designation the state HTC program makes some 400 current properties eligible that are designated RTHL, but not NR. The THC requires that all new SAL's must already have NR designation, meaning SAL designation is not an alternative to NR designation. RTHL designation may be an option for properties only seeking state tax credits, however the THC only reviews RTHL applications once a year, in the fall and so the timing of the designation may be an issue. A property can be eligible for designation and undergo the designation process during rehab, but must obtain designation before the THC will issue a certificate of eligibility, unlike the federal program, which allows a 30 month window after completion of the project for the historical designation to be made (*Texas Register*, 2014, p.3).

Federal and state HTC projects must meet the Secretary of the Interior's Standards for Rehabilitation. Having a state reviewer can be seen as an advantage over a reviewer located in Washington, D.C. who may never come to see the project in person and relies on photographs and drawings to make their determination. The THC reviewer is not required to visit the project site, but as a practice they make every attempt to conduct site visits. This practice may not be practical if the program becomes popular and the workload becomes too great for the current staff levels. Following the standards often requires the expertise of a historic preservation specialist and or a preservation architect who is familiar with the standards, especially because the standards are applied to design issues on both the exterior and interior of the building.

One of the most important differences between the state HTC and the federal HTC is the investment amount needed to qualify for the credit. The federal HRTC uses the adjusted basis test to ensure that the rehabilitation work is considered substantial. Adjusted basis is the value or net cost of an asset after adjusting for tax related items. The adjusted basis for a building is generally described as the purchase price, minus the value of the land, minus any depreciation that has been taken, plus any capital improvements that have been made to the building under the current owner. The resulting number is called the basis. The rehab expenses must equal the adjusted basis plus \$1 in order to qualify. The basis test can keep modest rehab projects from being eligible for the federal HRTC. The state HTC was designed to be more widely available for smaller projects by requiring only a \$5,000 investment in "eligible costs and expenses". Not all project expenses count toward the threshold amount. The state program uses the same criteria, Section 47(c)(2) of the Internal Revenue Code, as the federal HRTC. At the federal level these expenses are called qualified rehabilitation expenses. Generally speaking the qualified expenses are those directly involved in the rehabilitation of the building such as

expenditures for structural components such as walls, floors, ceilings, windows, doors, etc. Ineligible expenses are those outside the actual rehabilitation work such as enlarging the property, landscaping and site work, and the cost of acquiring the property.

The THC is expected to adopt a rule that explicitly allows non-tax paying entities such as municipalities and non-profits to use the state tax credit as long as they meet the other eligibility requirements.

## **2ND STEP: DETERMINING VALUE OF STATE CREDIT**

The gross value of the tax credits is based on the eligible costs and expenses; expenses directly related to repair and improvement of architectural and structural features of the historic structure. In order to get an accurate value of the tax credits it is important to get a realistic estimate on the cost of rehabilitation work from experienced architects and contractors. Rehabilitation work is known to be more labor intensive than new construction and also requires more skilled artisans than typical construction. The appropriate materials often need to be in-kind for original materials and may be hard to come by and be more expensive than readily available materials found at big box home improvement stores. In creating a pro forma for the project it is necessary to break down qualified rehab expenses and non-qualified rehab expenses in order to get a valid estimate of the value of the tax credits.

Eligible costs and expenses can be broken down into two categories- hard costs and soft costs. In general, qualifying hard costs include anything that's considered to be a structural component of the building such as walls, partitions, plumbing, electrical, floors, ceilings, windows, doors, permanent coverings, heating and cooling systems, elevators, stairs, fire escapes, and other items related to maintenance and operation of the building, as defined by Treasury Regulation 1.48-1(e)(2). The typical soft costs that qualify are

those that are typically charged to a capital account such as architect fees, interest and taxes paid during construction, engineering fees, developer fees, construction management fees, and preservation consultant fees.

Expenses that do not count toward the tax credit include soft costs such as acquisition costs, feasibility studies, and leasing expenses. Hard costs that do not qualify include most outside work such as landscaping, parking, sidewalks, signage, and new construction. Interior hard costs that do not qualify are generally finish-out items such as appliances, cabinetry, window treatments, and carpeting if it's tacked and not glued.

Once estimates are made for expenses they can be plugged into the pro forma to get an estimate on the overall value of the state historic tax credit. If the owner of the building has a state franchise tax liability and determines, with the help of an accountant, that they can directly use the entire value of the tax credit then they will be able to take advantage of the full amount of the credit. If the building owner does not pay the state franchise tax or does not have a liability greater or equal to the amount of the accrued credit, then they will need to transfer or sell the tax credit. By selling or transferring the tax credit to an entity that pays the tax the building owner will lose a percentage of the tax credit. We can look at other states with mature tax credit markets and assume that as the tax credit program grows that credits may be bought for \$0.65-\$0.85 on the dollar (National Trust Community Investment Corporation, 2014).

HB500 created several ways for Texas businesses to reduce their franchise tax liability, the state historic tax credit being one of those. HB 500 sections 1-13 created several industry-specific deductions while section 14 of the bill created an actual tax credit that can be created or bought by any tax paying entity.

### **3RD STEP: FEDERAL TAX CREDITS**

In order to be eligible for the federal tax credit a building must be individually listed in the National Register or contributing to a National Register Historic District. A building can also be eligible for listing in the National Register, which allows a project to begin the designation process and obtain designation by the time the building is placed in service. The building must be income-producing so owner-occupied condominiums, townhouses, and single-family residential projects do not qualify. Often the biggest hurdle for small projects is meeting the basis test to qualify as a substantial rehabilitation. One of the main reasons to go after state tax credits if the project qualifies for federal credits is that they both require the project design to follow the Secretary of Interior's Standards for Rehabilitation. Once it is determined that the project will also qualify for federal HTC it is simple to calculate the initial value of the credits based on the pro forma used for state tax credits by multiplying the total QRE by 20%. Syndication of tax credits is a tedious process that also devalues the credit. A benefit of the federal HTC is that the credit can be carried forward for 20 years, unlike the state credit that can only be carried forward for five years.

As part of the THC's rules for the tax credit, a project that is going after both federal and state tax credits must be approved by the National Park Service. Essentially the THC will defer to the National Park Service (NPS) for final determination on certificates of completed work. This goes against what was viewed by many preservationists as a benefit of the state tax credit, the THC is given the authority to approve or deny state tax credit projects. This was viewed as a benefit since the THC staff has a policy of visiting projects on-site when necessary. The THC claims that by allowing the NPS the final approval is establishes consistency and efficiencies for the applicants and THC reviewers (Office of Secretary of State, 2014, pg.2).

## **USING JUST THE STATE TAX CREDIT**

Many projects will be able to use the state HTC and not the federal HTC due to differences in eligibility requirements. Projects that do not meet the adjusted basis test for the Federal HTC need only spend \$5,000 in qualified expenses to be eligible for the Texas HTC. This small financial investment requirement will likely result in small main street commercial properties taking advantage of the state tax credit. The program will be a success if small commercial buildings are rehabilitated in communities of all sizes. This coupled with the ability to sell the tax credit for cash will most likely be the reason the program will succeed.

One type of project that will only use the state credit is former HRTC projects that are need in some updating and maintenance. An example of such a project is the Cadillac Lofts project in San Antonio. The building was converted into apartments in 1999 utilizing the federal HRTC. Fifteen years later the building is in need of basic repair and maintenance such as paint, window glazing and also some upgrades to common areas and individual apartment interiors. The cost of these repairs do not meet the threshold for the federal program, but the 25% state tax credit is enticing enough to allow THC to review the entire project.

Another advantage of the state program is the availability to non-tax paying entities, like non-profits and municipalities that have had a hard time using the federal program. The state tax credit is easily transferrable and the Attorney General's office has made it clear that the entity undertaking the work need not be a tax paying entity. The THC plans to undertake process to amend the rule to explicitly allow tax exempt entities to be eligible for the credit. This determination opens up a large number of potential

projects for buildings that are owned by non-profits, municipalities, and other entities that have not been able to use the federal program because of the difficulty of syndicating tax credits. The building itself will need to meet the eligibility requirements, most notably Section 47(c)(2), Internal Revenue Code requirement that the property be either nonresidential real property, residential real property, or real property which has a class life of more than 12.5 year. Non-tax paying entities that own such properties can now take advantage of the credit and invest in the rehabilitation of their historic properties. Most municipalities own historic properties. Although maintenance and upkeep can be costly and are not always a priority for tight city budgets, using the 25% tax credit can stretch rehab budgets and ensure that historic buildings are occupied.

A perceived benefit of projects utilizing the state credit is that the project reviewer is at the state level and has a better understanding of the site and project as opposed to a federal reviewer in Washington, D.C. who must rely solely on photographs and drawings. Projects using both tax credits must be approved by the NPS. One could argue that state and federal reviewers should come to the same conclusion regarding design changes based on the Secretary of the Interior's Standards for rehabilitation, but subjectivity is an inherent part of design review.

## **Chapter 4: Case Study**

While no study creates a complete picture of economic benefits, or finds a magical formula for profitability, significant evidence of positive economic benefits of historic preservation activity has been expressed in many economic studies (Mason, R. 2005 p.5). In choosing a case study it was important to find a potential project that would be a useful model for small and large projects alike. In order to be a successful statewide program the tax credit will need to be an attractive financial incentive both for sophisticated investors and for small building owners with no previous tax credit or rehabilitation experience. I chose a small brick commercial building on the east side of downtown San Antonio. The size and design of the two story building make it similar to many buildings found in small town main streets, medium sized cities and even in the original urban core of large metro areas. The owners have never rehabilitated a historic property and do not have experience with redevelopment tax credits. This case study will not be able to follow the project for the entire time it takes the owners to complete the rehabilitation of their building, rather, it will document the key elements of a decision making process as they weigh the financial value of the tax credit against the time, effort, and government oversight.

### **THE BUILDING: 1120 E. COMMERCE ST. SAN ANTONIO, TX**

The owners acquired the property in 2013 with the intent of creating living spaces on the second floor and retail on the first floor. This is the first time they have taken on a rehabilitation project. They do not have other investors and are financing the project through their financial institution. The City of San Antonio has a Center City Development Office that oversees incentives aimed at revitalizing the urban core. The



owners are working with the City to utilize all possible incentives such as the Center City Housing Incentive Policy which includes city fee waivers, San Antonio Water Systems impact fee waivers, real property tax reimbursement grants, inner city incentive fund loans, and mixed use development forgivable loans.



Illustration3.1: Front façade of 1120 E. Commerce

1120 E. Commerce (previously known as 1116-1118 E. Commerce) is a two-story commercial brick building built in the early 1900's as part of the commercial development that followed the completion of the Southern Pacific Depot in 1902 two blocks away in a neighborhood known locally as St. Paul Square. The building has a prominent location in downtown San Antonio. It is the entry into the Eastside of San Antonio on Commerce Street. It abuts Texas Department of Transportation right of way and is highly visible from Interstate 37. Putting the building back in service will enhance

the commercial district and improve the first impression people have of the Eastside. The district is largely intact with many, now empty, commercial buildings that were built to serve the needs of travelers using the Southern Pacific Depot. As was a common trend at the time, the majority of the first floors of the buildings had commercial uses with the second floors used as residences. The second floor of 1120 E. Commerce retains visible clues along the interior walls of how the space was divided into small rooms with a center loaded hallway. The 6,000 square foot interior is mostly a shell space. The building has not had a viable use since the 1970's and has sat vacant since.

Eligibility:

1120 E. Commerce is within the boundaries of the Southern Pacific Depot National Register Historic District. When the district was created in 1979 the property was listed as 1116 E. Commerce and was designated as "compatible", meaning that it was built during the period of significance but had been altered so as not to contribute to the historic integrity of the district. Removal of the 1950's era slip cover would allow the building to regain contributing status. The recommendation has been made to the owners to first remove the metal slip cover and expose the original windows that remain on the 2nd floor. Once the slip cover is removed the Texas Historical Commission's History Program Division will make a determination on the eligibility of the building as a contributing structure. Visual inspections of the slip cover lead one to believe that it can be removed without causing harm to the remaining original facade underneath. If deemed contributing to the district, the building would meet designation requirements for both state and federal HTC.



Illustration3.2: Interior shot showing metal slip cover protecting original windows

#### **INTERPRETING THE PRO FORMA**

The building will have commercial and rental residential uses. State and federal programs require buildings be income-producing and depreciable. The rehabilitation will be greater than \$5,000 and so will meet the state's requirement for substantial rehabilitation. The federal requirement to spend more than the adjusted basis (purchase price, minus cost of land, plus capital improvements, minus depreciation already taken) means that qualified rehab expenses must be more than \$86,829. Eligible expenses (see Table 4.2) are estimated to be \$418,456, meeting the adjusted basis test for the federal program. As the final eligibility requirement, the project will need to follow the Secretary of the Interior's (SOI) Standards for Rehabilitation. The owners have been advised by the author to use a preservation architect to ensure the project is approved by the THC and NPS. Exterior work will be reviewed by the local preservation office and commission adding another level of review. Local review is mandatory and must be completed before work can start and so should help ensure that exterior changes will meet the SOI standards.

In order to determine the value of tax credits the projects' estimated costs must be broken down into eligible costs and expenses and non-eligible costs, also known as qualified rehabilitation expenses and non-qualified rehab expenses (NPS). For this type of project the majority of costs associated with bringing the building up to current code and getting it to a "shell" condition will be eligible expenses. Some tenant finish out expenses such as cabinetry and exterior enhancements like landscaping and parking will not count and so are separated in the pro forma as non-eligible expenses.

