Encouraging Historic Preservation Through the Federal Tax System: The Tax Reform Act of 1976

I. INTRODUCTION

The Tax Reform Act of 1976 (TRA) contains provisions[1] which at the time of enactment were hailed as a "major new impetus" to this country's historic preservation movement.[2] Proponents described these provisions, found in section 2124 of the TRA, as ideally equipped to further the goals of both preservationists and environmentalists concerned with rehabilitating decaying city neighborhoods.[3] The Act is significant in that it reflects the current strength of the preservation movement. After a ten year struggle against a strong anti-tax shelter movement, it has finally achieved important tax incentives for the rehabilitation of historic buildings.[4]

1. Tax Reform Act of 1976, Pub. L. No. 94-455, § 2124, 90 Stat. 1916 (1976).

2. N.Y. Times, Jan. 2, 1977, § 8 (Real Estate), at 1; *id.*, Oct. 27, 1976, § 1, at 40, col. 2.

3. Senator J. Glen Beall, who introduced the amendment to the TRA which resulted in the enactment of section 2124's preservation provisions, stated:

> My amendment seeks to reinvigorate our urban communities and reaffirm our sense of neighborhood while at the same time preserving our heritage. . . . We can do this by constructively utilizing our federal tax system so as to encourage the long range and highly desirable preservation and environmental goals which we as a Congress have set for our nation.

PRESERVATION NEWS, September 1976, at 3.

4. Tax reforms of the kind contained in section 2124 were first called for as early as 1966. WITH HERITAGE SO RICH 209 (1966) (Report of a Special Committee on Historic Preservation under the auspices of the United States Conference of Mayors) [hereinafter cited as WITH HERITAGE SO RICH]. They were first submitted to Congress by Representative John Byrnes as part of the President's Environmental Program of 1972 in the form of an Environmental Protection Tax Act, H.R. 14669, 92d Cong., 2d Sess. (1972). This bill, which also contained provisions aimed at encouraging the preservation of coastal wetlands, was reintroduced unsuccessfully in 1973 as H.R. 5584, 93d Cong., 1st Sess. (1973), and again in 1975 as H.R. 6225, 94th Cong., 1st Sess. (1975), by Representative Barber Conable. Senator Beall incorporated the portions of the Environmental Protection Tax Act relevant to this article

Section 2124 has three major goals: (1) to promote private investment in the rehabilitation of qualifying historic structures by allowing rapid amortization of rehabilitation expenditures and providing for accelerated depreciation of substantially rehabilitated buildings; (2) to eliminate existing tax incentives to demolish or alter historic structures by disallowing certain deductions for demolition costs and losses and for accelerated depreciation of replacement structures; and (3) to encourage conservation-oriented use of historic (and other) properties by allowing charitable deductions for contributions of partial interests in the properties.

Whether or not the provisions of section 2124 will have the salutary effects intended by its proponents will depend largely on the strength of the tax incentives and disincentives created and on the resolution of certain ambiguities concerning the technical implementation of the Act. The statutory language itself is not entirely clear on certain crucial issues, such as how buildings qualify for the Act's benefits, whether the various benefits can be combined as to one building, and how the taxpayer will fare on subsequent disposition of the property. While such issues may be resolved by amendments contained in the proposed Technical Corrections Act of 1977 (TCA) now pending before Congress,[5] that Act, if passed in its present form, will raise new problems. In addition, technical problems have arisen from administrative regulations promulgated by the Secretary of the Interior, who must certify certain aspects of the rehabilitation process before the benefits contained in section 2124 become available to the taxpayer. In short, the Act's capacity to promote private investment in historic rehabilitation is necessarily limited by its remaining ambiguities and structural weaknesses.

As a preliminary step, this note will explain the Act's major provisions and trace the policies underlying its present form. It will explore the main problems in the technical implementation of the TRA which may hinder its effectiveness, particularly in light of pending legislative attempts to resolve those problems. Finally, it will put the TRA into perspective within the overall framework of the historic preservation movement.

into the Historic Structures Tax Act which was introduced in 1973 as S. 2347, 93d Cong., 1st Sess. (1973), and again in 1975 as S. 667, 94th Cong., 1st Sess. (1975). S. 667, in slightly modified form, served as the basis for section 2124 of the TRA.

5. H.R. 6715, 95th Cong., 1st Sess. § (2)(F) (1977).

II. Section 2124: Underlying Policies and Major Provisions

A. *Policy Considerations*

1. *Preservationists and Environmentalists: A Meeting of the Minds*

The incentives for historic preservation contained in the TRA can best be understood as the result of a process whereby preservationists and environmentalists came to recognize a shared interest in encouraging the rehabilitation of decaying urban commercial districts and the urgent need for federal tax reforms aimed at furthering that interest.

By the mid-1960's, historic preservationists were becoming alarmed at the tremendous rate at which historic buildings were succumbing to the wrecker's ball.[6] Throughout the next decade, many groups began to realize that any attempt to save specific landmarks in imminent danger of being bulldozed was "too little too late."[7] Moreover, a sense was developing among preservationists that the goal of their movement should not be geared so much toward saving individual structures of historic significance, as toward conveying a sense of time and place by preserving the architectural and historic quality of entire neighborhoods.[8]

Three main target areas were set out for the movement: (1) to consider architectural, design, and esthetic as well as historic and cultural values; (2) to look beyond the individual building to entire districts of historic and architectural value;[9] and (3) to study

6. By 1966, nearly half the buildings which had originally been recorded in 1941 by the Historic American Buildings Survey—a program of the National Park Service for assembling a national archive of architectural documentation on historic American architecture—had already been destroyed. With Heritage So Rich, *supra* note 4, at 205.

7. [1973] Council on Environmental Quality Ann. Rep. 24.

8. Obviously, historic preservation must be concerned with individual buildings, indeed, with individual features of individual buildings. But if it is limited to that, the result may be artificial, theatrical, unrelated to everyday life—a curiosity, a place that one visits, but one that has lost the power of belonging through its interconnections.

National Trust for Historic Preservation, Historic Districts 3 (1975).

9. The concept of adaptive rehabilitation—the idea that the nation's historic and architectural heritage should be preserved "as a living part of our community life and development"—was enshrined as a congressional policy in the National Historic Preservation Act of 1966, § 1, 16 U.S.C. § 470(b) (1976).

economic conditions and tax policies affecting preservation efforts.[10]

During these same years, environmentalists were decrying the deteriorating quality of urban life. The Council on Environmental Quality, which was to have a hand in the original drafting of section 2124, described the situation in 1970:

> Pressed for revenues, many cities bow to the demands of developers to replace historic buildings and distinctive architecture with almost uniform steel and glass box office buildings. Unfortunately, this construction may simply put more people on the sidewalks and more cars on the streets, more monotonous skyscrapers towering above, and more noise and congestion below. Much downtown rebuilding has furthered the trend toward daytime cities with facilities such as offices and banks, which have no nighttime uses. Cities and neighborhoods are replaced by the dullest in modern architecture.[11]

2. *The Beneficial Side Effects of Historic Rehabilitation*

The adaptive rehabilitation of potentially attractive older neighborhoods to suit contemporary needs came to be seen as a worthy goal for several reasons. Primary among these is the revitalizing impact such rehabilitation can have on the central cities. The ability to attract people downtown is both socially and culturally beneficial. Furthermore, there are economic benefits in the form of greater revenues from tourism, higher property values, and the consequent increase in the city's tax revenues.[12] A major obstacle to inner city revitalization is the "red-lining" practice of financial institutions which refuse to make loans and mortgages in neighborhoods they regard as too old or too deteriorated.[13] There is some

10. WITH HERITAGE SO RICH, *supra* note 4, at 207.

11. [1970] COUNCIL ON ENVIRONMENTAL QUALITY ANN. REP. 168.

12. It is worth noting here that not all of these economic effects are equally desirable in all situations. The rise in property taxes and the influx of affluent neighbors caused by rehabilitation often result in the exodus of less affluent residents of the neighborhood. These residents, if they are homeowners, may be partially compensated by the rise in their property values, but the social implications of this kind of population dislocation must still be reckoned with. Also, local property tax systems which increase the tax burdens on owners of historic properties whose buildings have increased in value as a result of their rehabilitative efforts may significantly diminish the economic attractiveness of rehabilitation projects for these owners.

13. This reluctance by banks to make loans for the restoration of older neighborhoods was cited by President Nixon as a major reason why the federal government should provide economic incentives for private rehabilitation projects. Special Message to the Congress Proposing the 1971 Environmental Program, 1971 PUB. PAPERS [48], at 139 (1972). Besides the proposals for income tax reforms affecting commercial

hope that rehabilitation efforts in historic urban districts will lead to increased lenders' confidence in these districts and in neighboring areas as well.