The owners of 1120 E. Commerce do not have a franchise tax liability and so will need to sell or transfer the credits. Based on estimates the owners have received for rehabilitation work they expect to spend approximately \$418,456 in qualified rehab expenses. 25% of the rehab expenses equals \$104,614. If we assume that owners can find a direct buyer, an entity with a substantial franchise tax liability, willing to pay \$0.85 on the dollar, then the tax credits would have a cash value of \$88,922. Since the credit will be sold, the owners will be assessed a short-term capital gains tax. The tax rate will depend on their tax bracket, assumed at 28%, and will further reduce the net value of the state historic tax credit. If a direct buyer of the credit could not be found the credits could be sold to a company such as Stonehenge and expect to take a further reduction in the value of the credit, likely in the range of \$0.75-\$0.80 on the dollar. The advantage of using the services of Stonehenge is that the company can also provide a commitment letter for the owners to help secure financing. After factoring the capital gains tax the net cash value of the state historic tax credit is approximately \$64,204.

Assuming the project will meet all of the federal HTC requirements, assessing the value of the credits simply requires multiplying 20% times \$418,456 for a total of \$83,691 that the owners can carry forward up to 20 years if necessary. A project of this

size is not nearly large enough to involve tax credit syndicators. The building owners will need to carryforward the credit for several years.

The income side of this pro forma is based on the current real estate market for San Antonio for both commercial and residential lease space. The building has a prime location. It is within walking distance to the Alamo, HemisFair Park, the Alamodome, and the Convention Center. The leasable space will get close to \$20 per square foot per year bringing in gross rent at approximately \$109,400. An industry standard of 6% vacancy rate is used to get an effective income of \$102,836, less operating expenses of \$23,010, minus annual debt services of \$43,515 (based on a cash investment of \$300,000 and a mortgage amount of \$506,156) resulting in a net income of \$36,311 without tax credits. The basic return on investment (ROI) is 4.5% for the first year. A typical pro forma projects returns for three to five years. In this case the sale of the state historic tax credits gives a cash infusion in the first year that can be used to offset the mortgage. The state historic tax credit is estimated to be worth \$88,922 before capital gains tax is accounted for. Assuming a tax rate of 28% brings the value down to \$64,024. With an assumed cash value of the state historic tax credits of \$64,024, the first year ROI jumps to 12.45%. The cash could be used to reduce the mortgage by 13%, increasing the ROI in subsequent years. The federal tax credit cannot be sold. Instead of having a cash value it will offset the tax liability of this investment property for several years. The value of the federal credit will vary each year depending on federal income tax liability, but it can be amortized over 20 years. The tax liability (\$6,917) is calculated by reducing the income (\$37,730) by the adjusted depreciation (\$13,025). The federal credit is estimated to be worth \$83,691. The HRTC requires the basis be adjusted when the building is placed in service by the full amount of the tax credit before the depreciation is calculated. This reduces the depreciation deductions over the tax life of the building (Novogradac & Co,

2012). If the tax liability remains the same the federal tax credit would essentially make this investment project tax free income for approximately 12 years.

On the cost side of the equation soft costs and hard costs are broken down into qualified rehab expenses and non-qualified based on Internal Revenue Code, Section 47 (c)(2). Architect and tax credit consulting fees are eligible expenses as are the tax credit application fees. For this particular project, the majority of the work needed is inside the building meaning the vast majority of expenses are eligible.

The building's exterior is subject to local review whether or not the owners utilized the tax credit. By using the tax credit the interior also becomes subject to review. Because this building is considered a shell building with little or no original character defining features remaining inside, there are very few restrictions from a design side on what can be done to the interior. This flexibility for the design of the interior was a deciding factor on whether or not to use the credits. Ultimately, the fact that the state historic tax credits have a cash value that can be fairly quickly recovered was the most important aspect of the tax credit.

This case study shows the value of the state historic tax credit and its ability to make a significant impact on the bottom line of a real estate investment. In this case the added expenses and extra time associated with going through the design review process is offset by the one-time cash infusion of the state historic tax credit and the multi-year tax abatement of the federal tax credit. The availability of a tax credit for small projects makes it a great tool for communities of all sizes. The ability to twin the state credit with the federal credit should increase the number of large rehabilitation projects as well.

**Table 4.1 Pro Forma for 1120 E. Commerce**

**PRO FORMA for Building Rehabilitation  
1st Year  
1120 E Commerce San Antonio, TX**

<b>INITIAL AMOUNTS</b>			
Purchase price		<b>300,000</b>	
<b>A Cost of rehabilitation</b>		<b>489,656</b>	
<b>Total Project Cost</b>		<b>789,656</b>	
<b>Loan to Value Ratio (LTV)</b>		<b>62.01%</b>	
<b>Mortgage Amount</b>		<b>489,656</b>	
<b>Cash investment</b>		<b>300,000</b>	
<b>ANNUALIZED AMOUNTS</b>			
<b>INCOME</b>			
<b>B Total Gross Rent</b>		<b>109,400</b>	
less assumed vacancy of	6%	6,564	
Gross Effective Income		102,836	
<b>C</b> less Operating Expenses		23,010	
<b>D</b> less annual Debt Service		42,097	
<b>Net Income (w/o tax credits)</b>		<b>37,730</b>	
<b>ROI #1 (without tax credits)</b>		<b>4.8%</b>	
<b>ROI #2 (with state tax credit cash)</b>		<b>12.89%</b>	
<b>Net income with tax credit</b>		<b>101,754</b>	
Debt coverage ratio		1.90	
<b>State Rehab Tax Credit</b>		<b>25%</b>	
Franchise Tax Credit Gross Value		104,614	
Gross cash value of tax credit at \$0.85		<b>88,922</b>	
Cash value less capital gains tax 28%		<b>64,024</b>	
<b>Federal Rehab Tax Credit</b>		<b>20%</b>	
Income Tax Credit Value		<b>83,691</b>	
adjusted Depreciable base		507,965	
No. of Years		39.0	
Annual depreciation		13,025	
Tax bracket		28%	
Income tax liability		6,917	
			<b>A Cost of Rehab</b>
			a Soft costs (QRE)
			44,056
			b Hard costs (QRE)
			374,400
			<b>Qualified Rehab Expenses</b>
			<b>418,456</b>
			a Soft Costs (Non QRE)
			6,500
			b Hard Costs (Non QRE)
			60,000
			c Rent-up Costs
			4,700
			<b>Non Qualified Rehab Expens</b>
			<b>71,200</b>
			<b>B Gross Rent</b>
			Leasable SF (1st fl.)
			2,700
			Rent/SF (1st fl)
			\$22.00
			Rentable Income (1st fl)
			59,400
			Leasable SF (2nd fl.)
			2,500
			Rent/SF (2nd fl)
			\$20.00
			Rentable Income (2nd fl)
			50,000
			<b>Total Gross Rent</b>
			109,400
			Vacancy
			6%
			<b>Operating Expenses</b>
			<b>C</b> Property Taxes
			6,000
			Insurance
			1,800
			Mgmt (3% Gross Rent Rcvd)
			3,282
			Legal/ Accounting
			2,800
			Realtor Lease-up Fee
			4,628
			Repair/ Maintenance
			2,500
			Maintenance Reserve
			2,000
			<b>Sub-total</b>
			23,010
			<b>D Debt Service</b>
			Mortgage
			489,656
			Interest Rate (%)
			6.00%
			Number of years
			20
			Monthly Payment
			3,508
			<b>Depreciation</b>
			Total Property Value
			789,656
			less Value of Land
			198,000
			Depreciable base
			591,656
			Income Tax Credit Tax Value
			83,691
			Adjusted depreciable base
			507,965
			Number of Years
			39
			Annual depreciation
			13,025
			Adjusted basis
			88,975

**Table 4.2 Breakdown of Qualified Rehab Expenses (Pro Forma Continued)**

<b>a Soft Costs (QRE)</b>		
Architect at x% of constructor	10%	37,440
Tax Credit Consultant	1.50%	5616
THC Application Fees		1,000
NPS Application Fee		1,287
Debt Service for 12 months		42,097
<b>Total</b>		<b>44,056</b>
<b>Soft Costs (Non QRE)</b>		
Attorney's fees		2,000
Closing costs		2,000
Permits		500
Constr. start-up costs		2,000
total		6,500
<b>b Hard Costs (Non QRE)</b>		
Demolition		2,500
Landscaping		2,500
Residential Interior Finish Out		37,500
Parking		17,500
total		60,000
<b>Hard Costs (QRE)</b>		
Total SF Rehabbed		5,200
Cost per SF (shell)		\$72
Construction		<b>374,400</b>
<b>c Administrative Costs</b>		
Advertising		2,000
Office Costs		1,500
Cleaning		1,200
Sub-total		4,700



## **Chapter 5: Recommendations for Implementation**

When H.B.500 passed it was seen as a "win" for historic preservation. Texas is now on par with 33 other states that leverage federal tax incentives for historic preservation. The creation of a new tax credit market is already drawing the attention of tax credit syndicators and experienced HTC developers. As more and more historic building owners and businesses learn about the availability and benefits of the tax credit there should be dramatic increases in the number of state and federal HTC projects.

### **IMPACT ON TEXAS HISTORICAL COMMISSION**

THC's Executive Director Mark Wolfe expects the tax credit program to "spur redevelopment of historic properties across the state, especially if someone can find a way to package credits from smaller projects in more rural communities". Assuming there is a significant increase in small projects then the challenge will be to service the program in a productive way (Personal communication, July 22, 2014). In fiscal year 2012 the THC only certified three federal HTC projects. In 2013 there were seven projects submitted. Thus far in fiscal year 2014 there have already been eighteen projects for review. The agency staff has plenty of experience in dealing with federal HRTC projects so when it came time to propose rules for the state HTC great effort was taken to mirror the federal program while also making the state program user friendly so that projects that do not qualify for the federal program can easily use just the state credit.

For the THC, the credit gives staff a new tool to help promote preservation efforts, but in reality it was also an "unfunded mandate" for the state agency. As a new program for the state agency to oversee there will be new costs to promoting and administering the program that did not come with line item funding. The THC did not

propose the tax credit program and did not have the program built into its proposed biannual budget going into the 83rd legislative session. The THC saw dramatic funding and staff cuts in 2011 and the 2013 budget did little to restore the damage done in the previous legislative session. The agency was given funding to restore seventeen full time employees across all departments. According to Wolfe the agency will have to ask the legislature for more positions, and requests like that are often denied (Personal communication, July 22, 2014).

The Architecture Division, which will oversee the new program, has allocated a new position to oversee the new state tax credit program. The position was first posted in April 2014 and will be filled by July 2014. The new staff will be responsible for the promotion of the program and for oversight of approval of projects. THC staff admits that if the program is successful in creating a substantial increase in tax credit projects the architecture division may need more staff before the 2015/2016 budget is approved. According to Sharon Fleming, the director of the Architecture Division, other division staff will be trained on the federal and state tax credit programs in order to help ease the workload for the newly designated position (personal communication, May 2, 2014).

Determining eligibility is the first phase in the project approval process and handled by the History Programs Division. In order to qualify for the tax credit a building must be listed in the National Register of Historic Places, contributing to a National Register District, or designated as a Recorded Texas Historic Landmark or a State Archaeological Landmark or contributing to a certified local historic district. The division will most likely see an increase in the number of requests for determinations of eligibility and nominations to the National Register of Historic Places.

The designation of RTHLs is handled by the History Programs Division as well, but by different staff than NR designations. RTHL designation applications are currently

reviewed once a year. This policy may need to change in order to meet the timing requirements of the tax credit program since designation is required by the time the building is placed in service.

The Main Street Program and the County Historic Commission coordinators will also have important roles to play in promoting the tax credit as they both have direct links to local preservation advocates and practitioners.

The state historic tax credit has the ability to bring a lot of positive recognition to the THC in the coming years. As a state agency that has had its share of cuts and threats of reduction in responsibilities, the new tax credit gives the agency the potential to increase staff as it demonstrates the significant economic impact historic rehabilitation has at both local and state levels.

#### **ROLE OF PRESERVATION TEXAS**

As the statewide grassroots advocacy group for historic preservation it will be incumbent upon Preservation Texas to take a lead in helping promote the availability of the new state tax credit. The organization has had a Most Endangered Places program in place for eleven years. Many of the identified endangered places could use the tax credits. Each year the advocacy group hosts an event in Austin to announce the most endangered places, an appropriate time to promote the tax credit program. During legislative sessions PT will also need to help make the case for more funding for the THC. As the program becomes well known and successful the THC will need to increase the staff administering the program. PT should also highlight the tax credit program through the Honor Awards by choosing projects that have utilized tax credits.

PT should also use its relationship with affinity groups such as Texas Downtown Association (TDA), Texas Society of Architects (TSA), the Texas chapter of American Planning Association (APATX), and others to host educational workshops on the program. TSA and APATX both host annual conferences with sessions on historic preservation topics. Both associations should host continuing education sessions on the new state historic tax credit. TSA has a historic resource committee that can help educate architects across the state on the benefits of using the tax credit. Those architects that specialize in historic preservation and adaptive reuse will likely see an increase in business since the design review process requires adherence to the Secretary of the Interior's Standards for Rehabilitation.

#### **ROLE OF LOCAL PRESERVATION ORGANIZATIONS**

Local preservation organizations will need to help take the lead in educating the public on the availability of the tax credit. They can help bring together property owners, architects, preservationists, developers, real estate agents, and city officials. They can play an important role by: helping identify and fund National Register nominations, holding symposiums or mini-conferences on how to use the tax credit, supporting municipality's redevelopment incentives, and touting preservation as an economic driver. As projects are completed, it will be important for the local preservation advocacy groups to recognize successful projects through awards programs. Documenting and promoting successful local projects will be another way local groups can support the THC during legislative sessions.

## **ROLE OF MUNICIPALITIES**

While building owners and developers must determine if individual projects make economic sense, municipalities must decide if public policies that encourage historic preservation provide benefits for the public sector. Does “preservation pay”? For most towns and cities the answer is “yes”, even without the state historic tax credit.

Investors of large rehab projects do expect municipalities to help with redevelopment costs through Tax Increment Financing funds, fee waivers, property tax rebates, etc. Developers and investors will look to municipalities for incentive packages to help offset the expenses of urban redevelopment. Cities will likely find themselves in competition with each other to attract sophisticated and experienced tax credit developers interested in historic rehab projects. Vacant and underutilized buildings plague most downtowns no matter the size of the community. Cities can promote rehabilitation of underutilized designated properties with local redevelopment incentives such as waiving of development and permit fees and creating forgivable loan programs to incentivize preferred development. Many cities are currently incentivizing urban housing and neighborhood retail. Creating or expanding tax increment reinvestment zones (TIRZ) are a common way to focus redevelopment efforts in particular neighborhoods.

While municipal preservation offices will not have direct role in the review of state tax credit projects, they will likely have purview over many projects. City preservation staff will need to be familiar with the program and ensure that local design guidelines are in keeping with the Secretary of the Interior's Standards. Staff should also be able to recognize projects that would qualify for the tax credit and notify owners of the program. Certified Local Government communities must also review National Register nominations. Since local designation is not enough for buildings to qualify for the state tax credit, local preservation commissions should be proactive in ensuring that eligible

districts and properties are appropriately designated by undertaking the National Register nomination process.

## **CONCLUSION**

The State of Texas has created a strong state historic tax credit. The number of rehabilitation projects across the state should increase dramatically as historic building owners and experienced tax credit developers learn of the tax credit and start putting it to use. The program has been thoughtfully designed to encourage small and large rehabilitations alike. If other state programs, such as Ohio and Kansas, can be used as models, then Texas can expect a healthy return on its investment in the tax credit program. Rehabilitated buildings increase local property tax rolls and increase state and local sales tax revenues. An economic impact study should be conducted five years after implementation to understand the financial impact on local economies and the state as a whole. As noted preservation economist Donovan Rypkema has found, more research into the relationship between historic preservation and economic development is still needed even though historic preservation is known to be a community strengthening tool (Rypkema, D., Cheong, C. & Mason, R. pg. 2. 2011). The new Texas Historic Preservation Rehabilitation Tax Credit will have a positive impact on historic preservation efforts, but just how great of an economic impact is yet to be seen.

## Appendix A      HB 500 Section 14

SECTION 14. (a) Chapter 171, Tax Code, is amended by adding Subchapter S to read as follows:

### SUBCHAPTER S. TAX CREDIT FOR CERTIFIED REHABILITATION OF CERTIFIED HISTORIC STRUCTURES

Sec. 171.901. DEFINITIONS. In this subchapter:

(1) "Certified historic structure" means a property in this state that is:

(A) listed individually in the National Register of Historic Places;

(B) designated as a Recorded Texas Historic Landmark under Section 442.006, Government Code, or as a state archeological landmark under Chapter 191, Natural Resources Code;  
Or

(C) certified by the commission as contributing to the historic significance of:

(i) a historic district listed in the National Register of Historic Places; or

(ii) a local district certified by the United States Department of the Interior in accordance with 36 C.F.R. Section 67.9.

(2) "Certified rehabilitation" means the rehabilitation of a certified historic structure that the commission has certified as meeting the United States secretary of the interior's Standards for Rehabilitation as defined in 36 C.F.R. Section 67.7.

(3) "Commission" means the Texas Historical Commission.

(4) "Eligible costs and expenses" means qualified rehabilitation expenditures as defined by Section 47(c)(2), Internal Revenue Code.

Sec. 171.902. ELIGIBILITY FOR CREDIT. An entity is eligible to apply for a credit in the amount and under the conditions and limitations provided by this subchapter against the tax imposed under this chapter.

Sec. 171.903. QUALIFICATION. An entity is eligible for a credit for eligible costs and expenses incurred in the certified rehabilitation of a certified historic structure as provided by this subchapter if:

(1) the rehabilitated certified historic structure is placed in service on or after September 1, 2013;

(2) the entity has an ownership interest in the certified historic structure in the year during which the structure is placed in service after the rehabilitation; and

(3) the total amount of the eligible costs and expenses incurred exceeds \$5,000.

Sec. 171.904. CERTIFICATION OF ELIGIBILITY. (a) Before claiming, selling, or assigning a credit under this subchapter, the entity that incurred the eligible costs and expenses in the rehabilitation of a certified historic structure must request from the commission a certificate of eligibility on which the commission

certifies that the work performed meets the definition of a certified rehabilitation. The entity must include with the entity's request:

(1) information on the property that is sufficient for the commission to determine whether the property meets the definition of a certified historic structure; and

(2) information on the rehabilitation, and photographs before and after work is performed, sufficient for the commission to determine whether the rehabilitation meets the United States secretary of the interior's Standards for Rehabilitation as defined in 36 C.F.R. Section 67.7.

(b) The commission shall issue a certificate of eligibility to an entity that has incurred eligible costs and expenses as provided by this subchapter. The certificate must:

(1) confirm that:

(A) the property to which the eligible costs and expenses relate is a certified historic structure; and

(B) the rehabilitation qualifies as a certified rehabilitation; and

(2) specify the date the certified historic structure was first placed in service after the rehabilitation.

(c) The entity must forward the certificate of eligibility and the following documentation to the comptroller to claim the tax credit:

(1) an audited cost report issued by a certified public accountant, as defined by Section 901.002, Occupations Code, that itemizes the eligible costs and expenses incurred in the certified rehabilitation of the certified historic structure by the entity;

(2) the date the certified historic structure was first placed in service after the rehabilitation and evidence of that placement in service; and

(3) an attestation of the total eligible costs and expenses incurred by the entity on the rehabilitation of the certified historic structure.

(d) For purposes of approving the tax credit under Subsection (c), the comptroller may rely on the audited cost report provided by the entity that requested the tax credit.

(e) An entity that sells or assigns a credit under this subchapter to another entity shall provide a copy of the certificate of eligibility, together with the audited cost report, to the purchaser or assignee.

Sec. 171.905. AMOUNT OF CREDIT; LIMITATIONS. (a) The total amount of the credit under this subchapter with respect to the rehabilitation of a single certified historic structure that may be claimed may not exceed 25 percent of the total eligible costs and expenses incurred in the certified rehabilitation of the certified historic structure.

(b) The total credit claimed for a report, including the amount of any carryforward under Section 171.906, may not exceed the amount of franchise tax due for the report after any other applicable tax credits.

(c) Eligible costs and expenses may only be counted once in



determining the amount of the tax credit available, and more than one entity may not claim a credit for the same eligible costs and expenses.

Sec. 171.906. CARRYFORWARD. (a) If an entity is eligible for a credit that exceeds the limitation under Section 171.905(b), the entity may carry the unused credit forward for not more than five consecutive reports.

(b) A carryforward is considered the remaining portion of a credit that cannot be claimed in the current year because of the limitation under Section 171.905(b).

Sec. 171.907. APPLICATION FOR CREDIT. (a) An entity must apply for a credit under this subchapter on or with the report for the period for which the credit is claimed.

(b) An entity shall file with any report on which the credit is claimed a copy of the certificate of eligibility issued by the commission under Section 171.904 and any other information required by the comptroller to sufficiently demonstrate that the entity is eligible for the credit.

(c) The burden of establishing eligibility for and the value of the credit is on the entity.

Sec. 171.908. SALE OR ASSIGNMENT OF CREDIT. (a) An entity that incurs eligible costs and expenses may sell or assign all or part of the credit that may be claimed for those costs and expenses to one or more entities, and any entity to which all or part of the credit is sold or assigned may sell or assign all or part of the credit to another entity. There is no limit on the total number of transactions for the sale or assignment of all or part of the total credit authorized under this subchapter, however, collectively all transfers are subject to the maximum total limits provided by Section 171.905.

(b) An entity that sells or assigns a credit under this section and the entity to which the credit is sold or assigned shall jointly submit written notice of the sale or assignment to the comptroller on a form promulgated by the comptroller not later than the 30th day after the date of the sale or assignment. The notice must include:

(1) the date of the sale or assignment;  
(2) the amount of the credit sold or assigned;  
(3) the names and federal tax identification numbers of the entity that sold or assigned the credit or part of the credit and the entity to which the credit or part of the credit was sold or assigned; and

(4) the amount of the credit owned by the selling or assigning entity before the sale or assignment, and the amount the selling or assigning entity retained, if any, after the sale or assignment.

(c) The sale or assignment of a credit in accordance with this section does not extend the period for which a credit may be carried forward and does not increase the total amount of the credit that may be claimed. After an entity claims a credit for eligible costs and expenses, another entity may not use the same costs and expenses as the basis for claiming a credit.

(d) Notwithstanding the requirements of this subchapter, a

credit earned or purchased by, or assigned to, a partnership, limited liability company, S corporation, or other pass-through entity may be allocated to the partners, members, or shareholders of that entity and claimed under this subchapter in accordance with the provisions of any agreement among the partners, members, or shareholders and without regard to the ownership interest of the partners, members, or shareholders in the rehabilitated certified historic structure, provided that the entity that claims the credit must be subject to the tax imposed under this chapter.

Sec. 171.909. RULES. The commission and the comptroller shall adopt rules necessary to implement this subchapter.

(b) This section takes effect January 1, 2015.

## Appendix B Attorney General Opinion GA-1045



ATTORNEY GENERAL OF TEXAS  
GREG ABBOTT

March 3, 2014

Mr. Mark Wolfe  
Executive Director  
Texas Historical Commission  
Post Office Box 12276  
Austin, Texas 78711-2276

Opinion No. GA-1045

Re: The Texas Historical Commission's implementation of House Bill 500, relating to a tax credit for the rehabilitation of certified historic structures (RQ-1149-GA)

Dear Mr. Wolfe:

You ask about the Texas Historical Commission's (the "Commission") implementation of House Bill 500, enacted by the Eighty-third Legislature.<sup>1</sup> You tell us that the bill, "which establishes a tax credit for certified rehabilitation of certified historic structures, includes two dates for implementation," and you ask the following questions regarding the tax credit program:

1. Does the Texas Historical Commission have the authority to begin reviewing applications for the tax credit prior to January 1, 2015, the effective date of this section of the bill?
2. May the Commission issue certificates of eligibility prior to January 1, 2015?
3. Is denial of a certificate of eligibility subject to appeal, and if so, is this appeal a contested case under Tex. Gov't Code ch. 2001?
4. May property owners whose qualifying historic structures are placed in service between September 1, 2013 and January 1, 2015, claim the credit?

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<sup>1</sup>See Letter from Mr. Mark Wolfe, Exec. Dir., Tex. Historical Comm'n, to Honorable Greg Abbott, Tex. Att'y Gen. at 1 (Aug. 30, 2013), <http://www.texasattorneygeneral.gov/opin> ("Request Letter").

5. Would costs and expenses incurred by an owner prior to either September 1, 2013 or January 1, 2015 be eligible for the credit?
6. To what tax year may credits for periods prior to January 1, 2015 be applied, if any?
7. Is it necessary that the owner of the property be subject to the franchise tax, or may a homeowner, nonprofit corporation, or other non-taxable entity make use of the credit through its sale or assignment to a taxable entity?

Request Letter at 1.

The franchise tax is imposed on taxable entities doing business in the state or chartered or organized in the state. *TGS-NOPEC Geophysical Co. v. Combs*, 340 S.W.3d 432, 437 (Tex. 2011). House Bill 500 concerns many different aspects of the franchise tax. See Act of May 26, 2013, 83d Leg., R.S., ch. 1232, 2013 Tex. Gen. Laws 3104, 3104-12 (“H.B. 500”). Relevant here, section 14 of H.B. 500, codified as subchapter S of Chapter 171 of the Tax Code, creates a new tax credit for “certified rehabilitation of certified historic structures.” H.B. 500 § 14(a), at 3109-11; TEX. TAX CODE ANN. §§ 171.901-.909 (West Supp. 2013) (subchapter S). An entity that is qualified to receive the credit must first request a certificate of eligibility from the Commission. TEX. TAX CODE ANN. §§ 171.902-.904 (West Supp. 2013). The entity must forward the certificate of eligibility, along with other documentation, to the Comptroller’s Office to claim the tax credit. *Id.* § 171.904(c).

Several important dates are relevant. H.B. 500 is generally effective on January 1, 2014, “except as otherwise provided.” H.B. 500 § 20, at 3111. Subchapter S is effective on January 1, 2015. H.B. 500 § 14(b), at 3111. Within subchapter S, the qualifications for the tax credit require that the “rehabilitated certified historic structure” be placed in service on or after September 1, 2013. TEX. TAX CODE ANN. § 171.903(1) (West Supp. 2013). These various dates give rise to your questions, which we address together where possible.

We address your sixth question first because the answer to it informs the answer to several of your other questions. The general rule is that a law does not speak until its effective date. *Norton v. Kleberg Cnty.*, 231 S.W.2d 716, 718 (Tex. 1950); see also *Calvert v. Gen. Asphalt Co.*, 409 S.W.2d 935, 938 (Tex. Civ. App.—Austin 1966, no writ) (recognizing that an act of the Legislature “performs no function whatsoever until its effective date”). By H.B. 500’s terms, subchapter S is not effective until January 1, 2015. H.B. 500 § 14(b), at 3111. Thus, the new tax

credit for rehabilitated certified historic structures created by subchapter S is not operative until January 1, 2015. Accordingly, the tax credit may not be applied prior to the 2015 tax year.<sup>2</sup>

An entity may qualify for the tax credit if the "rehabilitated certified historic structure is placed in service on or after September 1, 2013." TEX. TAX CODE ANN. § 171.903(1) (West Supp. 2013). The September 1, 2013 date is merely a date, prior to the tax credit's effective date, used to determine whether an entity qualifies for the tax credit; it does not impact subchapter S's effective date. Thus, in answer to your fourth question, property owners whose qualifying historic structures are placed in service between September 1, 2013 and January 1, 2015 are eligible for the tax credit, but not until the 2015 tax year.