The National Advisory Council on Historic Preservation pointed to other benefits resulting from a policy of adaptive rehabilitation:[14] the creation of jobs by encouraging rehabilitation work which is significantly more labor intensive than new construction; the conservation of energy and raw materials by reusing sound, existing buildings which use natural sources of heating, cooling, and lighting more effectively; and the revitalization of existing commercial centers that do not require substantial new public investment in infrastructure.[15] Finally, rehabilitation may be more feasible simply because it can be cheaper than new construction.[16]

3. *The Need for Federal Tax Reform*

Besides the red-lining practices already mentioned and the dismal inadequacy of direct federal funding for preservation activities,[17] the perpetuation of a "total demolition" approach by urban renewal officials had the effect of eroding relatively stable old neighborhoods.[18] Reform of the federal income tax laws to end such practices suggested itself for several reasons. Tax considerations are recognized as a major and often controlling factor in in-

historic buildings, President Nixon also proposed a bill providing for federal insurance of loans of up to $15,000 for the restoration of historic private residences. *Id.* That bill became law as the Emergency Home Purchase Assistance Act of 1974, Pub. L. No. 93-449, 88 Stat. 1364 (codified in scattered sections of 12 U.S.C.).

14. The Advisory Council on Historic Preservation, an independent agency of the executive branch of the federal government, was created by the National Historic Preservation Act of 1966, 16 U.S.C. §§ 470-470t (1976). Among its functions is that of advising the President and Congress on matters relating to historic preservation.

15. 122 CONG. REC. S12,708 (daily ed. July 28, 1976) (memorandum cited by Sen. J. Glenn Beall entitled *Historical Preservation Tax Revisions*, prepared by the Advisory Council on Historic Preservation).

16. For example, Canal Square in Georgetown, Washington, D.C. was renovated for $17 per square foot, as opposed to estimated new construction costs of $60-$100 per square foot. *Saving Old Buildings—and Money, Too*, NATION'S BUSINESS, June 1971, at 47.

17. One estimate puts the current annual need nationwide at $400 million, with direct federal funding of historic preservation in the range of only $10-$15 million. Boasberg, *Historic Preservation: Suggested Directions for Federal Legislation*, 12 WAKE FOREST L. REV. 75, 81 (1976) [hereinafter cited as Boasberg].

18. Advisory Council on Historic Preservation, *Historic Preservation: Federal-State Cooperative Efforts*, 3 REPORT 13 (June 1975) (Special Issue, a summary of State Historic Preservation Officer responses to a questionnaire distributed by the Advisory Council) [hereinafter cited as ACHP Report].

vestment decisions in the private sector.[19] However, perhaps most important in bringing the Internal Revenue Code to the attention of preservation-minded Congressmen were the pre-1976 provisions favoring demolition and new construction over rehabilitation of older buildings.

Prior to the TRA, a taxpayer could deduct as current losses the cost of demolishing an old building and the remaining undepreciated basis of the demolished building, unless the building had been acquired with a view toward its demolition.[20] Moreover, any depreciable replacement structure would be subject to the very favorable accelerated depreciation methods allowable to the original users under the Internal Revenue Code (I.R.C.),[21] including the 150 percent declining balance method (200 percent in the case of residential rental property).[22] By contrast, used property generally could not qualify for accelerated depreciation, except that certain used residential rental property could be depreciated using the 125

19. Indeed, some economic decisions in the private sector affecting historic properties are made solely on the basis of tax consequences. Consequently, diminishing or increasing the tax liability accruing from a certain action can have a significant effect on the decision to take that action. While tax policy at all levels of government influences action in the private sector, changes in the Federal revenue laws generally have the most pronounced effect on the taxpayer's burden. Therefore, modifications in the Internal Revenue Code present considerable potential for establishing tax incentives (and disincentives) to stimulate private preservation activity.

121 CONG. REC. 3006 (1975) (1973 analysis by the Advisory Council on Historic Preservation).

20. I.R.C. § 165(a); Treas. Reg. § 1.165-3 (1977).

21. I.R.C. § 167(a) provides that a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business or of property held by the taxpayer for the production of income shall be allowed as a depreciation deduction. Thus, private residences are not ordinarily depreciable.

22. I.R.C. § 167(b) and (j). The most basic method of depreciation is the straight line method, by which equal annual portions of the building's basis (generally, the cost of the building) are deducted over the building's entire useful life. Accelerated depreciation methods allow the taxpayer to take larger deductions in the early years of the building's useful life than would be allowable under the straight line method and smaller deductions later on. The declining balance form of accelerated depreciation involves applying a uniform rate to the remaining undepreciated basis of the property each year. Thus, for example, in using the 200 percent declining balance method, the taxpayer would make a deduction in the first year equal to twice that allowable under the straight line method, and he would continue to apply this 200 percent formula (200% of what the straight line method would allow given the remaining undepreciated basis) to the remaining basis in the following years. Similarly, the 150 percent and 125 percent declining balance methods allow application of those rates to the remaining basis.

percent declining balance method if it had a useful life of 20 years or more at the time of acquisition.[23]

Accelerated depreciation constitutes a tax shelter and is advantageous to the taxpayer for several reasons. The first among these is its deferral value. The ability to take larger deductions and thus save taxes in the early years, despite smaller than normal deductions later, is valuable to the taxpayer because of the time value of money; since he has the use of those saved tax dollars in the meantime, he has a kind of interest-free loan from the government.

The second beneficial aspect of accelerated depreciation is increased leverage. Leverage is the ability to take depreciation deductions against the entire amount invested in a building, even though a very high percentage of that amount may have been borrowed by the taxpayer.

The final advantage of the shelter is known as rate conversion. This involves current depreciation deductions against ordinary income; should there be any gain on a subsequent sale of the property, there is preferential capital gains treatment of at least a portion of that gain.[24] As a result, not only is the taxpayer often able to defer paying taxes on his income to the extent of the depreciation deductions, but he is also able to pay a much lower capital gains rate on at least a part of the gain reflecting those earlier deductions.

To the extent, therefore, that Congress had structured the Code prior to the TRA to allow current deduction of demolition costs and losses and highly beneficial accelerated depreciation of new buildings, it unwittingly created a situation where the destruction of historic old buildings was encouraged. The provisions of the TRA are partly aimed at eliminating this preference for demolition and replacement in the federal tax laws insofar as it affects historic structures.

B. *Certified Historic Structures*

In order to qualify for the benefits contained in section 2124, a building must meet its qualifications as a "certified historic structure." According to this section, a certified historic structure is any building or structure of a depreciable character[25] which

23. I.R.C. § 167(j).

24. The "recapture" provisions, I.R.C. §§ 1245 and 1250, can have the effect of subjecting all or part of such gains to ordinary income rates.

25. *See* note 21, *supra*.

(A) is listed in the National Register,
(B) is located in a Registered Historic District and is certified by the Secretary of the Interior as being of historic significance to the district, or
(C) is located in an historic district designated under a statute of the appropriate State or local government if such statute is certified by the Secretary of the Interior to the Secretary of the Treasury as containing criteria which will substantially achieve the purpose of preserving and rehabilitating buildings of historic significance to the district.[26]

This definition is as significant for its exclusions as for its inclusions. First, the category of certified historic structures clearly applies only to commercial properties, including those used for rental purposes. Thus, private residences cannot qualify since they are not ordinarily depreciable.[27] Second, to the extent that Congress was willing to bestow the benefits of the TRA upon historic structures which are not listed in the National Register,[28] its clear preference was for districts over individual landmarks. In other words, while a non-Register building can qualify if it is within a proper district created by a state or local government, it cannot qualify if that government has designated it merely as an individual

26. New I.R.C. § 191(d). (All subsequent references in this note are to the Internal Revenue Code of 1954, *as amended*. The term "new" is used to designate a provision added by the TRA.)

27. The analysis by the Advisory Council on Historic Preservation cited three reasons for the exclusion of noncommercial properties from the Act's benefits. The first was that "it would require a radical change of long-standing tax policy" to extend depreciation and amortization deductions to properties that are neither used in the trade or business nor held for the production of income by the taxpayer. The Advisory Council then noted that "the primary concern of the drafters was the threat to historic buildings in declining urban commercial districts, and the bill reflects this." Finally, historic noncommercial properties were considered adequately serviced by the Emergency Home Purchase Assistance Act of 1974, *see* note 13, *supra*, which provided for federal insurance of loans of up to $15,000 for the renovation of noncommercial properties meeting National Register criteria. 121 CONG. REC. 3006 (1975).