Your fifth question involves costs and expenses incurred prior to either September 1, 2013 or January 1, 2015. The tax credit incorporates "eligible costs and expenses incurred in the certified rehabilitation of a certified historic structure as provided by" the subchapter. *Id.* § 171.903; *see also id.* § 171.901(4) (defining "eligible costs and expenses"). Subchapter S does not limit the eligible costs and expenses based on when they were incurred; its date limitation to qualify for the tax credit requires only that the structure be placed in service on or after September 1, 2013. *Id.* § 171.903(1). Thus, any costs and expenses, whenever incurred, that are "eligible costs and expenses" under the statute would be eligible for the tax credit, but not until the 2015 tax year.

Your first and second questions involve the Commission's authority prior to January 1, 2015. Section 2001.006 of the Government Code provides that

[i]n preparation for the implementation of legislation that has become law but has not taken effect, a state agency may adopt a rule or take other administrative action that the agency determines is necessary or appropriate and that the agency would have been authorized to take had the legislation been in effect at the time of the action.<sup>3</sup>

TEX. GOV'T CODE ANN. § 2001.006(b) (West 2008). Section 2001.006 limits that power, however, so that a rule adopted under 2001.006(b) "may not take effect earlier than the legislation being implemented takes effect." *Id.* § 2001.006(d). An administrative action taken

<sup>2</sup>In briefing submitted to this office, the Comptroller of Public Accounts agrees that the tax "credits cannot be created for periods prior to January 1, 2015." Brief from William S. Hamner, Director, Tax Admin., Tex. Comptroller of Pub. Accounts at 2 (Sept. 24, 2013) (on file with the Op. Comm.).

<sup>3</sup>Section 2001.006(a)(2) enumerates factors by which to determine whether legislation has "become law." TEX. GOV'T CODE ANN. § 2001.006(a)(2) (West 2008).

under that section “may not result in implementation or enforcement of the applicable legislation or rule before the legislation or rule takes effect.” *Id.* The Commission is authorized to adopt rules to implement the new tax credit. TEX. TAX CODE ANN. § 171.909 (West Supp. 2013). Under section 2001.006, it may adopt rules or take administrative action relating to the new tax credit prior to the January 1, 2015 effective date of subchapter S. See TEX. GOV’T CODE ANN. § 2001.006(b) (West 2008). However, under section 2001.006(d), any rule may not take effect earlier than January 1, 2015, and any administrative action may not result in implementation or enforcement of the statute. See *id.* § 2001.006(d). Accordingly, in response to your first question, the Commission has authority to review applications prior to January 1, 2015, provided that doing so does not involve the implementation of an administrative rule. In response to your second question, the Commission may not issue certificates of eligibility prior to January 1, 2015, because, unlike reviewing applications, issuing certificates would constitute implementation or enforcement of the statute prior to its effective date.

With regard to your third question, no provision in subchapter S provides for an appeal of the Commission’s denial of an application for a certificate of eligibility. See generally TEX. TAX CODE ANN. §§ 171.901–909 (West Supp. 2013). A court would likely conclude that the Administrative Procedure Act also does not provide a means of appealing the Commission’s actions in this context. See *Bacon v. Tex. Historical Comm’n*, 411 S.W.3d 161, 180 (Tex. App.—Austin 2013, no pet.) (considering Commission’s denial of application regarding historical marker and recognizing that no judicial review of the denial was created indirectly through the Administrative Procedure Act “because the right of judicial review provided therein applies only to final decisions in contested cases” and that the Commission proceeding was not a contested case).

Although no statute authorizes an appeal of the Commission’s denial of a certificate of eligibility, property owners whose applications are wrongfully denied are not without judicial recourse. Subchapter S imposes a mandatory duty on the Commission to issue certificates of eligibility to qualifying applicants. See TEX. TAX CODE ANN. § 171.904(b) (West Supp. 2013) (“The Commission shall issue . . . .”); TEX. GOV’T CODE ANN. § 311.016(2) (West 2013) (providing that the term “shall” usually imposes a duty). Thus, if a property owner who met the statutory criteria for a certificate of eligibility was nevertheless denied the certificate, the property owner may be entitled to mandamus relief ordering the Commission to issue a certificate. See *In re Smith*, 333 S.W.3d 582, 585 (Tex. 2011) (orig. proceeding) (discussing required elements for mandamus relief). In the alternative, Texas courts may recognize a so-called *ultra vires* claim for declaratory relief if the Commission acts outside its legal authority on a matter in which it has no discretion. See *City of El Paso v. Heinrich*, 284 S.W.3d 366, 370–77 (Tex. 2009) (discussing *ultra vires* exception to sovereign immunity in a declaratory judgment action). We caution, however, that whether any particular legal claim is available in a given case is not a question we can answer here.

Relevant to your last question, section 14 expressly authorizes an “entity that incurs eligible costs and expenses” to “sell or assign all or part of the credit . . . to one or more entities.” H.B. 500 § 14(a), at 3110–11 (codified at TEX. TAX CODE ANN. § 171.908(a)); see also *id.* (authorizing resale of sold credit). Section 14 utilizes the term “entity” in all provisions providing for the new tax credit. See H.B. 500 § 14(a), at 3109–11 (codified at TEX. TAX CODE

ANN. §§ 171.902, .903, .904, .906, .907, .908). Unlike chapter 171 as a whole, which utilizes the terms “taxable entity” and “passive entity” to determine the applicability of the franchise tax, section 14 does not utilize language limiting those entities that can qualify for the tax credit to taxable entities. See TEX. TAX CODE ANN. §§ 171.001 (West 2008) (imposing franchise tax on taxable entities), 171.0002 (West Supp. 2012) (defining “taxable entity”), 171.0003 (West 2008) (defining “passive entity”); see also *FM Props. Operating Co. v. City of Austin*, 22 S.W.3d 868, 885 (Tex. 2000) (relying on principle of statutory construction that the Legislature knows how to enact laws effectuating its intent). The distinction in the language suggests that entities able to apply for the credit may not be the same as those claiming the credit. Further, there is no provision in section 14 that expressly limits the tax credit to only taxable entities. See generally H.B. 500 § 14(a), at 3109–11 (codified at TEX. TAX CODE ANN. §§ 171.901–909). For these reasons, we conclude that the tax credit created by section 14 is available to entities that are not subject to the franchise tax. This conclusion does not render the tax credit useless because an entity that is not a taxable entity, though unable to claim the credit against the franchise tax, could still benefit by selling or assigning the credit to a taxable entity that could. See *id.* H.B. 500 § 14(a), at 3110–11 (codified at TEX. TAX CODE ANN. § 171.908 (providing for the sale or assignment of the credit)).

S U M M A R Y

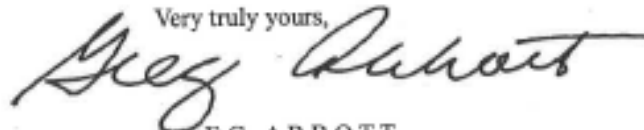
The new tax credit for rehabilitated certified historic structures created in House Bill 500, to be codified in the Tax Code at chapter 171, subchapter S, is not operative until the 2015 tax year. Thus, the new tax credit may not be applied in years prior to 2015.

An entity whose qualifying rehabilitated certified historic structure is placed in service between September 1, 2013 and January 1, 2015 may be eligible for the new tax credit, but not until the 2015 tax year. Similarly, "eligible costs and expenses" associated with the rehabilitated certified historic structure, whenever incurred, would be eligible for the new tax credit, but not until the 2015 tax year.

The Commission has authority to review applications prior to January 1, 2015, provided that doing so does not involve the implementation of an administrative rule. The Commission may not issue certificates of eligibility prior to January 1, 2015, because issuing certificates, unlike reviewing applications, would constitute implementation or enforcement of the statute prior to its effective date.

The new tax credit is not limited to taxable entities. It may be claimed and transferred by an entity that owns a rehabilitated certified historic structure even if the entity is not subject to the franchise tax.

Very truly yours,



GREG ABBOTT  
Attorney General of Texas

DANIEL T. HODGE  
First Assistant Attorney General

JAMES D. BLACKLOCK  
Deputy Attorney General for Legal Counsel

VIRGINIA K. HOELSCHER  
Chair, Opinion Committee

Charlotte M. Harper  
Assistant Attorney General, Opinion Committee



## **Appendix C      Rules of Texas Historic Preservation Tax Credit Program**

**Texas Administrative Code  
Title 13 Cultural Resources  
Part II Texas Historical Commission  
Chapter 13 Administration of State Franchise Tax Credits for Certified Rehabilitation of Certified Historic Structures**

### **RULES**

#### **TEXAS HISTORIC PRESERVATION TAX CREDIT PROGRAM**

Texas Administrative Code, Title 13, Cultural Resources

Chapter 13, Administration of State Franchise Tax Credit for Certified Rehabilitation of Certified Historic Structures

#### **§ 13.1. Definitions.**

The following words and terms when used in these rules shall have the following meanings unless the context clearly indicates otherwise:

- (1) Applicant--The entity that has submitted an application for a building or structure it owns or for which it has a contract to purchase.
- (2) Application--A fully completed Texas Historic Preservation Tax Credit Certification Application form submitted to the Commission, which includes three parts:
  - (A) Part A - Evaluation of Significance, to be used by the Commission to make a determination whether the building is a certified historic structure;
  - (B) Part B - Description of Rehabilitation, to be used by the Commission to review proposed projects for compliance with the Standards for Rehabilitation; and
  - (C) Part C - Request for Certification of Completed Work, to be used by the Commission to review completed projects for compliance with the work approved under Part B.
- (3) Application fee--The fee charged by the Commission and paid by the applicant for the review of Part B and Part C of the application as follows:

Eligible costs and expenses	Part A review fee	Part B review fee	Part C review fee
\$5,000 to \$50,000	\$ -	\$ 150	\$ 150
\$50,001 to \$100,000	\$ -	\$ 250	\$ 250
\$100,001 to \$250,000	\$ -	\$ 375	\$ 375
\$250,001 to \$500,000	\$ -	\$ 500	\$ 500
\$500,001 to \$6,000,000	\$ -	0.15% of estimated eligible costs and expenses	0.15% of final eligible costs and expenses
Over \$6,000,000	\$ -	\$ 9,000	\$ 9,000

(4) Audited cost report--Such documentation as defined by the Comptroller in the Texas Administrative Code, Title 34, Chapter 3, Tax Administration [cross-reference Comptroller's rules].

(5) Building--Any edifice enclosing a space within its walls, and usually covered by a roof, the purpose of which is principally to shelter any form of human activity, such as shelter or housing, or to provide working, office, parking, display, or sales space. The term includes among other examples, banks, office buildings, factories, warehouses, barns, railway or bus stations, and stores and may also be used to refer to a historically and functionally related unit, such as a courthouse and jail or a house and barn. Functional constructions made usually for purposes other than creating human shelter or activity such as bridges, windmills, and towers are not considered buildings under this definition and are not eligible to be certified historic structures.

(6) Certificate of eligibility--A document issued by the Commission to the Owner, following review and approval of a Part C application, that confirms the property to which the eligible costs and expenses relate is a certified historic structure and the rehabilitation qualifies as a certified rehabilitation; and specifies the date the certified historic structure was first placed in service after the rehabilitation.

(7) Certified historic structure--A building or buildings located on a property in Texas that is certified by the Commission as:

- (A) listed individually in the National Register of Historic Places;
- (B) designated as a Recorded Texas Historic Landmark under § 442.006, Texas Government Code, or as a State Antiquities Landmark under Chapter 191, Texas Natural Resources Code; *see* 13 Tex. Admin. Code § 21.6 and 26.3(63)-(64); or
- (C) certified by the Commission as contributing to the historic significance of:
  - (i) a historic district listed in the National Register of Historic Places;
or

(ii) a certified local district as per 36 CFR 67.9.

(8) Certified local district--A local historic district certified by the United States Department of the Interior in accordance with 36 C.F.R. § 67.9.

(9) Certified rehabilitation--The rehabilitation of a certified historic structure that the Commission has certified as meeting the Standards for Rehabilitation. If the project is submitted for the federal rehabilitation tax credit it must be reviewed by the National Park Service prior to a determination that it meets the requirements for a certificated rehabilitation under this rule. In the absence of a determination for the federal rehabilitation tax credit, the Commission shall have the sole responsibility for certifying the project.

(10) Commission--The Texas Historical Commission. For the purpose of notifications or filing of any applications or other correspondence, delivery shall be made to: Texas Historic Preservation Tax Credit Program, Texas Historical Commission, 1700 North Congress Avenue, Suite B-65, P.O. Box 12276, Austin, Texas 78711-2276.

(11) Comptroller--The Texas Comptroller of Public Accounts.

(12) Contributing--A building in a historic district considered to be historically, culturally, or architecturally significant according to the criteria established by state or federal government, including those formally promulgated by the National Park Service and the United States Department of the Interior at 36 C.F.R. Part 60 and applicable National Register bulletins.

(13) Credit--The tax credit for the certified rehabilitation of certified historic structures available pursuant to Chapter 171, Subchapter S of the Texas Tax Code.

(14) District--A geographically definable area, urban or rural, possessing a significant concentration, linkage, or continuity of sites, buildings, structures, or objects united by past events or aesthetically by plan or physical development. A district may also comprise individual elements separated geographically but linked by association or history.

(15) Eligible costs and expenses--The qualified rehabilitation expenditures as defined by Section 47(c)(2), Internal Revenue Code, including rehabilitation expenses as set out in 26 C.F.R. § 1.48-12(c), incurred during the project.

(16) Federal rehabilitation tax credit-- A federal income tax credit for 20% of qualified rehabilitation expenditures with respect to a certified historic structure, as defined in Section 47, Internal Revenue Code; 26 C.F.R. § 1.48-12; and 36 C.F.R. Part 67.