In 1977, Senator Thurmond introduced a bill, S. 1158, 95th Cong., 1st Sess. (1977), currently pending before the Senate Committee on Finance, which would allow owners of nondepreciable historic structures to amortize their rehabilitation expenditures pursuant to I.R.C. § 191 as introduced by the TRA. The bill would not make the accelerated depreciation provisions of the TRA applicable to nondepreciable buildings.

28. The National Register is a list, maintained and expanded by the National Park Service pursuant to 16 U.S.C. §§ 470-470t (1976), of districts, sites, structures, and objects significant in American history, architecture, archeology, and culture. The criteria used to evaluate properties nominated to the National Register are set out at 36 C.F.R. § 60.6 (1977).

landmark. These exclusions are indicative of the drafters' primary concern with the rehabilitation of urban commercial districts.

Section 2124, as enacted, seems to draw a distinction between historic districts listed in the National Register ("Registered Historic Districts") and those designated under state or local statutes. Under this apparent distinction, a building within a "Registered Historic District" will qualify for the Act's benefits only if the Secretary of the Interior certifies it as being of historic significance to its district, whereas any building within a state or locally designated historic district can qualify, regardless of its historic significance to the district, as soon as the district-creating statute is properly certified. Such a distinction could lead to a difference in the level of protection afforded buildings within federal and local districts under the Act. However, any practical effect that this apparent distinction may have seems to have been avoided by the regulations pertaining to certifications of historic significance promulgated by the Department of the Interior in October of 1977.[29]

These regulations define "Registered Historic District" as "any district listed in the National Register or any district designated under a State or local statute" which has been appropriately certified by the Secretary of the Interior.[30] The regulations go on to set out the procedures for obtaining a certification of historic significance as they apply to "Registered Historic Districts," thereby suggesting that, under the actual operation of the Act, even buildings within nonfederally designated districts will have to obtain such certification in order to qualify.[31] This interpretation

29. *See* 42 Fed. Reg. 54,548 (1977) (to be codified in 36 C.F.R. § 67).

30. *Id.* at 54,549 (to be codified in 36 C.F.R. § 67.2(g)).

31. However, even the regulations are somewhat ambiguous on this point. The final regulations have undergone some modification since the publication of temporary regulations seven months earlier. 42 Fed. Reg. 14,121 (1977). Those earlier interim regulations, while adopting the same tactic of lumping federal and local districts together under the rubric of "Registered Historic District," referred only to the Registered Historic District "listed in the National Register" in their provisions relating to certifications of historic significance. *Id.* at 14,123. On the other hand, while the final regulations contained historic significance certification provisions which referred to "Registered Historic District" in general terms, they also adopted a definition of "certified historic structure" which, unlike that contained in the interim regulations, did not clearly require a structure within a state or local district to be of historic significance to the district. 42 Fed. Reg. 54,548, 54,549 (1977) (to be codified in 36 C.F.R. § 67.2(a)). Nevertheless, the general language of the final regulations gives greater support to the interpretation that federal and nonfederal districts are to be similarly treated as regards the requirement of historic significance certifications, and the National Trust for Historic Preservation has adopted that view.

should result in a more consistent and equitable application of the Act. Under the final regulations, a structure will generally be of historic significance to its district if it 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."[32]

This controversy over the applicability of the requirement of historic significance certifications could soon become academic if the TCA introduced by Representative Al Ullman on April 28, 1977, is enacted.[33] That bill would amend I.R.C. section 191(d) to provide, first, that any building within a "registered historic district" would require a certification of historic significance to qualify as a certified historic structure, and, second, that the term "registered historic district" would include both districts listed in the National Register and any district

> (i) which is designated under a statute of the appropriate State or local government, if such statute is certified by the Secretary of the Interior to the Secretary as containing criteria which will substantially achieve the purpose of preserving and rehabilitating buildings of historic significance to the district, and (ii) which is certified by the Secretary of the Interior to the Secretary as meeting substantially all of the requirements for the listing of districts in the National Register.[34]

While this section is helpful in that it clears up any remaining ambiguity concerning the equality of treatment of National Register districts and state or local districts with regard to historic significance certification, it imposes a new requirement on state or local districts of meeting substantially all National Register criteria. The purported reason for this new requirement is to "establish more equivalent treatment for all types of historic districts and structures."[35] While equivalent treatment is certainly a worthy goal, it should not blind Congress to countervailing considerations on this issue.

Requiring state and locally designated districts to meet National Register criteria is inadvisable because those criteria are too inflexible. One commentator has noted that "[t]he Register's current focus on architectural, historical and cultural definitions . . . is too

32. 42 Fed. Reg. 54,548, 54,550 (1977) (to be codified in 36 C.R.F. § 67.5).
33. H.R. 6715, 95th Cong., 1st Sess. (1977).
34. *Id.* § 2(f)(1).
35. H.R. REP. NO. 700, 95th Cong., 1st Sess. 13 (1977).

narrow to include listing of neighborhoods which may lack significant buildings of architectural distinction but which, nevertheless, retain a degree of historic integrity and constitute a livable unit of identifiable character and pleasing proportion."[36] Another group has complained that "the insistence upon integrity of design, feeling, and workmanship discriminates against areas where organic growth has produced a stylistic mixture. . . . Because of the variety in physical structures, these areas can often support a varied rent structure and provide a refreshing diversity of uses and people."[37] Thus, in the interest of having section 2124's tax incentives generate rehabilitation in the broadest justifiable range of neighborhoods, the imposition of National Register criteria on nonfederally designated districts should be avoided as too confining.

Perhaps even more disadvantageous, however, would be the impact on both the certification process under the TRA and the integrity of state and local district designation of such a requirement. If the requirement is enacted, the owner of a building within a state or locally designated district who wants to qualify for the Act's benefits would have to obtain certification of (1) the statute creating his district, (2) the district itself, (3) the historic significance of his building to the district, and (4) the appropriateness of his rehabilitation plans. Such an unnecessarily complicated process would serve only to discourage owners from rehabilitating pursuant to the Act's incentives.

Furthermore, the requirement undermines the integrity of the designation process used by state and local commissions, a point not lost upon those bodies.[38] Such a requirement flies in the face of the justification for including non-Register properties within the scope of the TRA—"to recognize and encourage State and local governments to establish historic districts as a way of revitalizing

36. Boasberg, *supra* note 17, at 88.

37. CITIZENS' ADVISORY COMMITTEE ON ENVIRONMENTAL QUALITY, REPORT TO THE PRESIDENT AND TO THE COUNCIL ON ENVIRONMENTAL QUALITY (1973).

38. Even the requirement that the district-creating statute be certified by the federal government caused some friction between federal and local preservation officials. For example, the New York City Landmark Preservation Commission reportedly balked at the notion that its standards for district designation might not be controlling under the TRA. N.Y. Times, Apr. 8, 1977, at 15, col. 4. As of March 1977, New York City had designated over 12,000 historic structures, 95 percent of which were located within 27 districts designated by the city. *Id.* While only 12 of those districts were also listed in the National Register, the Register listed three historic districts not designated by the city. N.Y. Times, Jan. 2, 1977, § 8 (Real Estate), at 1.

our urban areas."[39] In short, while the TCA is desirable insofar as it eliminates any existing ambiguities, its requirement of National Register characteristics for nonfederal districts may serve only to hinder the effectiveness of section 2124.

C. *The Major Provisions of Section* 2124

Section 2124 of the TRA contains five major provisions which create tax incentives and disincentives aimed at furthering the preservation movement. The general structure of these provisions is outlined below.

1. *Amortization of Rehabilitation Expenses*

Section 2124 adds section 191 to the Internal Revenue Code,[40]

39. 122 CONG. REC. S12,708 (daily ed. July 28, 1976) (remarks of Sen. Beall).

40. New I.R.C. § 191 provides in pertinent part:

(a) Allowance of Deduction.—Every person, at his election, shall be entitled to a deduction with respect to the amortization of the amortizable basis of any certified historic structure (as defined in subsection (d)) based on a period of 60 months. Such amortization deduction shall be an amount, with respect to each month of such period within the taxable year, equal to the amortizable basis at the end of such month divided by the number of months (including the month for which the deduction is computed) remaining in the period. Such amortizable basis at the end of the month shall be computed without regard to the amortization deduction for such month. The amortization deduction provided by this section with respect to any month shall be in lieu of the depreciation deduction with respect to such basis for such month provided by section 167. The 60-month period shall begin, as to any historic structure, at the election of the taxpayer, with the month following the month in which the basis is acquired, or with the suceeding taxable year.

(b) Election of Amortization.—The election of the taxpayer to take the amortization deduction and to begin the 60-month period with the month following the month in which the basis is acquired, or with the taxable year succeeding the taxable year in which such basis is acquired, shall be made by filing with the Secretary, in such manner, in such form, and within such time as the Secretary may by regulations prescribe, a statement of such election.

(c) Termination of Amortization Deduction.—A taxpayer who has elected under subsection (b) to take the amortization deduction provided in subsection (a) may, at any time after making such election, discontinue the amortization deduction with respect to the remainder of the amortization period, such discontinuance to begin as of the beginning of any month specified by the taxpayer in a notice in writing filed with the Secretary before the beginning of such month. The depreciation deduction provided under section 167 shall be allowed, beginning with the first month as to which the amortization deduction does not apply, and the taxpayer shall not be entitled to any further amortization deduction under this section with respect to such certified historic structure.

(d) Definitions.—For purpoes of this section—

. . . .

which allows a taxpayer who has made expenditures in the certified rehabilitation of a certified historic structure[41] to amortize those expenditures over a 60-month (5-year) period. In order to qualify under this section, the expenditures must be such as would otherwise be eligible for the depreciation allowance under I.R.C. section 167; the amortization deductions under this section are to be taken in lieu of the depreciation deductions normally attributable to that portion of the structure's basis represented by the rehabilitation expenditures. Thus, that portion is referred to as the amortizable basis. A certified rehabilitation of a qualifying historic structure is one which has been certified by the Secretary of the Interior "as being consistent with the historic character of such property or the district in which such property is located."[42] There is no minimum or maximum amount of expenditure necessary to qualify as a certified rehabilitation.

The taxpayer must elect to amortize his rehabilitation expenditures under I.R.C. section 191.[43] The taxpayer may begin the 60-month amortization period with the month following the month in which the amortizable basis is acquired or with the succeeding taxable year. The amortization deductions shall be equal with respect to each month in the 5-year period. That portion of the structure's adjusted basis which is not attributable to the rehabilitation expenditures shall be subject to the depreciation deductions allowable under I.R.C. section 167. The taxpayer may discontinue the amortization deductions at any time and revert to the use of section 167 depreciation deductions for the remainder of the amortizable basis. Like all provisions of section 2124, the amortization provi-

(2) **Amortizable Basis.**—The term "amortizable basis" means the portion of the basis attributable to amounts expended in connection with certified rehabilitation.

(3) **Certified Rehabilitation.**—The term "certified rehabilitation" means any rehabilitation of a certified historic structure which the Secretary of the Interior has certified to the Secretary as being consistent with the historic character of such property or the district in which such property is located.

(e) **Depreciation Deduction.**—The depreciation deduction provided by section 167 shall, despite the provisions of subsection (a), be allowed with respect to the portion of the adjusted basis which is not the amortizable basis.

41. *See* notes 25-39 and accompanying text *supra*.

42. New I.R.C. § 191 (d)(3). The regulations covering certification of rehabilitations are set out at 42 Fed. Reg. 54,548 (1977) (to be codified in 36 C.F.R. § 67).

43. Temporary Treasury Department regulations governing the election procedure are set out at 42 Fed. Reg. 18,275-18,276 (1977).

sions have a prescribed effective life;[44] section 191 applies with respect to additions to capital account made after June 14, 1976 and before June 15, 1981.

2. *Accelerated Depreciation of Substantially Rehabilitated Property*

Section 2124 of the TRA also adds a new section 167(o) to the Internal Revenue Code.[45] Under this new section, a taxpayer may compute the depreciation deductions for the entire basis of a "substantially rehabilitated historic property" as though he were the original user of such property. As a result, the taxpayer is entitled to depreciate the property using the accelerated depreciation methods allowable to original users under I.R.C. section 167. Thus, instead of being limited to the straight line depreciation method (or the 125 percent declining balance method for certain used residential rental property), the taxpayer can use the more favorable 150 percent declining balance method (or the 200 percent declining balance method for certain residential rental property).[46] In order to qualify as a "substantially rehabilitated historic property," the certified historic structure[47] must have undergone a cer-

44. Senator Beall created the 5-year termination date in the belief that tax expenditures, like other federal programs, should be periodically reviewed. *See* 122 CONG. REC. S12,708 (daily ed. July 28, 1976) (remarks of Sen. Beall).

45. New I.R.C. § 167(o) provides:

> **(1) General Rule.**—Pursuant to regulations prescribed by the Secretary, the taxpayer may elect to compute the depreciation deduction attributable to substantially rehabilitated historic property as though the original use of such property commenced with him. The election shall be effective with respect to the taxable year referred to in paragraph (2) and all succeeding taxable years.
>
> **(2) Substantially Rehabilitated Property.**—For purposes of paragraph (1), the term "substantially rehabilitated historic property" means any certified historic structure (as defined in section 191(d)(1)) with respect to which the additions to capital account for any certified rehabilitation (as defined in section 191(d)(3)) during the 24-month period ending on the last day of any taxable year, reduced by any amounts allowed or allowable as depreciation or amortization with respect thereto, exceeds [*sic*] the greater of—
>
> (A) the adjusted basis of such property, or
>
> (B) $5,000.
>
> The adjusted basis of the property shall be determined as of the beginning of the first day of such 24-month period, or of the holding period of the property (within the meaning of section 1250(e)), whichever is later.

46. *See* notes 21-23 and accompanying text *supra*. The taxpayer is likewise entitled to utilize other methods of accelerated depreciation consistent with the requirements of I.R.C. § 167(b) and (j).

47. *See* notes 25-39 and accompanying text *supra*.

tified rehabilitation[48] in which the capital expenditures (reduced by any amounts allowed as depreciation or amortization with respect thereto) incurred during the 24-month period ending on the last day of any taxable year exceed the greater of (1) the adjusted basis of the property on the first day of the 24-month period (or of the holding period of the property, whichever is later) or (2) $5,000. Thus, as long as the rehabilitation expenditures meet the minimum amount, the taxpayer may take accelerated depreciation deductions based on the entire adjusted basis of the structure.

Thus, in contrast to the amortization provisions, these provisions authorizing accelerated depreciation call for deductions which apply to the entire adjusted basis of the structure and which extend throughout the structure's remaining useful life. These provisions also require minimum rehabilitation expenditures, and, unlike the amortization provisions, they do not provide for deductions beginning in the month after the additions to the capital account are made. The provisions apply with respect to such additions occurring after June 30, 1976 and before July 1, 1981.

If the taxpayer can qualify for either the amortization or the accelerated depreciation deductions, he must decide which will be more beneficial to him. The amortization provisions may be more attractive to the taxpayer whose adjusted basis in the property is low, since they allow him to write off all his rehabilitation expenditures within five years. By contrast, the accelerated depreciation provisions may be more attractive to the owner of a building with a high adjusted basis, "because as the cost of the building increases in relation to the rehabilitation costs, depreciation becomes a larger factor and amortization a lesser one."[49] Finally, the taxpayer will want to consider the provisions relating to recapture of amortization and depreciation upon disposition of the property, an issue to be dealt with below.

3. *Demolition Costs and Losses*

Besides attempting to stimulate historic rehabilitation directly through the use of the tax incentives outlined above, section 2124 also seeks to eliminate the Code's preference for demolition and replacement as it relates to historic buildings. Prior to the TRA,

48. *See* note 42 and accompanying text *supra*.

49. 121 CONG. REC. 3007 (1975) (analysis by the Advisory Council on Historic Preservation).

the Code encouraged demolition of old buildings by allowing the taxpayer to deduct as current losses the cost of demolition and the remaining undepreciated basis of the demolished building (unless the building had been acquired with a view toward its demolition).[50]

Section 2124 seeks to do away with this encouragement in the case of historic buildings by adding section 280B to the Code.[51] It provides that, in the case of the demolition of a certified historic structure, the above costs and losses must be added to the taxpayer's basis in the land on which the structure stood instead of being currently deducted. Since those amounts cannot even be depreciated as part of the basis of any replacement structure, the taxpayer is effectively prevented from either taking a current deduction or taking future depreciation deductions with respect to them, land being a nondepreciable asset.[52] Thus, the only tax benefit the taxpayer will receive relative to those amounts will be a decreased gain upon subsequent disposition of the property. This postponement of the tax benefit generally makes demolition a much less attractive alternative for the taxpayer. Moreover, instead of serving as deductions against ordinary income, those amounts in many situations will serve only to reduce a gain that would be taxed at less onerous capital gains rates, thereby producing even less benefit to the taxpayer.

Because of the possibility that a taxpayer wishing to demolish a building within an historic district could escape the impact of section 280B simply by failing to seek certification of the building's historic significance to the district (thereby preventing the building

50. I.R.C. § 165(a); Treas. Reg. § 1.165-3 (1977).

51. New I.R.C. § 280B provides:

(a) **General Rule.**—In the case of the demolition of a certified historic structure (as defined in section 191(d)(1))—

(1) no deduction otherwise allowable under this chapter shall be allowed to the owner or lessee of such structure for—

(A) any amount expended for such demolition, or

(B) any loss sustained on account of such demolition; and

(2) amounts described in paragraph (1) shall be treated as properly chargeable to capital account with respect to the land on which the demolished structure was located.