(17) National Park Service-- The agency of the U.S. Department of the Interior that is responsible for certifying projects to receive the federal rehabilitation tax credit.

(18) Owner-- A person, partnership, company, corporation, or other entity holding an ownership interest in a property, which can include full or partial ownership in fee simple.

(19) Phased development--A rehabilitation project which may reasonably be expected to be completed in two or more distinct states of development, as defined by Treasury Regulation 26 C.F.R. § 1.48-12(b)(2)(v). Each phase of a phased development can independently support an Application for a credit as though it was a stand-alone rehabilitation. If any completed phase of the rehabilitation project does not meet the requirements of a certified rehabilitation, future applications by the same owner for the same certified historic structure will not be considered.

(20) Placed in service--A status obtained upon completion of the rehabilitation project when the building is ready to be reoccupied and any permits and licenses needed to occupy the building have been issued. Evidence of the date a property is placed in service includes a certificate of occupancy issued by the local building official and/or an architect's certificate of substantial completion.

(21) Property--A parcel of real property containing one or more buildings or structures that is the subject of an application for a credit.

(22) Rehabilitation--The process of returning a building or buildings to a state of utility, through repair or alteration, which makes possible an efficient use while retaining those portions and features of the building and its site and environment which are significant.

(23) Rehabilitation plan--Descriptions, drawings, construction plans, and specifications for the proposed rehabilitation of a certified historic structure in sufficient detail to enable the Commission to evaluate compliance with the Standards for Rehabilitation.

(24) Standards for Rehabilitation--The United States Secretary of the Interior's Standards for Rehabilitation as defined in 36 C.F.R. § 67.7.

(25) Structure-- A building; see also certified historic structure.

### **§ 13.2. Qualification Requirements.**

(a) Qualification for credit.

(1) An Owner is eligible for a credit for eligible costs and expenses incurred in the certified rehabilitation of a certified historic structure if:

- (A) the rehabilitated certified historic structure is placed in service on or after September 1, 2013;
- (B) the Owner has an ownership interest in the certified historic structure in the year during which the structure is placed in service after the rehabilitation; and
- (C) the total amount of the eligible costs and expenses incurred exceeds \$5,000.

(2) A property for which eligible costs and expenses are submitted for the credit must meet Internal Revenue Code § 47(c)(2) which includes:

- (A) non-residential real property; or
- (B) residential rental property.

(b) Eligible costs and expenses. Eligible costs and expenses means those costs and expenses allowed pursuant to Internal Revenue Code 47(c)(2). Such eligible costs and expenses, include, but are not limited to:

- (1) expenditures associated with structural components as defined by Treasury Regulation 1.48-1(e)(2) including walls, partitions, floors, ceilings, windows and doors, stairs, elevators, escalators, sprinkling systems, fire escapes, components of central air conditioning, heating, plumbing, and electrical systems and other components related to the operation or maintenance of the building;
- (2) architectural services;
- (3) engineering services;
- (4) construction management and labor, materials, and reasonable overhead;
- (5) subcontracted services;
- (6) development fees;
- (7) construction period interest and taxes; and
- (8) other items referenced in Internal Revenue Code § 47(c)(2).

(c) Ineligible costs and expenses. Eligible costs and expenses as defined in Internal Revenue Code § 47(c)(2) do not include the following:

- (1) the cost of acquiring any interest in the property;
- (2) the personal labor by the applicant;
- (3) any cost associated with the enlargement of an existing building;
- (4) site work expenditures, including any landscaping, sidewalks, paving, decks, outdoor lighting remote from the building, fencing, retaining walls or similar expenditures; or
- (5) any cost associated with the rehabilitation of an outbuilding or ancillary structure unless it is certified by the Commission to contribute to the historical significance of the property..

- (d) Eligibility date for costs and expenses.
- (1) If the rehabilitated certified historic structure is placed in service on or after September 1, 2013, but before January 1, 2015, the Application may include eligible costs and expenses for the project incurred up to 60 months prior to the date the property is placed in service.
  - (2) If the rehabilitated certified historic structure is placed in service on or after January 1, 2015, Part A of the Texas Historic Preservation Tax Credit Certification Application must be submitted prior to the building being placed in service.
  - (3) While the credit may be claimed for eligible costs and expenses incurred prior to the filing of an application, potential applicants are urged to file parts A and B of the application at the earliest possible date. This will allow the Commission to review the application and provide guidance to the applicant that will increase the chances that the application will ultimately be approved and the credit received.
- (e) Phased development. Part B applications for rehabilitation of the same certified historic structure may be submitted by the same owner only if they describe clearly defined phases of work that align with a cost report that separates the eligible costs and expenses by phase. Separate Part B and C applications shall be submitted for review by the Commission prior to issuance of a certificate of eligibility for each phase.
- (f) Amount of credit. The total amount of credit available is twenty-five percent (25%) of the aggregate eligible costs and expenses incurred in the certified rehabilitation of the certified historic structure.

### **§ 13.3. Evaluation of Significance.**

- (a) Application Part A – Evaluation of Significance. Part A of the application requires information to allow the Commission to evaluate whether a building is a certified historic structure and shall be completed for all buildings to be included in the project. Part A of the application is evaluated against criteria for significance and integrity issued by the National Park Service.
- (b) Application Requirements. Information to be submitted in the Part A includes:
- (1) Name, mailing address, telephone number, and email address of the property owner(s) and Applicant if different from the Owner;
  - (2) Name and address of the property;
  - (3) Name of the historic district, if applicable;
  - (4) Current photographs (not smaller than 4"x6", printed at 300 ppi if digital) of the building and its site, showing exterior and interior features and spaces adequate to document the property's significance;
  - (5) Date of construction of the property;

- (6) Brief description of the appearance of the property, including alterations, characteristic features and estimated date or dates of construction and alterations;
  - (7) Brief statement of significance summarizing why a property is:
    - (A) eligible for individual listing in the National Register of Historic Places;
    - (B) contributes to a historic district listed in the National Register of Historic Places or a certified local district; or
    - (C) contributes to a potential historic district, accompanied by:
      - (i) a map showing the boundary of the potential historic district and the location of the property within the district;
      - (ii) photographs of other properties in the district; and
      - (iii) justification for the district's eligibility for listing in the National Register of Historic Places;
  - (8) A map showing the location of the historic property;
  - (9) Signature of the Owner and Applicant if different from the Owner requesting the determination; and
  - (10) Other information required on the application by the Commission.
- (c) Consultation with Commission. Any person may informally consult with the Commission to determine whether a property is:
- (1) listed individually in the National Register of Historic Places;
  - (2) designated as a Recorded Texas Historic Landmark or State Antiquities Landmark; or
  - (3) certified by the Commission as contributing to the historic significance of a historic district listed in the National Register of Historic Places or a certified local district.
- (d) Automatic qualification as certified historic structure. If a property is individually listed in the National Register of Historic Places or designated as a Recorded Texas Historic Landmark or State Antiquities Landmark, then it is a certified historic structure and should be indicated as such on Part A of the application.
- (e) Preliminary determination of significance. An Applicant for a property not listed in the National Register of Historic Places, neither individually nor as a contributing element to a historic district; not designated a Recorded Texas Historic Landmark nor State Antiquities Landmark; and not listed in a certified local district may obtain a preliminary determination from the Commission as to whether the property is individually eligible to become a certified historic structure or is eligible as a contributing structure in a potential historic district by submitting Part A of the application. Determination will be based on criteria for listing in the National Register of Historic Places. Applications for a preliminary determination of significance must show how the

property meets one of the following criteria for listing in the National Register of Historic Places and any applicable criteria considerations from the National Park Service.

(1) National Register of Historic Places criteria. The quality of significance in American history, architecture, archeology, engineering, and culture is present in districts, sites, buildings, structures, and objects that possess integrity of location, design, setting, materials, workmanship, feeling, and association and one or more of (A) through (D) below:

(A) Properties that are associated with events that have made a significant contribution to the broad patterns of our history; or

(B) that are associated with the lives of persons significant in our past; or

(C) that embody distinctive characteristics of a type, period, or method of construction, or that represent the work of a master, or that possess high artistic values, or that represent a significant and distinguishable entity whose components may lack individual distinction; or

(D) that have yielded, or may be likely to yield, information important in prehistory or history.

(2) Criteria considerations. Ordinarily cemeteries, birthplaces, or graves of historical figures, properties owned by religious institutions or used for religious purposes, structures that have been moved from their original locations, reconstructed historic buildings, properties primarily commemorative in nature, and properties that have achieved significance within the past 50 years shall not be considered eligible for the National Register. However, such properties will qualify if they are integral parts of districts that do meet the criteria of if they fall within the following categories:

(A) A religious property deriving primary significance from architectural or artistic distinction or historical importance; or

(B) A building or structure removed from its original location but which is significant primarily for architectural value, or which is the surviving structure most importantly associated with a historic person or event; or

(C) A birthplace or grave of a historical figure of outstanding importance if there is no appropriate site or building directly associated with his productive life.

(D) A cemetery which derives its primary significance from graves of persons of transcendent importance, from age, from distinctive design features, or from association with historic events; or

(E) A reconstructed building when accurately executed in a suitable environment and presented in a dignified manner as part of a restoration master plan, and when no other building or structure with the same association has survived; or



(F) A property primarily commemorative in intent if design, age, tradition, or symbolic value has invested it with its own exceptional significance; or

(G) A property achieving significance within the past 50 years if it is of exceptional importance.

(3) Issuance of a preliminary determination of significance does not bind the Commission to the designation of an individual historic structure or district. Applicants proceed with rehabilitation projects at their own risk. If a structure is ultimately not listed in the National Register of Historic Places, designated as a Recorded Texas Historic Landmark, or certified as a contributing element to a local district pursuant to 36 C.F.R. § 67.9, the preliminary determination does not become final, and the owner will not be eligible for the credit. The Commission shall not issue a certificate of eligibility until or unless the designation is final.

(f) Determination of contributing structures in existing historic districts. If a property is located in a district listed in the National Register of Historic Places or in a certified local district, an Applicant or an owner of the property shall request that the Commission determine whether the property is of historic significance contributing to the district by submitting Part A of the application. The Commission evaluates properties located within historic districts listed in the National Register of Historic Places or certified local districts to determine whether they contribute to the historic significance of the district by applying the following standards:

(1) A property contributing to the historic significance of a district is one which by location, design, setting, materials, workmanship, feeling, and association adds to the district's sense of time and place and historical development.

(2) A property does not contribute to the historic significance of a district if it does not add to the district's sense of time and place and historical development, or if its location, design, setting materials, workmanship, feeling, and association have been so altered or have so deteriorated that the overall integrity of the building has been irretrievably lost.

(3) Generally, buildings that have been built within the past 50 years shall not be considered to contribute to the significance of a district unless a strong justification concerning their historical or architectural merit is given or the historical attributes of the district are considered to be less than 50 years old at the date of application.

(4) Certification of significance will be made on the basis of the appearance and condition of the property before beginning the rehabilitation work.

(5) If a nonhistoric surface material obscures a building's façade, it may be necessary for the owner to remove a portion of the surface material so that a determination of significance can be made. After the material has been removed, if the obscured façade has retained substantial historic integrity and the property

otherwise contributes to the significance of the historic district, it will be considered eligible to be a certified historic structure.

(g) **Subsequent Designation.** If a property is not automatically qualified as a certified historic structure, an owner of a property shall request that the Commission determine whether the property is of historic significance by submitting Part A of the application in accordance with § 13.3(e-f). Upon listing in the National Register of Historic Places, designation as a Recorded Texas Historic Landmark, or certification as a contributing element to a local district pursuant to 36 C.F.R. § 67.9, a revised Part A should be submitted as stated in § 13.3(d). A building must be a certified historic structure prior to the issuance of the certificate by the Commission as required by Section 171.904(b)(1)(A) of the Texas Tax Code.

(h) **Multiple buildings.** If a property contains more than one building and the Commission determines that the buildings have been functionally related historically to serve an overall purpose (such as a residence and a carriage house), then the functionally related buildings will be treated as a single certified historic structure, regardless of whether one of the buildings is separately listed in the National Register of Historic Places or as a Recorded Texas Historic Landmark or is located within a historic district. Buildings that are functionally related historically are those that have functioned together to serve an overall purpose during the property's period of significance.

(i) **Portions of buildings.** Portions of buildings, such as single condominium apartment units, are not independently eligible for certification. Two or more buildings or structures located on a single tract or parcel of land (or contiguous tracts or parcels), which are operated as an integrated unit (as evidenced by their operation, management and financing), may be treated as a single building or structure for the purposes of certification.

(j) **Relocation of historic buildings.** Relocation of a historic building from its original site may disqualify the building from eligibility or result in removal of designation as a certified historic structure. Applications involving buildings that have been moved or are to be moved will be evaluated on a case-by-case basis under the applicable criteria for designation as provided in this section. For a building listed in the National Register of Historic Places, the applicant will be responsible for updating the National Register of Historic Places nomination for the property or district, or the relocated building will not be considered a certified historic structure for the purpose of this credit. For a building designated as a Recorded Texas Historic Landmark, the applicant will be responsible for notifying the Commission and otherwise complying with the requirements of 13 Tex. Admin. Code § 21.11 prior to undertaking any relocation.

#### **§ 13.4. Description of Rehabilitation.**

(a) Application Part B – Description of Rehabilitation. Part B of the application requires information to allow the Commission to determine whether the proposed rehabilitation work is consistent with the Standards for Rehabilitation and shall be completed for all projects and phases of projects. Part B may only be submitted with Part A of the application or after the Part A of the application has been submitted to the Commission.