(b) **Special Rule for Registered Historic Districts.**—For purposes of this section, any building or other structure located in a Registered Historic District shall be treated as a certified historic structure unless the Secretary of the Interior has certified, prior to the demolition of such structure, that such structure is not of historic significance to the district.

52. Treas. Reg. § 1.167(a)-2 (1956).

from qualifying as a certified historic structure), the section creates a special rule for "Registered Historic Districts." Under this rule, a building within such a district is presumed to be a certified historic structure for the purposes of section 280B unless the Secretary of the Interior certifies, prior to the demolition of the building, that it is not of historic significance to the district. Thus, the taxpayer's failure to act affirmatively to seek certification will not save him from the limitation imposed by section 280B.

A problem with this special rule is that it refers only to "Registered Historic Districts," thereby creating the same ambiguity as to whether nonfederally designated historic districts are included within the rule's protection.[53] The regulations promulgated by the Department of the Interior interpret the term "Registered Historic District" as applicable to both federally and locally designated districts. This may eliminate the ambiguity.[54] However, the proposed TCA contains a provision which would amend section 280B to make it completely clear that the nonfederally designated district is to be given equivalent protection under the special rule.[55] Such an amendment is desirable to eliminate any possibility of evasion by taxpayers wishing to demolish buildings within nonfederally designated districts. The provisions of section 280B are to apply with respect to demolitions commencing after June 30, 1976 and before January 1, 1981.

4. *Depreciation of Improvements*

Besides eliminating the Code's incentives to demolition, the TRA attempts to eliminate the Code's preference for new construction as it relates to historic building sites. Prior to the TRA, a taxpayer who was the original user of a depreciable structure was entitled to use the very favorable accelerated depreciation methods with regard to that structure.[56] Section 2124 changes this policy with respect to replacements of historic structures by adding a new section 167(n) to the Code.[57] Under this new section, depreciation deductions for

53. *See* notes 29-31 and accompanying text *supra*.

54. *See* 42 Fed. Reg. 54,548, 54,549 (1977) (to be codified in 36 C.F.R. § 67.2(g)).

55. H.R. 6715, 95th Cong., 1st Sess. § 2(f)(5) (1977). This provision also contains a slight language change for new I.R.C. § 280B, further emphasizing the requirement that the taxpayer who wishes to demolish a building within an historic district obtain certification of the building's lack of historic significance before beginning the demolition.

56. *See* notes 21 & 22 and accompanying text *supra*.

57. New I.R.C. § 167(n) provides:

any structure built on a site formerly occupied by a certified historic structure which has been demolished or substantially altered (other than by virtue of a certified rehabilitation) shall be limited to those allowable under the straight line method. Because of the comparatively greater tax benefits accruing from the use of accelerated depreciation,[58] this limitation to straight line depreciation should prove to be a significant factor in reducing the incentive to replace historic buildings with new construction or to alter them substantially without obtaining certification of such rehabilitation.

Unlike the provisions of the TRA relating to demolition costs and losses, the new section 167(n) does not contain a special rule for historic districts. In other words, the taxpayer who wants to demolish a building within an historic district might still be entitled to accelerated depreciation on the replacement structure simply by failing to seek certification of the original building's historic significance to the district (thereby preventing the building from qualifying as a certified historic structure). This loophole would seem to be closed to an extent by Interior Department regulations which permit a State Historic Preservation Officer[59] to request such certifications in lieu of the record owner of the property.[60] However, a more satisfactory solution is proposed by the TCA, which would

(1) **In General.**—In the case of any property in whole or in part constructed, reconstructed, erected, or used on a site which was, on or after June 30, 1976, occupied by a certified historic structure (as defined in section 191(d)(1)) which is demolished or substantially altered (other than by virtue of a certified rehabilitation as defined in section 191(d)(3)) after such date—

(A) subsections (b), (j), (k), and (l) shall not apply,

(B) the term "reasonable allowance" as used in subsection (a) shall mean only an allowance computed under the straight line method.

(2) **Exception.**—The limitations imposed by this subsection shall not apply to personal property.

58. *See* notes 21-24 and accompanying text *supra*.

59. The State Historic Preservation Officers are responsible for administering the National Register program within their jurisdictions. Details as to their functions are set out at 36 C.F.R. § 60.5 (1977).

60. The final regulations promulgated by the Department of the Interior provide in pertinent part:

> Ordinarily, only the record owner of the property in question may apply for the certifications described in §§ 67.4 and 67.6 hereof. However, upon request of a State Historic Preservation Officer, the Secretary [of the Interior] may determine whether or not a particular structure located within a Registered Historic District qualifies as a certified historic structure. The Secretary shall do so, however, only after notifying the property owner of record of the request, informing such owner of the possible tax consequences of such decision, and permitting the property owner to submit written comments to the Secretary prior to decision.

42 Fed. Reg. 54,548, 54,550 (1977) (to be codified in 36 C.F.R. § 67.3(a)).

provide that any building within a federal, state, or local historic district is to be treated as a certified historic structure for the purposes of section 167(n) unless the Secretary of the Interior certifies, before the beginning of any demolition or substantial alteration, that the building is not of historic significance to its district.[61] This amendment is an improvement because it relieves the State Historic Preservation Officers of the burden of seeking certification of threatened buildings within historic districts before the record owners can demolish them. The burden of obtaining the nonhistoric clearance is placed on the owner himself who wishes to retain his accelerated depreciation privileges.

Another problem under section 167(n), as enacted, is that a taxpayer who replaces a building without historic significance to the state or local district in which it is located may nevertheless be deprived of his accelerated depreciation privileges on the replacement structure. Under a technical reading of the TRA, any building within a state or locally designated district can be treated as a certified historic structure even though not certified as historically significant to its district.[62] While the Interior Department regulations apparently contradict such a technical reading,[63] ultimate resolution of this ambiguity may have to await enactment of the TCA with its amendments to section 191(d)'s definition of a certified historic structure.[64]

The provisions of section 167(n) apply to that portion of the basis which is attributable to construction or reconstruction after December 31, 1975 and before January 1, 1981.

5. *Transfers of Partial Interests in Property for Conservation Purposes*

Section 2124(e) of the TRA contains provisions aimed at encouraging the "conservation"-oriented use of both historic and nonhistoric properties. The Act amends section 170(f)(3) of the Internal Revenue Code by increasing the availability of charitable deductions for contributions of partial interests in property. Prior to the TRA, a taxpayer would not have been entitled to a charitable deduction for a contribution to charity (not in trust) of less than the taxpayer's entire interest in the property unless it was a contribu-

61. H.R. 6715, 95th Cong., 1st Sess. § 2(f)(4) (1977).
62. *See* notes 29-31 and accompanying text *supra*.
63. *See* 42 Fed. Reg. 54,548 (1977) (to be codified in 36 C.F.R. § 67).
64. *See* notes 33 & 34 and accompanying text *supra*.

tion of an undivided interest in the property, a contribution which would have been entitled to a charitable deduction if it had been made in trust, or a contribution of a remainder interest in a personal residence or farm.[65]

Under the new section 170(f)(3), the taxpayer is allowed a charitable deduction for a contribution to a charitable organization exclusively for "conservation purposes" of (1) a lease on, option to purchase, or easement with respect to real property of not less than 30 years' duration, or (2) a remainder interest in real property. For the purposes of the section, the term "conservation purposes" means the preservation of land areas for public outdoor recreation or education, or for scenic enjoyment, the preservation of historically important land areas or structures, or the protection of natural environmental systems.[66] Qualified donee organizations include state and local governments (including their landmark preservation commissions), and may include private preservation societies as well.[67]

Insofar as these provisions relate to historic preservation, they are in keeping with the general purposes of the other provisions of section 2124, with certain significant distinctions. First, there is no requirement here that the property in question be a certified historic structure, the category that has governed all the other provisions. Conceivably, the charitable contribution could be an interest in a noncommercial building. It could, moreover, be an interest in an historic site on which no building stands at all. At present, there is no indication as to what standards will be applied to determine the historic qualifications of the properties in question. Prior to the TRA, the Internal Revenue Service showed itself willing to uphold the deductibility of contributions of perpetual open space easements on historic properties that would not meet the requirements of a certified historic structure;[68] it remains to be

65. STAFF OF JOINT COMM. ON TAX., 94TH CONG., 2D SESS., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1976 643 (1976).

66. This broad definition of "conservation purposes" reflects the genesis of the TRA from the general Environmental Protection Tax Act of 1972, which included provisions aimed at encouraging the preservation of coastal wetlands as well as of historic buildings. *See* note 4 *supra*.