(b) Application Requirements. If a property is a certified historic structure or receives a preliminary determination of significance, an Applicant or Owner of the property shall request that the Commission determine whether the rehabilitation plan is in conformance with the Standards for Rehabilitation. Information to be submitted in the Part B includes:

- (1) Name, mailing address, telephone number, and email address of the Owner and Applicant if different from the Owner;
- (2) Name and address of the property;
- (3) Current photographs (not smaller than 4"x6", printed at 300 ppi if digital) of the building and its site, showing exterior and interior features and spaces adequate to document the property's condition immediately prior to commencement of work;
- (4) A rehabilitation plan including drawings of the site plan and the building floor plans showing existing conditions and all proposed work with elevation drawings if applicable to illustrate any new construction, alterations, or additions. Drawings of the existing building condition and drawings of the proposed project are required to substantiate the scope of the project. If the project is a phased development, a description of all phases of work with the associated timeline shall be provided;
- (5) Additional photos as necessary to completely illustrate all areas of the building that will be affected by the rehabilitation;
- (6) A timeframe by which all work included in the project will be completed with a projected starting date and completion or placed in service date;
- (7) An estimate of the aggregate eligible costs and expenses;
- (8) Signature of the Owner, and Applicant if different from the Owner, requesting the review; and
- (9) Other information required on the application by the Commission.

(c) Determination of certified rehabilitation. Part B rehabilitation plans are reviewed by staff of the Commission for consistency with the Standards for Rehabilitation as set forth below:

- (1) A property shall be used for its historic purpose or be placed in a new use that requires minimal change to the defining characteristics of the building and its site and environment.

- (2) The historic character of a property shall be retained and preserved. The removal of historic materials or alteration of features and spaces that characterize a property shall be avoided.
- (3) Each property shall be recognized as a physical record of its time, place, and use. Changes that create a false sense of historical development, such as adding conjectural features or architectural elements from other buildings, shall not be undertaken.
- (4) Most properties change over time; those changes that have acquired historic significance in their own right shall be retained and preserved.
- (5) Distinctive features, finishes, and construction techniques or examples of craftsmanship that characterize a historic property shall be preserved.
- (6) Deteriorated historic features shall be repaired rather than replaced. Where the severity of deterioration requires replacement of a distinctive feature, the new feature shall match the old in design, color, texture, and other visual qualities and, where possible, materials. Replacement of missing features shall be substantiated by documentary, physical, or pictorial evidence.
- (7) Chemical or physical treatments, such as sandblasting, that cause damage to historic materials shall not be used. The surface cleaning of structures, if appropriate, shall be undertaken using the gentlest means possible.
- (8) Significant archeological resources affected by a project shall be protected and preserved. If such resources must be disturbed, mitigation measures shall be undertaken.
- (9) New additions, exterior alterations, or related new construction shall not destroy historic materials that characterize the property. The new work shall be differentiated from the old and shall be compatible with the massing, size, scale, and architectural features to protect the historic integrity of the property and its environment.
- (10) New additions and adjacent or related new construction shall be undertaken in such a manner that if removed in the future, the essential form and integrity of the historic property and its environment would be unimpaired.

### **§ 13.5. Request for Certification of Completed Work.**

- (a) Application Part C – Request for Certification of Completed Work. Part C of the application requires information to allow the Commission to certify the completed work follows the Standards for Rehabilitation and the rehabilitation plan as approved by the Commission in the Part B review. Part C may be submitted when the project is placed in service.
- (b) Application requirements. Information to be submitted in the Part C includes:
  - (1) Name, mailing address, telephone number, and email address of the property owner(s);

- (2) Tax identification number(s);
- (3) Name and address of the property;
- (4) Photographs (not smaller than 4"x6", printed at 300 ppi if digital) of the completed work showing similar views of the photographs provided in Parts A and B;
- (5) Evidence of the placed in service date, such as a certificate of occupancy issued by the local building official or a certificate of substantial completion; and
- (6) Other information required on the application by the Commission.

### **§ 13.6. Application Review Process.**

- (a) Application form. The Commission staff will develop the application and may modify it as needed over time. All required forms, including application parts A, B, C, and amendment forms, are available from the Commission at no cost.
- (b) Delivery. Applications will be accepted beginning on January 1, 2015 and continuously thereafter. Applications should be delivered to the Commission by mail, hand delivery, or courier service. Faxed or e-mailed applications will not be accepted.
- (c) Application Part A – Evaluation of Significance. Part A of the application will be used by the Commission to confirm historic designation or to determine if the property is eligible for qualification as a certified historic structure.
  - (1) If a property is individually listed in the National Register of Historic Places or designated as a Recorded Texas Historic Landmark or State Antiquities Landmark, the property is qualified as a certified historic structure.
  - (2) The applicant will be responsible for providing sufficient information to the Commission with which the Commission staff may make a determination. If all requested information is not provided to make a determination that a building is eligible for designation as a certified historic structure, the staff may request additional information from the applicant. If the additional information requested is not provided in a timely manner, the application will be considered incomplete and review of the application will be placed on hold until sufficient information is received.
  - (3) The Commission staff review of Part A of a complete application, unless otherwise provided in § 13.8, and shall notify the applicant in writing of any determination it makes upon completing the review of Part A of the application.
  - (4) There is no fee to review Part A of the application.
- (d) Application Part B – Description of Rehabilitation. Part B of the application will be used by the Commission to review proposed projects for compliance with the Standards for Rehabilitation.
  - (1) The applicant will be responsible for providing sufficient information, including photographs taken prior to the project, to the Commission with which

the Commission staff may make a determination. If all requested information is not provided to make a determination that a project is eligible as a certified rehabilitation, staff may request additional information from the applicant, usually required to be submitted within 30 days. If the additional information requested is not provided in a timely manner, the application will be considered incomplete and review of the application will be placed on hold until sufficient information is received.

(2) The Commission staff will review Part B of a complete application, unless otherwise provided in § 13.8, and shall notify the applicant in writing of any determination it makes upon completing the review of Part B of the application. In reviewing Part B of the application, the Commission shall determine if Part B is approved or not as follows:

- (i) Consistent with the Standards for Rehabilitation as determined by the Commission. If all aspects of the Part B of the application meet the standards for rehabilitation, no additional information is required, and no conditions are imposed on the work, Part B is approved.
- (ii) Consistent with the Standards for Rehabilitation with specific conditions of work required. The Commission may determine that the work described in the plan must be performed in a specific manner or with specific materials in order to fully comply with the Standards for Rehabilitation. In such cases, the Part B may be approved with specific conditions required. For applications found to be consistent with the Standards for Rehabilitation with specific conditions required, the applicant shall provide written acceptance to the Commission of all specific conditions required. Otherwise the application will be determined to be not consistent with the Standards for Rehabilitation; applications found to be consistent with the Standards for Rehabilitation with specific conditions required may proceed with the work but will only be eligible for the credit if the conditions listed are met as part of the rehabilitation work. Failure to follow the conditions may result in a determination by the Commission that the project is not consistent with the Standards for Rehabilitation; or
- (iii) Not consistent with the Standards for Rehabilitation. Applications found not to be consistent with the Standards for Rehabilitation will be considered to be ineligible applications; the Commission shall make recommendations to the applicant that might bring the project into conformance with the Standards for Rehabilitation, however no warranty is made that the recommendations will bring the project into compliance with the Standards for Rehabilitation; the applicant may reapply and it will

be treated as a new application and will be subject to a new application fee.

(3) An application fee is required to be received by the Commission before Commission review of Part B of the application. The fee is based on the estimated amount of eligible costs and expenses listed by the applicant on Part B of the application.

(i) Applicants must submit the fee with their Part B application or the application will be placed on hold until the fee is received. The fee is calculated according to a fee schedule approved by the Commission and included in the application.

(ii) The fee is based on the estimated aggregate eligible costs and expenses indicated in the Part B application and is not refundable. Resubmission of a rejected application or under any other circumstances will require a new fee. Amendments to a pending application or approved project do not require additional fees.

(4) Amendment Sheet. Changes to the project not anticipated in the original application shall be submitted to the Commission on an amendment sheet and must be approved by the Commission as consistent with the Standards for Rehabilitation before they are included in the project. The Commission shall review the amendment sheet and issue a determination in writing regarding whether or not the proposed change in the project is consistent with the Standards for Rehabilitation.

(5) Scope of Review. The review encompasses the building's site and environment as well as any buildings that were functionally related historically. Therefore, any new construction and site improvements occurring on the historic property are considered part of the project. Individual condominiums or commercial spaces within a larger historic building are not considered individual properties apart from the whole. The scope of review for a project is not limited to the work that qualifies as an eligible expense. Likewise, all work completed by the current owner twenty-four (24) months before the submission of the application is considered part of the project, as is the cumulative effect of any work in previously completed or future phases.

(e) Application Part C - Request for Certification of Completed Work. Part C of the application will be used by the Commission to review completed projects for compliance with the work approved under Part B.

(1) The applicant shall file Part C of the application after the building is placed in service.

(2) The applicant will be responsible for providing sufficient information, including photographs before and after the project, to the Commission by which the Commission staff may verify compliance with the approved Part B. If all

requested information is not provided to make a determination that a project is eligible as a certified rehabilitation, the application is incomplete and review of the application will be placed on hold until sufficient information is received.

(3) The Commission staff will review Part C of a complete application, unless otherwise provided in § 13.8, and shall notify the applicant in writing of any determination it makes upon completing the review of Part C of the application.

(i) If the completed project is found to be in compliance with the approved Part B and any required conditions and consistent with the Standards for Rehabilitation, and the building is a certified historic structure at the time of the application, the Commission shall approve the project. The Commission then shall issue to the applicant a certificate of eligibility that confirms the property to which the eligible costs and expenses relate is a certified historic structure and the rehabilitation qualifies as a certified rehabilitation and specifies the date the certified historic structure was first placed in service after the rehabilitation.

(ii) If the completed project is not consistent with the Standards for Rehabilitation, with the approved Part B, and/or the specific conditions required, and the project cannot, in the opinion of the Commission, be brought into compliance, or if the building is not a certified historic structure at the time of the application, then the Commission shall deny Part C of the application and no certificate of eligibility shall be issued.

(iii) If the completed project is not consistent with the Standards for Rehabilitation, with the approved Part B, and/or the specific conditions required, and the project can, in the opinion of the Commission, be brought into compliance, the Commission may issue remedial conditions that will bring the project into compliance. The applicant shall complete the remedial work and file an amended Part C. If the remedial work, in the opinion of the Commission, brings the project into compliance, then the Commission shall issue a certificate of eligibility.

(4) An application fee is charged before Commission review of the Part C of the application based on the amount of eligible costs and expenses listed by applicant on Part C of the application.

(i) Applicants must submit the fee with their Part C application or the application will be placed on hold until the fee is received. The fee is calculated according to a fee schedule approved by the Commission and included in the application.

(ii) The fee is based on the eligible costs and expenses as indicated in the audited cost report and is not refundable. Resubmission of a rejected



application or under any other circumstances will require a new fee. Amendments do not require additional fees.

**§ 13.7. Inspection.**

- (a) Inspection. The Commission may conduct an inspection of a project for which an application has been submitted to review current conditions, work completed in association with the current application, or previously executed phases of work.
- (b) Notice. The Commission must give reasonable notice of not less than 48 hours to the applicant of its intent to inspect the property.
- (c) Eligibility for the credit. Completed phases of work that do not meet the Standards for Rehabilitation are not eligible for the credit, and future phases of work performed by the same owner on the same building shall not be eligible for a credit under this program.

**§ 13.8. Relationship with the Federal Rehabilitation Tax Credit Program.**

- (a) Projects seeking federal and state credits. Projects seeking certification for both the federal rehabilitation tax credit and the Texas Historic Preservation Tax Credit must meet eligibility requirements for each program separately.
  - (1) Applicants for both programs shall submit the first page of the Part A, B, and C application forms, accompanied by the Part 1, 2, and 3 application forms for the federal rehabilitation tax credit program, respectively.
  - (2) A project also submitted for the federal rehabilitation tax credit will be reviewed and approved or rejected by the National Park Service before the Commission issues its determinations under this chapter. The Commission will consider National Park Service decisions in rendering its determinations. A project that receives certification for the purposes of the federal rehabilitation tax credit will receive a certification of eligibility pursuant to the Texas Historic Preservation Tax Credit, provided that the building is a certified historic structure at the time the credit is taken.
  - (3) The review fees required per § 13.6, Application Review Process, must be paid before the Commission will issue any determinations or certifications pursuant to the Texas Historic Preservation Tax Credit, even if the project has previously received certification by the National Park Service for the federal rehabilitation tax credit.
- (b) Projects seeking state credit exclusively. If the applicant is eligible to claim a state credit exclusively, then the application forms for the Texas Historic Preservation Tax Credit provided by Commission shall be used. Determinations by the Commission that a project includes a certified historic structure and/or a certified rehabilitation apply only to

the Texas Historic Preservation Tax Credit Program and are not binding on any other local or federal tax credit program.

# Appendix D      THC Request for Opinion RQ-1149-GA

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OPINION COMMITTEE

**TEXAS HISTORICAL COMMISSION**  
*real places telling real stories*

August 30, 2013

FILE # MI-47381-13  
I.D. # 47381

The Honorable Greg Abbott  
Attorney General of Texas  
Attention: Opinions Committee  
P.O. Box 12548  
Austin, Texas 78711

**RQ-1149-GA**

Dear General Abbott:

On behalf of the Texas Historical Commission, I ask for your official opinion concerning the implementation and interpretation of House Bill 500 passed by the 83<sup>rd</sup> Legislature, Regular Session. A section of the bill charges the Commission with the evaluation of properties that may qualify for a credit against the state franchise tax, and my questions concern that issue.

Section 14 of H.B. 500, which establishes a tax credit for the certified rehabilitation of certified historic structures, includes two dates for implementation. Section 14 (b) indicates that this section of the bill takes effect on January 1, 2015. Another part of this section of the bill enacts Texas Tax Code § 171.903(1), which provides that rehabilitated certified historic structures placed in service on or after September 1, 2013 are eligible for the tax credit. The Commission is authorized to issue certificates of eligibility upon determining the building and rehabilitation meet the requirements of the statute. Tex. Tax Code § 171.904(b).

Accordingly, I ask the following questions concerning the tax credit program:

1. Does the Texas Historical Commission have the authority to begin reviewing applications for the tax credit prior to January 1, 2015, the effective date of this section of the bill?
2. May the Commission issue certificates of eligibility prior to January 1, 2015?
3. Is denial of a certificate of eligibility subject to appeal, and if so, is this appeal a contested case under Tex. Gov't Code ch. 2001?
4. May property owners whose qualifying historic structures are placed in service between September 1, 2013 and January 1, 2015, claim the credit?
5. Would costs and expenses incurred by an owner prior to either September 1, 2013 or January 1, 2015 be eligible for the credit?
6. To what tax year may credits for periods prior to January 1, 2015 be applied, if any?

Section 171.908 of the Tax Code as adopted by the bill allows for unlimited sale or assignment of all or part of the credit. Part (d) of that section provides that "the entity that claims the credit must be subject to the tax imposed by this chapter." No other section of the bill specifies that the owner of the property must be an entity that is subject to the franchise tax. Accordingly, I ask the following additional question:

7. Is it necessary that the owner of the property be subject to the franchise tax, or may a homeowner, nonprofit corporation, or other non-taxable entity make use of the credit through its sale or assignment to a taxable entity?

RICK PERRY, GOVERNOR • MATTHEW F. KREISLE, III, CHAIRMAN • MARK WOLFE, EXECUTIVE DIRECTOR  
P.O. BOX 12276 • AUSTIN, TEXAS • 78711-2276 • P 512.463.6100 • F 512.475.4872 • www.thc.state.tx.us



Thank you for considering this request. With the new fiscal year upon us, property owners, developers, tax credit marketers and state legislators are calling our offices daily for guidance. Your assistance is very much appreciated.

Sincerely,

A handwritten signature in cursive script that reads "Mark Wolfe". The signature is written in black ink and is positioned to the right of the typed name and title.

Mark Wolfe  
Executive Director

CC: Matt Kreisle, Chairman, Texas Historical Commission  
Joe Thrash, Assistant Attorney General, Administrative Law Division

## Appendix E      Memorandum from the Texas Consortium for Quality Redevelopment

### MEMORANDUM

**TO:**            Attorney General, State of Texas

**FROM:**        The Texas Consortium for Quality Redevelopment

**DATE:**        September 24, 2013

**RE:**            RQ-1149-GA; Inquiry from Texas Historical Commission regarding H.B.  
500, Section 14 – State of Texas Historic Tax Credits.

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**Introduction:**

On August 30, 2013, Mark Wolfe, the Executive Director of the Texas Historical Commission, wrote to you seeking your official opinion concerning the implementation and interpretation of House Bill 500, “An Act relating to the computation of the franchise tax, including certain exclusions from the tax” (the “Act”), passed by the 83<sup>rd</sup> Legislature, Regular Session.<sup>1</sup> Mr. Wolfe requested your opinion on seven questions pertaining to Section 14 of the Act, which created a “Tax Credit for Certified Rehabilitation of Certified Historic Structures” (the “Tax Credit”). On September 4, 2013, you wrote to Mr. Wolfe informing him that you will consider the issues presented by him and issue an opinion. Your letter to Mr. Wolfe invited interested parties to submit briefs by September 24, 2013.

In response to that invitation, The Texas Consortium for Quality Redevelopment is pleased to submit the following brief on behalf of a collection of interested parties who constitute many facets of the historic rehabilitation community, including, but not limited to, building owners, real estate developers, investors, tax attorneys, accountants, and preservation consultants who have come together to provide suggested guidance in connection with the Act. This group brings a great deal of experience regarding the administration and utilization of historic rehabilitation tax credits at the federal level and in many states with state historic rehabilitation tax credits. The following suggestions are based on this group’s experience, and we appreciate your consideration of our perspective as practitioners.

Section 14 of the Act (“Section 14”) is to be codified in the Texas Tax Code under Chapter 171 as Subchapter S, Sections 171.901 through 171.909, and implements the Tax Credit. The Texas Historical Commission (the “Commission”) and the Texas Comptroller of Public Accounts (the “Comptroller”) are empowered under the Act to adopt rules necessary to implement the

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<sup>1</sup> Tax. H.B. 500, 83<sup>rd</sup> Leg., R.S. (2013).

program.<sup>2</sup> Mr. Wolfe's request concerns the authority to initiate various processes needed to establish the Tax Credit program as well as clarification of the timeline and eligibility presented by the Act. You have made available to interested parties the opportunity to provide briefs on the issues raised. Accordingly, we offer this Memorandum concerning the Commission's inquiries.

**Timeline Under the Act:**

**September 1, 2013** (the "Initial Eligibility Date") – An entity is eligible to apply for a Tax Credit for eligible costs and expenses in excess of \$5,000 incurred in the certified rehabilitation of a certified historic structure if the rehabilitated certified historic structure is placed in service on or after the Initial Eligibility Date.<sup>3</sup>

**January 1, 2014** – Act takes effect, except as otherwise provided in the Act.<sup>4</sup> Act applies only to a report originally due on or after the effective date of the Act.<sup>5</sup>

**January 1, 2015** (the "Credit Availability Date") – Section 14 takes effect.<sup>6</sup>

**Controlling Law:**

The statutory provisions relating to the Commissioner's general authority to promulgate regulations implementing legislation in advance of the "effective date" of such legislation is clearly set out in the applicable provisions of the Administrative Procedure Act provisions contained within the Texas Government Code, as follows:

**In preparation for the implementation of legislation that has become law but has not taken effect a state agency may adopt a rule or take other administrative action that the agency determines is necessary or appropriate and that the agency would have been authorized to take had the legislation been in effect at the time of the action.<sup>7</sup>**

**Questions Raised by the Commission:**

**1. Does the Texas Historical Commission have the authority to begin reviewing applications for the tax credit prior to January 1, 2015, the effective date of this section of the bill? Yes, the Texas Historical Commission and the Comptroller have the authority to**

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<sup>2</sup> TAX CODE § 171.909.

<sup>3</sup> *Id.* § 171.903.

<sup>4</sup> Tax. H.B. 500, 83<sup>rd</sup> Leg., R.S. § 20 (2013).

<sup>5</sup> *Id.* § 19.

<sup>6</sup> TAX CODE § 171.909(b).

<sup>7</sup> GOV'T CODE § 2001.006(b).

**begin reviewing applications for the Tax Credit prior to January 1, 2015, the effective date of Section 14 of the Act.**

The Commission<sup>8</sup> and the Comptroller<sup>9</sup> are state agencies. As expressly set out above, in preparation for the implementation of legislation that has become law<sup>10</sup> but has not taken effect<sup>11</sup>, a state agency is given the authority to adopt a rule or take other administrative action that the agency determines is necessary or appropriate and that the agency would have been authorized to take had the legislation been in effect at the time of the action.<sup>12</sup> Once the rule is adopted but before it has taken effect, a state agency may take administrative action that the agency determines is necessary or appropriate and that the agency would have been authorized to take had the rule been in effect at the time of the action.<sup>13</sup>

The Commission's activities involved in issuing a Certificate of Eligibility and the Comptroller's activities preceding, but not including, issuance of a Tax Credit Certificate are entirely administrative, and, therefore, pursuant to clear language of the cited authority, may be undertaken in advance of the January 1, 2015 effective date of the legislation which is being implemented. The Commission's review of applications for Certificates of Eligibility and issuance of that Certificate of Eligibility are entirely administrative functions. Likewise, the Comptroller's review of costs and expenses is also an entirely administrative function. These actions are entirely administrative and have no legal consequences prior to the Credit Availability Date of January 1, 2015, as defined above. However, these actions are required to be taken in order to implement and give effect to the statutory provisions creating eligibility for the credit from and after September 1, 2013, and prior to the date that the credit may be claimed and utilized. Such intent is implicit in the legislative provisions which create a separate Initial Eligibility Date (September 1, 2013), and a subsequent Credit Availability Date (January 1, 2015). Since the Comptroller's issuance of a Tax Credit Certificate is an operational function rather than an administrative function, that activity, the actual issuance of Tax Credit Certificates, would be the only action contemplated by the legislation, which could not occur until on or after January 1, 2015.

It is essential to the legislative structure and chronology that the Commission be able to undertake the preliminary approval of rehabilitation projects in the period between the Initial Eligibility Date of September 1, 2013 and the Credit Availability Date of January 1, 2015, as described in the attached proposed rules. These entirely administrative preliminary activities include issuance of the Preliminary Determination of Eligibility, State Part 1, State Part 2, and Part 3 approvals, as set forth in the attached proposed rules. The Act promotes and encourages

<sup>8</sup> Gov'T CODE § 442.002(a).

<sup>9</sup> Gov'T CODE § 403.013(a)(1).

<sup>10</sup> *Id.* § 2001.006(a)(2)(A).

<sup>11</sup> TAX CODE § 171.909(b).

<sup>12</sup> Gov'T CODE § 2001.006(b).

<sup>13</sup> *Id.* § 2001.006(c).

activity resulting in rehabilitation projects being placed in service on or after September 1, 2013, which is well in advance of January 1, 2015. In order for projects to benefit from the incentive, it is important that the Commission take administrative steps to facilitate the financing of rehabilitation activity that will ultimately result in projects being issued a Tax Credit Certificate by the Comptroller on or after January 1, 2015. Projects relying on the incentive to facilitate their construction financing, must, at a bare minimum, have the benefit of the Commission providing administrative preliminary approvals (Preliminary Determination of Eligibility, State Part 1, State Part 2, and State Part 3 as contemplated in the attached proposed rules) in the period between September 1, 2013 and January 1, 2015. Without an administrative preliminary Certificate of Eligibility from the Commission during that period, projects relying on the legislative intent will not be able to access commitments for construction financing. Since an administrative Certificate of Eligibility would not create a Tax Credit, the issuance of a Certificate of Eligibility is entirely administrative, but essential to the accomplishment of the legislative intent.

Since the Tax Credit can only be claimed if a Certificate of Eligibility from the Commission is attached to the annual franchise report<sup>14</sup>, the Commission would substantially delay the anticipated implementation of the Tax Credit program if it fails to undertake the requisite preliminary administrative functions until on or after the Credit Availability Date of January 1, 2015. Because the process of administratively confirming a qualified rehabilitation project does not by itself provide a Tax Credit, the Commission's process of administratively reviewing applications for compliance with the requirements for a Certificate of Eligibility merely facilitates the program so that the actual claiming of the Tax Credit on and after the Credit Availability Date (the ultimate "effective date" of the legislation) can be accomplished more rapidly. We also note that the Commission already performs similar administrative reviews in connection with qualifying applicants for Federal Historic Tax Credits, so there should be relatively little that needs to be done other than to adopt regulations and forms for the state Tax Credit.

In the period between September 1, 2013 and January 1, 2015, The Texas Historical Commission and the Comptroller do have the administrative authority to undertake all steps in the process leading up to, but not including, the Comptroller's issuance of a Tax Credit Certificate.

**2. May the Commission issue Certificates of Eligibility prior to January 1, 2015? Yes, the Commission may issue Certificates of Eligibility as well as State Part 1, State Part 2, and State Part 3 approvals prior to January 1, 2015.**

As set out above, the Commission's review and issuance of a Certificate of Eligibility is an entirely administrative activity allowed for under the Administrative Procedure Act.<sup>15</sup> The

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<sup>14</sup> *Id.* § 171.904(c).

<sup>15</sup> *Id.* § 2001.006(c).



Comptroller's issuance of a Tax Credit Certificate creates a Tax Credit, and, as such, that activity is the only one in the process that cannot be undertaken prior to January 1, 2015. Review of the historical significance of structures and the techniques used in their rehabilitation is not an activity whose meaning is limited to processing the Tax Credit. The Commission already has an interest in making certain that structures of historic significance are preserved and that rehabilitation does not inadvertently destroy the historic significance of the buildings. The Commission already performs the nearly identical administrative reviews of projects qualifying for Federal Historic Tax Credits. Accordingly, the Commission should be legally able to perform the administrative review functions for the initial applicants to the state Tax Credit program and then issue all initial Certificates of Eligibility between September 1, 2013 and January 1, 2015. Since it is an entirely administrative function, the Commission may issue Certificates of Eligibility prior to January 1, 2015.

In any event, it is essential to the accomplishment of the legislative intent that the Commission be able to undertake the preliminary approval of rehabilitation projects as described in the attached proposed rules and issue the Preliminary Determination of Eligibility, State Part, State Part 2, and State Part 3 in the period between the Initial Eligibility Date of September 1, 2013 and the Credit Availability Date of January 1, 2015.

**3. Is denial of a Certificate of Eligibility subject to appeal, and if so, is this appeal a contested case under Tex. Gov't Code ch. 2001? Yes, denial of a Certificate of Eligibility would be subject to appeal, and, yes, because the Commission is a state agency with statewide jurisdiction that makes rules or determines contested cases, Chapter 2001 of the Government Code applies.<sup>16</sup>**

The rules anticipated for the Tax Credit program would establish statements of general applicability that implements, interprets, or prescribes law or policy, as set out in the Act, and therefore comply with the definition of "rules" as set out in Chapter 2001.<sup>17</sup> Accordingly, a dispute over whether or not a project is qualified for the issuance of a Certificate of Eligibility, and therefore a Tax Credit, would appear to be a "contested case" or "a proceeding ... in which the legal rights, duties, or privileges of a party are to be determined by a state agency after an opportunity for adjudicative hearing."<sup>18</sup> Such a contested case would be subject to the adjudicative process set out in Chapter 2001.