67. I.R.C. § 170(b)(1)(A). The private preservation societies might qualify as charitable donees under I.R.C. § 170(c)(2) if they are tax-exempt organizations under I.R.C. § 501(c)(3). *See* Halvorson, *Qualifying as a Section 501(c)(3) Organization*, PRESERVATION NEWS, May 1976, Supplement at 4. Note further the requirement as to the organization's sources of support contained in I.R.C. § 170(b)(1)(A)(vi).

68. *See* Rev. Rul. 75-358, 1975-34 I.R.B. (1975). The Internal Revenue Service

seen whether this liberality will continue under the TRA.

The new provisions should encourage contributions taking the form of a lease, option to purchase, or easement of at least 30 years' duration or of a remainder interest.[69] The contribution would be valued as the fair market value of the partial interest at the time of the contribution.[70] In the case of easements, this is generally measured as the difference in market value between the property encumbered and unencumbered by the easement. The easements could take the form of scenic or facade easements or development rights restrictions.[71] The provisions of section 2124(e) also authorize corresponding charitable deductions under the estate and gift tax laws.

As enacted, the amendments to section 170(f)(3) apply only with respect to contributions made after June 13, 1976 and before June 14, 1977. Thus, the opportunity to make such contributions expired little more than 8 months after the enactment of the TRA. Evidently, this early termination date was due to inadvertence on the part of the drafters, and legislation has been submitted that would make the termination date conform with the other 5-year provisions.[72]

III. Questions on the Technical Implementation of Section 2124

The premise underlying all the provisions of section 2124 is that taxpayers, familiar with the section's implications, will arrange their activities in such a way as to maximize their tax benefits and simul-

there upheld the deductibility of an easement on a mansion which had been designated a state historic landmark, but was neither a National Register property nor within an historic district.

At least one commentator has noted the Service's general support of preservation transactions. *See* Brenneman, *Easements and Their Taxation*, PRESERVATION NEWS, May 1976, Supplement at 3.

69. Wade Greene has written on the role played by tax deductions in charitable giving: "The 'charitable' deduction plays a central role in influencing both the amount and the direction of giving. According to econometric studies made for the Commission on Private Philanthropy and Public Needs, one-third of all giving is generated by the deduction." N.Y. TIMES MAGAZINE, May 23, 1976, at 40.

70. Treas. Reg. § 1.170A-7(c) (1972).

71. For a thorough discussion of the various possible contributions and their ramifications, *see* Comment, *Historic Preservation and the Tax Reform Act of 1976*, 11 U.S.F.L. REV. 453, 479-90 (1977).

72. Senator Mathias has introduced S. 685, 95th Cong., 1st Sess. (1977), which would set the termination date at June 14, 1981. 123 CONG. REC. S2480 (daily ed. February 10, 1977). This proposed amendment is not contained in the TCA.

taneously further the preservation movement. This policy demands, first, that taxpayers know about and feel certain about the Act's provisions and, second, that the provisions are significant enough incentives to affect taxpayers' behavior. As has already been seen through examining the Act's major provisions, many aspects of the TRA as passed are so ambiguous or so structurally unsound that amending legislation was submitted in order to make the Act a more viable preservation-oriented tool. This portion of the article will cover the major remaining questions and problems concerning the operation of the Act.

A. *Issues Relating to Certification Procedures*

In order for section 2124 to be called into play, the Secretary of the Interior must certify the historic qualifications of the properties and rehabilitation projects in question.[73] In the most involved case, this process entails certification of a state or local district-creating statute, the historical significance of a property to its district, and the rehabilitation itself.[74] The certification process is a crucial factor in the effectiveness of section 2124's incentives and disincentives; to the extent that the process engenders delay, uncertainty, expense, and needless complication, the strength of those incentives and disincentives is diminished.

1. *Certification of State or Local Statutes*

The first step towards making the benefits of section 2124 applicable to any non-Register structure is the certification of the state or local statute which created the historic district in which the structure is located. The Department of the Interior has published regulations detailing procedures for certifying statutes that contain criteria "which will substantially achieve the purpose of preserving and rehabilitating buildings of historic significance to the district."[75]

Under these procedures, only a duly authorized representative of the government which enacted the statute can request certification. He does so by preparing an application which includes documenta-

73. *See* notes 26-32 and accompanying text *supra*.

74. If passed in its present form, the TCA would also require that any district created under a certified state or local statute be itself certified as meeting substantially all of the requirements for the listing of districts in the National Register. *See* note 34 *supra*.

75. 42 Fed. Reg. 40,436 (1977) (to be codified in 36 C.F.R. § 67.9).

tion on every district created under the statute, with descriptions, statements of significance, maps, and photographs. The application goes first to the State Historic Preservation Officer who has 45 days to review it and make a recommendation, and then to the Keeper of the National Register who is to review it and the recommendation and make a decision within 45 days. The only objective criterion contained in the regulations is a requirement that the statute "generally must provide for a duly designated review body, such as a review board or commission, with power to review proposed alternatives to structures within the boundaries of the district or districts designated under the statute."[76]

Viewing these procedures from the standpoint of the taxpayer seeking to rehabilitate and to be assured of amortization or accelerated depreciation, one notes the extensive and costly preparation required of the state or local government for this phase of the certification process and also the potential for delay.[77] The temporary regulations do provide that certification of the statute may occur without all the documentation, but they then require that documentation on any particular district designated under the statute be submitted before the Secretary of the Interior will process requests for certification of any individual structures within that district.[78] If taxpayers from several districts within a local or state government's jurisdiction seek eligibility, they are totally dependent upon the government's capacity to produce the requisite documentation in a reasonable time for maximization of their benefits under the Act. Moreover, the regulations are silent on whether the Secretary of the Interior will entertain individual certification requests from taxpayers while their local or state government's certification application is still being considered. Since statute certification may take as long as three months, it does not seem advisable to require taxpayers to await statute certification before submitting individual certification requests. The best hope is that state and local governments will act quickly of their own initiative to obtain certification and, thus, make the provisions of section 2124 as broadly applicable as possible.

76. 42 Fed. Reg. 40,436, 40,437 (1977).

77. The documentation required of a city like New York, which has designated more than 25 districts, would be considerable. *See* note 38 *supra*.

78. This also applies to documentation on additional districts designated under a state or local statute which was certified prior to designation of such districts.

The possibility that the State Historic Preservation Officer (SHPO) may not presently be capable of participating in the certification process prompted the Department of the Interior to provide for an option that would bypass the Officer in the case of certification requests for historical significance or rehabilitation.[79] The same option should be included in the final regulations on statute certification. Finally, the time period for review of the request should be shortened if at all possible.[80]

2. *Certifications of Historic Significance and of Rehabilitation*

The Department of the Interior has published final regulations concerning certification of a structure's historic significance to its district and certification of its rehabilitation.[81] Ordinarily it is only the record owner of the property who can request the certifications. However, the regulations do provide that a SHPO may, in some instances, request certification of an individual structure.[82] If the amortization and depreciation benefits under section 2124 are found to be available to lessees who rehabilitate historic structures,[83] it would be helpful if the regulations would also permit the rehabilitation certification request to be made by the lessee. In the case of long-term lessees, preservation policy may even support regulations permitting requests for certification of the structure's historic significance to come from the lessee as well.

To request certification of the historic significance of a structure, the taxpayer follows the same process of submitting documentation on the structure to the SHPO (unless the Officer indicates his inability to participate in the certification process), who has 45 days to make a recommendation and to forward the materials to the Keeper of the National Register. The Keeper will then obtain a grant or denial of certification from the Secretary of the Interior within 30 days.[84] A structure will be found to contribute to the

79. *See* 42 Fed. Reg. 54,548, 54,549-54,550 (1977) (to be codified in 36 C.F.R. § 67.3(b)).

80. The final regulations on certifications of historic significance cut the review period of the Keeper of the National Register from 45 days, as was first proposed, to 30 days. *Compare* 42 Fed. Reg. 14,123 (1977) *with* 42 Fed. Reg. 54,548, 54,550 (1977) (to be codified in 36 C.F.R. § 67.4(f)).

81. 42 Fed. Reg. 54,548 (1977) (to be codified in 36 C.F.R. § 67).

82. This would most likely occur in the situation where the record holder wanted to demolish the historic property and yet maintain his accelerated depreciation privileges on the replacement structure. *See* note 60 *supra*.

83. *See* note 104 and accompanying text *infra*.

84. *See* note 80 *supra*.

historic significance of the district if it is one which by location, design, setting, materials, workmanship, feeling, and association adds to the district's sense of time, place, and historical development, but not if the integrity of the original design or individual architectural features or spaces have been irretrievably lost. Also, the structure ordinarily must be 50 years old to be eligible.[85]

These procedures covering certification of the structure itself present no problem, with the caveat that they are not clear as to the result if the Secretary of the Interior fails to act on the certification application within 30 days after receiving it from the SHPO. Since certainty and speed are such important factors to the success of the tax incentives, the regulations should more clearly insure adherence to the time schedule by the governmental reviewing officers. A provision calling for automatic approval of the taxpayer's request upon governmental noncompliance with the deadlines is one possible solution.

The procedures for obtaining certification of a rehabilitation are somewhat more complicated. The taxpayer's first step is to submit documentation on the building and the rehabilitation to the SHPO. This documentation, which may be filed before, during, or after the rehabilitation work, must include information on the building's existing condition, a description of the rehabilitation work and its effect on existing architectural features, and photographs and drawings showing existing conditions and the proposed or completed work. Within 45 days, the Officer is to determine whether the project is likely to meet the Secretary of the Interior's "Standards for Rehabilitation" and to forward the materials, along with his recommendation, to the Secretary.[86]

Upon receiving this application, the Secretary of the Interior shall determine, "normally" within 45 days, if the project meets the Standards for Rehabilitation. The determination is merely a preliminary formality; actual certification cannot occur until after completion of the project. If the project does not meet the Standards at this preliminary stage, the Secretary will advise the applicant of any necessary revisions.[87] There is nothing in the regulations which would penalize the Secretary for missing his 45-day

85. 42 Fed. Reg. 54,548, 54,550 (1977) (to be codified in 36 C.F.R. § 67.5).

86. *Id.* at 54,550-54,551 (to be codified in 36 C.F.R. § 67.6). *See also* NATIONAL TRUST FOR HISTORIC PRESERVATION, QUESTIONS AND ANSWERS ON THE HISTORIC PRESERVATION PROVISIONS OF THE TAX REFORM ACT 8 (1977).

87. *Id.*

deadline, or which would provide guidance as to a further timetable for an applicant who has had to revise his project.

The actual Standards for Rehabilitation contain criteria generally aimed at allowing an adaptive use for the property while preserving its historical and architectural integrity and genuineness. The major problem with these Standards is an ambiguity as to whether they are meant to apply to interior as well as to exterior phases of the rehabilitation work.[88] In the interest of furthering section 2124's goal of encouraging economically viable uses of rehabilitated buildings, the regulations should contain a provision which would clearly allow the Secretary of the Interior to determine that a building's interior is not of sufficient historic significance to warrant mandatory compliance with the Standards for Rehabilitation.

Once the project is completed, the taxpayer must notify the SHPO in writing of the completion date and of the taxpayer's belief that the completed project is consistent with the Standards for Rehabilitation. The SHPO may also require photographs and other documentation to be submitted.[89] The regulations provide that a representative of the Secretary of the Interior may make, "normally" within 30 days, an on-site inspection of the completed project. However, the Secretary of the Interior reserves the right to make such an inspection "at any time" after the completion of the rehabilitation and to withdraw the certification of any rehabilitation found not to meet the Secretary's Standards.[90] This last provision seems unnecessarily harsh, creating uncertainty for the taxpayer who seeks only to commence amortization or accelerated depreciation at the earliest possible date.

Whether or not inspection occurs, the SHPO must forward his recommendation to the Secretary of the Interior within 30 days after receiving the documentation. The Secretary will then decide "normally" within 15 days, whether to grant or deny certification. Again, the regulations contain no provision which gives the Secretary any incentive to conform to the deadline.[91]

The actual timing of these certification requests is also problematical. The regulations allow the taxpayer to file simultaneous requests for certification of a structure's historic significance and of the rehabilitation project. However, the regulations forbid the Sec-

88. 42 Fed. Reg. 54,548, 54,551-54,552 (1977) (to be codified in 36 C.F.R. § 67.7).
89. *See* note 86 *supra*.
90. *Id.*
91. *Id.*

retary to make any determination as to whether a rehabilitation project is consistent with the Standards for Rehabilitation before the structure itself has been certified, unless the taxpayer has requested such certification and has obtained confirmation from the SHPO that either the structure or its district appears to meet National Register Criteria for Evaluation and will likely be nominated to the National Register.[92] This section of the regulations is intended to allow preliminary approval of rehabilitation projects for buildings which could only qualify as certified historic structures if they succeed in becoming National Register properties. However, the wording of the section has the unhappy result of preventing preliminary approval of rehabilitation projects for structures which already fall within the category of state or locally designated districts but are merely in the process of being certified themselves. The regulations should be amended to provide that owners of buildings which already fall within one of the categories of possible certified historic structures should have an equal right to obtain preliminary approval (and, if necessary, suggestions for revisions) of their rehabilitation projects as owners who are at the stage of seeking to render their structures certifiable through National Register listing.

In summary, the regulations could better serve to minimize uncertainty and delay if they allowed contemporaneous filing of the various certification requests to the greatest extent practicable and if they contained incentives to encourage government officials to conform to the deadlines. Lessees should be allowed to file certification requests if they are the truly interested parties. The treatment of interior rehabilitation should be more clearly specified. Finally, the provision in the regulations that certifications made by the Secretary of the Interior are not to be binding upon the Internal Revenue Service with respect to tax consequences should not be allowed to endanger the finality of any determinations made by the Secretary as to the historic quality of any structure or rehabilitation.[93]

B. *Recapture of Amortization and Depreciation*

The Internal Revenue Code contains provisions which are designed to recapture from the taxpayer the tax benefit he has re-

92. *Id.*
93. 42 Fed. Reg. 54,548, 54,549 (1977) (to be codified in 36 C.F.R. § 67.1).

ceived through depreciation and amortization deductions which have exceeded the actual economic depreciation of his property. In other words, when a taxpayer sells or otherwise disposes at a profit of property on which he has taken depreciation or amortization deductions, I.R.C. sections 1245 and 1250 require the taxpayer to treat some or all of the gain as ordinary income. This same policy applies to the recapture of the amortization and accelerated depreciation deductions allowable to rehabilitated certified historic structures under TRA section 2124. However, the recapture rules in instances where section 2124 applies are problematical.

Section 2124 amends the Code to provide that amortization deductions taken pursuant to I.R.C. section 191 will be recaptured from the taxpayer selling at a gain according to the rules of I.R.C. section 1245. Section 1245 is the harsher of the two recapture provisions. In effect, it requires the taxpayer to treat all of that portion of the gain attributable to the amortization deductions as ordinary income, instead of being taxed at the more favorable capital gains rates. This requirement effectively wipes out the rate conversion element of the tax shelter created by the amortization allowances.[94]

By contrast, recapture of the accelerated depreciation deductions allowable under section 2124 is to follow the rules under I.R.C. section 1250. Generally, under those rules, only that portion of the taxpayer's gain which reflects the extent to which the accelerated depreciation deductions exceeded the straight line depreciation deductions otherwise allowable is treated as ordinary income.[95] The remainder of the gain, including the portion that would reflect straight line depreciation, had that been the method used, is taxed at the lower capital gains rates.

Because of the current distinction between the methods of recapturing amortization and accelerated depreciation on the sale or other disposition of a rehabilitated certified historic structure, the Code makes the accelerated depreciation provisions much more attractive than the amortization alternative for the taxpayer who could qualify for either. This situation severely diminishes the tax benefit to be derived from the amortization election, consequently reducing to a significant degree the effectiveness of the incentive to rehabilitate. The legislative history of section 2124 indicates that it

94. *See* text accompanying note 24 *supra*.

95. Even under I.R.C. § 1250, that much of the gain which represents the entire amount of depreciation taken, whether straight line or accelerated, shall be taxed as ordinary income if the taxpayer held the property for less than one year.

was not the intent of the drafters to make the amortization deductions subject to the harsher recapture treatment of I.R.C. section 1245, a treatment which is generally applied only to depreciable personal property and rarely to realty.[96]

The TCA proposes an amendment to the Code which would make the amortization deductions allowable under I.R.C. section 191 subject to the less harsh recapture rules under I.R.C. section 1250.[97] Thus, under the proposed legislation, recapture would be limited to the excess of the amortization deductions claimed over the otherwise allowable straight line depreciation computed on the basis of the actual useful life of the improvements.[98] Enactment of this amendment is crucial to the full effectiveness of the amortization election under I.R.C. section 191 as a preservation-furthering device.