**4. May property owners whose qualifying historic structures are placed in service between September 1, 2013 and January 1, 2015, claim the credit? Yes, property owners whose qualifying historic structures are placed in service between September 1, 2013 and**

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<sup>16</sup> *Id.* § 2001.003(7).

<sup>17</sup> *Id.* § 2001.003(6).

<sup>18</sup> *Id.* § 2001.003(1).

January 1, 2015 may claim the credit, but only on or after the Credit Availability Date of January 1, 2015.

The Act specifically provides:

*QUALIFICATION. An entity is eligible for a credit for eligible costs and expenses incurred in the certified rehabilitation of a certified historic structure as provided by this subchapter if:*

*(1) the rehabilitated certified historic structure is placed in service on or after September 1, 2013; ...<sup>19</sup>*

Two of the basic rules of statutory construction are (i) that if the language of a statute is plain and unambiguous it must be given effect, and (ii) that every word or clause must be given effect.<sup>20</sup> The Legislature gave importance to September 1, 2013 as the Initial Eligibility Date. If the Legislature had not intended for projects placed in service between September 1, 2013 and January 1, 2015 to be eligible to claim the Tax Credit, then the Legislature would not have provided September 1, 2013 as the Initial Eligibility Date. Furthermore, the Legislature had the opportunity to include a specific provision making a special rule for properties that were placed in service between the Initial Eligibility Date of September 1, 2013 and the Credit Availability Date of January 1, 2015, however, they did not do so. Accordingly, the plain meaning of the Act should be followed and interpreted to permit property owners to claim the Tax Credit on or after the Credit Availability date of January 1, 2015, if their qualifying historic structures with certified rehabilitations are placed in service at any time on or after the Initial Eligibility Date of September 1, 2013.

**5. Would costs and expenses incurred by an owner prior to either September 1, 2013 or January 1, 2015 be eligible for the credit? Yes, costs and expenses incurred by a property owner prior to both September 1, 2013 and January 1, 2015 are eligible for a credit.**

A property owner whose rehabilitated certified historic structure is placed in service on or after the Initial Eligibility Date of September 1, 2013 qualifies for the Tax Credit so long as the required criteria are met.<sup>21</sup> One criterion is that the total amount of the eligible costs and expenses incurred must exceed \$5,000.<sup>22</sup> Another criterion is that a qualified rehabilitation must meet the United States Secretary of the Interior's Standards for Rehabilitation as defined in 36 C.F.R. Section 67.7 in order to qualify for the Tax Credit.<sup>23</sup> It is clear that a certain amount of

<sup>19</sup> TAX CODE § 171.903.

<sup>20</sup> Clark & Connolly, The Writing Center, Georgetown University Law Center, A Guide to Reading, Interpreting and Applying Statutes 9 (2006).

<sup>21</sup> TAX CODE § 171.903(1).

<sup>22</sup> TAX CODE § 171.903(3).

<sup>23</sup> *Id.* § 171.904(a)(2).

time is needed to accomplish such rehabilitation. Section 14 does not limit the amount of time between commencement and completion of a qualified rehabilitation. Section 14 does not specify a date by which a qualified rehabilitation must be commenced in advance of the Initial Eligibility Date of September 1, 2013 in order to place in service on or after that date. A project that is placed in service prior to the Initial Eligibility Date of September 1, 2013 would not be eligible. However, so long as a qualified project (i) has not been placed in service prior to the Initial Eligibility Date of September 1, 2013, and (ii) incurs at least \$5,000 in costs and expenditures, any qualified costs and expenses consistent with the Secretary of the Interior's Standards for Rehabilitation incurred prior to the project's placed in service date are eligible.

**6. To what tax year may credits for the period prior to January 1, 2015 be applied, if any?**

Pursuant to Section 19 of the Act, the Act applies only to an annual franchise tax report that is originally due on or after the effective date of the Act,<sup>24</sup> which is January 1, 2014.<sup>25</sup> Accordingly, the applicability of the Act, which is not contradicted by the terms of Section 14, indicates that the Tax Credit may be applied to the franchise tax obligation originally evidenced by a filing in calendar year 2014. Under the terms of Section 14, however, which is not effective until the Credit Availability Date of January 1, 2015, the report claiming the Tax Credit may only be filed after Section 14 is effective, *i.e.*, the Credit Availability Date of January 1, 2015. The Tax Code permits an application for a refund or a credit at any time before the expiration of the period during which the Comptroller may assess a deficiency for the tax.<sup>26</sup> Absent a fraudulent report, failure to file a report or a gross error in the report,<sup>27</sup> that period is four years from the date that the tax was due.<sup>28</sup> Accordingly, if a report due in 2014 is not filed until 2015, or if an amendment report is filed in 2015, then the Tax Credit should be applicable against the 2014 franchise tax obligation because that is an obligation pursuant to a report originally due on or after the January 1, 2014 effective date of the Act, as set forth in Section 20 of the Act. As an example, if a building is placed in service in 2014, that building could receive a Tax Credit Certificate in 2015 that could be used to offset 2014 tax liability. The significance of the term "placed in service," which is used four times throughout the Act, is that the Tax Credit is "earned" in the year the property is placed in service; can be "used" to offset tax liability incurred during the year in which the building is placed in service; and can be "claimed" on any report that is filed after the January 1, 2015 Credit Availability Date, subject to the carryforward provisions.

**7. Is it necessary that the owner of the property be subject to the franchise tax, or may a homeowner, nonprofit corporation, or other non-taxable entity make use of the credit**

<sup>24</sup> Tax. H.B. 500, 83<sup>rd</sup> Leg., R.S. § 19 (2013).

<sup>25</sup> *Id.* § 20.

<sup>26</sup> TAX CODE § 111.107.

<sup>27</sup> *Id.* § 111.205(a).

<sup>28</sup> *Id.* § 111.201.

through its sale or assignment to a taxable entity? No, it is not necessary that the owner of the property be subject to the franchise tax. Yes, a nonprofit corporation or other non-taxable entity may make use of the credit through its sale or assignment of a Tax Credit Certificate to a taxable entity.

The owner of the property may be any kind of entity, including a taxable entity, a nonprofit entity, or a non-taxable entity, such as a partnership or a limited liability company. Therefore, any kind of entity, regardless of its tax status and regardless of whether it has franchise tax liability, can apply for a Certificate of Eligibility and a Tax Credit Certificate. An entity must apply to the Comptroller for a Tax Credit on or with the franchise tax report for the period for which the credit is claimed, but there is no requirement that the entity applying for the Tax Credit be a taxable entity or have franchise tax liability (an entity without franchise tax liability would file a franchise tax report indicating zero franchise tax liability and also submit to the Comptroller the Certificate of Eligibility, an audited costs and expenses report, the date the property was placed in service, and an attestation of the eligible costs and expenses).<sup>29</sup> Section 14 of the Act (i) makes all types of property owners eligible, without regard to the type of entity<sup>30</sup>, (ii) never restricts eligibility to a “taxable entity”, and (iii) allows a property owner to allocate, transfer, assign, or sell the Tax Credits to any kind of entity multiple times, so long as the required reporting to the Comptroller is undertaken.<sup>31</sup> Section 14 of the Act also expressly permits disproportionate allocation of the Tax Credit to entities regardless of tax status, so long as the entity that ultimately utilizes the Tax Credit is subject to franchise tax.<sup>32</sup> That permission allows Tax Credits to be allocated to a member or partner, regardless of whether it is a taxable entity or a non-taxable entity, of a limited liability company, partnership, or other pass-through entity, in a manner disproportionate to such member’s or partner’s percentage ownership and/or capital account in such limited liability company, partnership or other pass-through entity, so long as the required reporting to the Comptroller is undertaken.<sup>33</sup> Section 14 of the Act also allows any subsequent allocatee, transferee, assignee, or owner to allocate, transfer, assign, or sell the Tax Credits to any kind of entity multiple times, so long as the required reporting to the Comptroller is undertaken. The only restriction is that the entity that ultimately utilizes the Tax Credit must be subject to the franchise tax.<sup>34</sup>

A franchise tax is imposed on each taxable entity that does business in Texas or that is chartered or organized in Texas.<sup>35</sup> Chapter 171 specifically defines a “taxable entity” as being a partnership, limited liability partnership, corporation, banking corporation, savings and loan association, limited liability company, business trust, professional association, business

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<sup>29</sup> *Id.* § 171.907.

<sup>30</sup> *Id.* § 171.902.

<sup>31</sup> *Id.* § 171.908(a).

<sup>32</sup> *Id.* § 171.908(d).

<sup>33</sup> *Id.* § 171.908(d).

<sup>34</sup> *Id.* § 171.908(d).

<sup>35</sup> *Id.* § 171.001(a).

association, joint venture, joint stock company, holding company, or other legal entity, including a combined group.<sup>36</sup> Chapter 171 specifically excludes a sole proprietorship and a general partnership, from the “taxable entity” definition.<sup>37</sup> Throughout Chapter 171, the term “entity” is generally used to refer to an organization that is not taxable. Section 14 was drafted as Subchapter S of Chapter 171 of the Tax Code, and is therefore subject to the general definitions of what constitutes a “taxable entity.” The language of Section 14 does not contain a single reference to “taxable entity.” Section 14 clearly intends to use the broader term, stating that an “entity” is eligible to apply for the Tax Credit,<sup>38</sup> and that the “entity” must have an ownership interest in the certified historic structure in the year during which the structure is placed in service once the rehabilitation is complete.<sup>39</sup> The failure to confine the availability of the Tax Credit to “taxable entities” evidences a legislative intention that other persons who do not themselves have franchise tax liability (such as individuals, nonprofit entities, non-taxable partnerships, and limited liability companies) are qualified for the Tax Credit if the ownership requirement is met.

This interpretation dovetails with the full transferability of the Tax Credit provided in Section 171.908 because it permits a non-taxable entity to obtain the Certificate of Eligibility from the Commission and then assign its rights to the Tax Credit to another entity who can then claim the Tax Credit. The only requirement is that the entity that ultimately utilizes the Tax Credit against their tax liability must be subject to the franchise tax<sup>40</sup>. This facilitates the use of the Tax Credit, making it a more flexible method of assisting in the financing of historical preservation developments, regardless of whether they are owned by a taxable or an exempt entity.

In Section 171.904 (Certification of Eligibility), subsections (a) and (b) relate to the Commission’s responsibilities, and subsections (c) through (e) relate to the Comptroller’s responsibilities. While it is clear that the Commission must issue its Certificate of Eligibility to the entity that qualified as being an owner and as having spent in excess of \$5,000 on a rehabilitated certified historic structure placed in service on or after the Initial Eligibility Date of September 1, 2013<sup>41</sup>, there is nothing to indicate that the recipient of that Certificate of Eligibility cannot then sell, assign, transfer, or allocate the Certificate of Eligibility to a taxable entity. That taxable entity could then forward the Certificate of Eligibility and other requisite documentation (audited cost report, attestation as to total eligible costs and expenses, etc.) to the Comptroller along with the annual franchise report on which the Tax Credit is to be claimed, and evidence of sale or assignment<sup>42</sup>. Section 14 is clear that such an assignment of the Tax Credit can be without regard to the ownership interest of the assignee in the project, provided that the

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<sup>36</sup> *Id.* § 171.0002(a).

<sup>37</sup> *Id.* § 171.0002(b).

<sup>38</sup> *Id.* § 171.902.

<sup>39</sup> *Id.* § 171.903(2).

<sup>40</sup> *Id.* § 171.908(d).

<sup>41</sup> *Id.* § 171.904(b).

<sup>42</sup> *Id.* § 171.904(c).

entity that claims the Tax Credit is subject to the franchise tax.<sup>43</sup> Both the assignor and the assignee would need to jointly submit written notice of the sale or assignment<sup>44</sup>, along with the annual franchise tax report for which the Tax Credit is claimed<sup>45</sup>. The Act does not seek to limit the timing on the assignment of the Tax Credit, other than to provide that assignment cannot extend the carryforward period or increase the amount of the Tax Credit that can be claimed.<sup>46</sup> There is no express limitation on the ability of the holder of a Certificate of Eligibility issued by the Commission to assign its rights under the Certificate of Eligibility and let the assignee be the taxable entity who first applies for the Tax Credit in an annual franchise tax report submitted on or after January 1, 2105.

**Conclusion:**

As The Texas Consortium for Quality Redevelopment, a group of practitioners experienced in state historic rehabilitation tax credits, we appreciate the opportunity you have given us to submit this brief. The new state historic rehabilitation tax credit will precipitate important economic development, community development, and historic preservation throughout Texas, from small main streets to the busiest downtowns. We look forward to lending our experience and perspective toward ensuring a well-functioning incentive that delivers impactful results for the state.

Depending on the information interested parties submit regarding the seven questions raised by Mr. Wolfe, we ask to reserve the ability to submit additional briefing and/or materials should that be warranted.

Submitted by The Texas Consortium for Quality Redevelopment  
c/o Stonehenge Capital Company  
3625 N Hall Street  
Dallas, Texas 75219  
(214) 599-8850

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<sup>43</sup> *Id.* § 171.908(d).

<sup>44</sup> *Id.* § 171.908(b).

<sup>45</sup> *Id.* § 171.907(a).

<sup>46</sup> *Id.* § 171.908(c).

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## **Vita**

Anna Hudson was born in Whitleyville, Tennessee to Charles and Janice Glover. She was the salutatorian of her graduating class in 1999 at Jackson County High School. She earned her B.A. in Spanish and International Business from the University of Memphis in 2003 graduating magna cum laude. She travelled abroad teaching English before attending the University of Texas at Austin from 2006-2008. After completing the coursework for MSCRP she moved to San Antonio, TX to work for the City's Office of Historic Preservation. Mrs. Hudson lives in San Antonio with her daughter and husband and works as a preservation consultant and commercial real estate agent.

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This report was typed by the author.