C. *Combined Amortization and Accelerated Depreciation on a Single Structure*

Section 2124, as enacted, creates an ambiguity as to whether a taxpayer who qualifies for either the amortization deductions under I.R.C. section 191 or the accelerated depreciation deductions under I.R.C. section 167(o) can combine the use of those two sections on a single structure. In other words, can a taxpayer amortize his rehabilitation expenditures over 5 years and, based on the same substantial rehabilitation, also take accelerated depreciation deductions on the remainder of the structure's basis over the structure's useful life? The ambiguity arises from an apparent conflict between

96. Senator Beall, who introduced the historic preservation tax reforms, described the amortization section as providing that "on the disposition of a certified historic structure, gain would be treated as ordinary income to the extent that the special writeoff provided under this section exceeded the depreciation deduction which would have otherwise been allowable, without regard to this provision." 122 CONG. REC. S12707 (daily ed. July 28, 1976) (remarks of Sen. Beall). *See also,* H.R. REP. NO. 1515, 94th Cong., 2d Sess. 399, 505, *reprinted in* [1976] U.S. CODE CONG. & AD. NEWS 4118, 4208. The only indication of any intent to the contrary is contained in a report by the Joint Committee on Taxation: "Amortization is to be recaptured as ordinary income on a sale of the property." STAFF OF JOINT COMM. ON TAX., 94TH CONG., 2D SESS., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1976 644 (1976).

97. H.R. 6715, 95th Cong., 1st Sess. § 2(f)(3) (1977).

98. It should be noted that, regardless of the recapture provisions applied, the excess of the accelerated depreciation or amortization deductions over the otherwise allowable straight line depreciation for any taxable year is an item of tax preference under I.R.C. § 57(a) and therefore subject to the minimum tax provisions.

the wording of the newly enacted I.R.C. section 191(e),[99] which seems to favor such combined use, and a statement made in a report by the Joint Committee on Taxation expressly prohibiting such a practice.[100]

Once again, the TCA provides a solution to the ambiguity. That bill contains an amendment to section 167(o) which would make it clear that a taxpayer could not take accelerated depreciation on a substantially rehabilitated historic structure if he had previously been allowed an amortization deduction on that structure.[101] The bill, however, goes too far. As presently worded, it would go beyond prohibiting the combined use of amortization and accelerated depreciation with respect to the same substantial rehabilitation and would prevent a taxpayer from ever being able to take accelerated depreciation on a structure once he had taken an amortization deduction with respect to it, even if the substantial rehabilitation giving rise to the accelerated depreciation deduction was distinct from the rehabilitation which gave rise to the amortization deduction.[102] The proposed amendment should be reworded to provide only that accelerated depreciation and amortization may not be elected for a single structure with respect to the same substantial rehabilitation.[103]

99. New I.R.C. § 191(e) provides: "The depreciation deduction provided by section 167 shall, despite the provisions of subsection (a), be allowed with respect to the portion of the adjusted basis which is not the amortizable basis." Because accelerated depreciation of substantially rehabilitated historic structures was provided for under new I.R.C. § 167(o), this provision could be interpreted as authorizing a combined use.

100. *See* STAFF OF JOINT COMM. ON TAX, 94th CONG., 2D SESS., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1976 at 644 (1976): "A taxpayer cannot elect 5-year amortization with respect to certain components of a structure and accelerated depreciation with respect to others."

101. H.R. 6715, 95th Cong., 1st Sess. § 2(f)(6) (1977).

102. New I.R.C. § 191(c) contains a similar weakness. It provides that a taxpayer who has once discontinued the amortization deductions "shall not be entitled to any further amortization deduction under this section with respect to such certified historic structure." The section fails to take into account the taxpayer who undertakes a series of certified rehabilitations of a single structure, and who is presently discouraged from exercising his right to discontinue the use of amortization before 5 years have elapsed for fear of permanently losing his right to elect amortization deductions with respect to that structure.

103. One commentator has raised the question of whether a taxpayer who rehabilitates an historic structure for use as rental housing for low-income families (as defined by I.R.C. § 167(k)) could combine the 5-year amortization allowance of § 167(k) with the accelerated depreciation provisions of new § 167(o). *See* Hessel, *Tax Incentives for Preservation and Rehabilitation of Historic Properties*, 5 J. REAL EST.

D. *Lessees and the TRA*

One final issue under the TRA is whether lessees who wish to undertake certified rehabilitations will be eligible for the tax benefits created by section 2124. Section 191(f) of the Internal Revenue Code specifically allows life tenants to take amortization deductions, and the regulations clearly authorize record owners of historic properties to benefit under the Act. Nowhere, however, is there any provision made for those who hold less than a life interest in the property.

Treasury Regulations section 1.167(a)-4 suggest that a lessee may recover capital expenditures for permanent improvements to leased property through allowances for depreciation or amortization. The Internal Revenue Service, however, has taken the tentative position that lessees are not eligible for any of the historic preservation tax benefits under the TRA.[104] This position seems to be contrary to standard practice and inadvisable for policy reasons. The federal tax laws are capable of encouraging the rehabilitation of innumerable historic buildings owned by governments or other tax-exempt organizations only if lessees of such buildings are allowed to take advantage of the Act's benefits. Any concern for protecting the rights of the record owner reluctant to have his building designated historically significant can be met by giving him a voice in or control over the certification process.

IV. Conclusion

It is clear that certain tax and other considerations may render the TRA less effective than was originally intended. All the technical problems and open issues outlined above have the effect of making the Act's benefits less certain or less attractive, thereby diminishing the potential incentives for preservation. Other provisions of the TRA which have the effect of dealing more harshly with tax preference items may also serve to reduce the impact of

TAX. 5, 17 1977). In light of the particular fear that historic preservation can often have the effect of dislocating less affluent prior residents of the rehabilitated neighborhood, *see* note 12 *supra*. policy-makers may wish to consider whether the taxpayer who undertakes to both rehabilitate and provide low-income rental housing might not deserve the double reward of § 167(k) amortization combined with new § 167(o) accelerated depreciation.

104. National Trust for Historic Preservation, Questions and Answers on the Historic Preservation Provisions of the Tax Reform Act 7 (1977).

section 2124 on real estate investment.[105] Moreover, the administrative demands of the Act's implementation will probably require a Congressional appropriation to keep up a smooth operation.

Factors outside the direct sphere of the Act's tax reforms will also have a considerable impact on the success of preservation efforts. As innumerable commentators have noted, local property tax systems that immediately impose higher assessments on the rehabilitating taxpayer can have the effect of wiping out or severely reducing the economic benefit to be derived from rehabilitation.[106] The high costs of maintaining old buildings continue.[107] Rehabilitating neighborhoods without dislocating the less affluent residents also remains a problem.[108] Proper rehabilitations demand skill, yet there is a shortage of architects and technicians well trained in restoration techniques.[109] Furthermore, there is a need for preliminary funding at the planning end of local projects, without which desired rehabilitation may never even get off the ground.[110]

Finally, there is the question of whether a program of direct federal expenditures may not make more sense than tax incentives. The peculiarities of the tax approach are such that owners of nondepreciable property and tax-exempt owners, including many preservation societies, are left totally unaffected by the benefits of the TRA. Moreover, because of the very nature of amortization and depreciation deductions, the benefits available under the Act are potentially much more valuable to upper bracket taxpayers than to those in the lower brackets. It is also possible that states which have expressed a willingness to match federal preservation grants may be less inclined to react to less visible tax incentives.[111] On the other hand, the overwhelming fact remains that the otherwise sluggish federal expenditures for rehabilitation will have doubled by 1981 as a result of the tax incentives created by section 2124.[112]

105. For a thorough discussion of those issues, *see* Comment, *Historic Preservation and the Tax Reform Act of 1976*, 11 U.S. L. REV. 453, 500-09 (1977).

106. *See, e.g.*, WITH HERITAGE SO RICH, *supra* note 4, at 210.

107. *See* Caplin, *Federal Tax Policy as Incentive for Preservation*, PRESERVATION NEWS (May, 1976), Supplement at 1.

108. *See* notes 12 & 103 *supra*.

109. *See* ACHP Report, *supra* note 18, at 14.

110. Boasberg, *supra* note 17, at 87.

111. *See, e.g.*, ACHP Report, *supra* note 18, at 15.

112. It has been estimated that the provisions of § 2124 will result in a federal tax revenue loss of $1 million in fiscal 1977, $3 million in fiscal 1978, and $16 million in

The Tax Reform Act of 1976 is undoubtedly a step in the right direction as far as this country's historic preservation movement is concerned. Its full impact, however, will have to await enactment of amending legislation aimed at clearing up the several weaknesses which now significantly hamper its effectiveness. However, the tax reforms, welcome as they may be, should not be looked upon as a conclusive victory; the need to preserve our national heritage and to revitalize our urban communities will demand ever more innovative measures.

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fiscal 1981. These tax expenditures would supplement direct federal expenditures for preservation which totalled between $10 million and $15 million according to one estimate for fiscal year 1875. *See* Boasberg, *supra* note 17, at 81.