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Community Developments

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Fact Sheet

Historic Tax Credits

Community Developments Fact Sheets are designed to share information about programs and initiatives of bankers and community development practitioners. These fact sheets differ from OCC bulletins and regulations in that they do not reflect agency policy and should not be considered regulatory or supervisory guidance. Some of the information used in the preparation of this fact sheet was obtained from publicly available sources. These sources are considered reliable and current, as of October 2019, but the use of this information does not constitute an endorsement of its accuracy by the OCC. This fact sheet does not constitute tax or legal advice. Banks should consult their own tax advisors about the tax treatments and consequences that may apply to their transactions.

This *Community Developments Fact Sheet* summarizes certain aspects of the Historic Tax Credit (HTC) program for national banks and federal savings associations (collectively, banks) and explains how HTCs may be used to support a bank's affordable housing and community development strategies.

What Is the Historic Tax Credit?

The HTC[1] encourages private sector investment in the rehabilitation and reuse of historic buildings.

The HTC program is formally known as the Federal Historic Preservation Tax Incentives Program. The HTC program is administered by the National Park Service and the Internal Revenue Service (IRS), in partnership with State Historic Preservation Offices (SHPO) located in each state, the District of Columbia, and the U.S. territories. The HTC program is designed to encourage the rehabilitation of certified historic buildings (those listed on the National Register of Historic Places or architecturally contributing to a National Register district) through the provision of tax credits equal to 20 percent of qualified rehabilitation expenditures (QRE).[2]

Since its inception in 1977, the HTC program has facilitated the rehabilitation of over 44,000 certified historic buildings and has attracted more than $96 billion in new private capital to the historic cores of cities and towns across the nation. These funds have enhanced property values; created jobs; generated local, state, and federal tax revenues; and revitalized communities in need of economic development.

[1] Refer to [26 USC 47] and [26 CFR 1.48-12]

[2] 26 USC 47 also previously provided for a 10 percent tax credit for the rehabilitation of non-historic, older (pre-1936) nonresidential properties. The 10 percent tax credit was eliminated by the Tax Cuts and Jobs Act. Refer to Pub. L. 115-97, 131 Stat. 2134-35.

How Does the HTC Program Work?

Property owners complete the three-part application process for historic preservation certification managed by the National Park Service and the relevant SHPO.

Typically, if developers of qualified rehabilitation projects are not in a position to use the tax credits, they will offer the credits to third parties, including banks, to raise the equity funding for a project and thereby reduce the amount of debt financing needed for property rehabilitation.

HTCs have been used in qualified rehabilitation projects that are also financed using new markets tax credits or low-income housing tax credits.[3]

Legal Authority

Under the powers granted by the National Bank Act, national banks have the authority to provide financing to HTC projects in return for the tax credits associated with the project.

National banks may make investments designed primarily to promote the public welfare (such as by providing housing, services, or jobs), including the welfare of low- and moderate-income (LMI) communities or families, under 12 USC 24(Eleventh) and its implementing regulation, 12 CFR 24. A national bank may provide equity financing for a historic property rehabilitation project by taking an ownership interest in an entity that holds such property for rehabilitation if the investment primarily promotes the public welfare, consistent with 12 CFR 24.3.[4] In addition, the investment must not expose the national bank to unlimited liability.[5] National banks seeking to provide financing to an HTC project under 12 CFR 24 must either request prior OCC approval or submit an after-the-fact notice to the OCC, depending on, among other factors, the national bank's capitalization and composite rating, its Community Reinvestment Act (CRA) performance, the nature of the project financing, and whether the national bank's aggregate public welfare investments under 12 CFR 24 exceed 5 percent of its capital and surplus.[6] In no event may a national bank's aggregate public welfare investments exceed 15 percent of its capital and surplus.[7]

Alternatively, depending on the specifics of the transaction, a national bank may finance an HTC project and be eligible to receive the federal HTCs by acquiring an interest in an entity, such as a fund that invests in properties eligible for the HTC, under 12 USC 24(Seventh). The substance of the transaction must remain the provision of financing for the rehabilitation of historic property.[8]

Federal savings associations (FSA) may make a public welfare investment in an

[3] Novogradac & Co. LLP, Brad Stanhope, "NMTC-HTC Twinning Back After HBH Slowdown" (December 5, 2017); HUD Exchange, "Using the Historic Tax Credit for Affordable Housing."

[4] Under 12 CFR 24.3, a national bank or national bank subsidiary may make an investment directly or indirectly if the investment primarily benefits LMI individuals, LMI areas, or other areas targeted by a governmental entity for redevelopment, or the investment would receive consideration as a qualified investment under 12 CFR 25.23.

[5] Refer to 12 CFR 24.4(b).

[6] Refer to 12 CFR 24.5.

[7] Refer to 12 CFR 24.4(a).

[8] Refer to OCC Corporate Decision No. 99-07.

entity that receives HTCs under several investment authorities, including

- community development-related equity investments in real estate pursuant to section 5(c)(3)(A) of the Home Owners' Loan Act.
- investments in service corporations for community development pursuant to 12 CFR 5.59.
- de minimis investments, generally equal to or less than the greater of 1 percent of capital or $250,000, pursuant to 12 CFR 160.36.

For more information on the FSA public welfare investment authorities, including permitted activities, consult the OCC's Federal Savings Association Investment Authorities web page.

Under these authorities, banks acquire an interest in an entity that holds the properties for rehabilitation, typically a limited partnership or limited liability company. Using this structure, banks provide the funding for HTC projects in return for the associated tax incentives.

How Are Tax Credits Calculated?

To qualify for HTCs, a building must be depreciable, so it must be income producing or used in a trade or business. In addition, a substantial amount must be spent rehabilitating the historic building, meaning that the cost of rehabilitation must exceed the pre-rehabilitation basis in the building.[9]

QREs are the development expenses on which HTCs can be claimed. Examples of QREs include the costs related to the repair or replacement of walls, floors, ceilings, windows, doors, air conditioning/heating systems, kitchen cabinets and appliances, plumbing and electrical fixtures, architects' fees, construction loan interest, and environmental reports. The dollar value of tax credits is calculated by multiplying the value of the QREs by the 20 percent HTC rate.

How Can HTCs Benefit a Bank?

Banks participate in the program for a number of reasons. Among them, banks may

- earn an attractive rate of return, when properly managed.
- receive CRA consideration as discussed in this fact sheet and clarified in the "Interagency Questions and Answers Regarding Community Reinvestment."
- combine HTC investments with other bank financing for the same project, such as bridge, construction, or permanent loans.
- diversify existing bank products for rehabilitating retail, office, and institutional properties in historic communities, many of which are located in LMI geographies, designated disaster areas, or designated distressed or underserved non-metropolitan, middle-income geographies.

Community Reinvestment Act

Some loans to or investments in projects that receive HTCs may also meet the definition of community development in the CRA regulations and, therefore, may receive CRA consideration. Community development includes affordable housing (including multifamily rental housing) for LMI individuals, community services targeted to LMI individuals, and activities that promote economic development by financing small

[9] Refer to National Park Service, Eligibility Requirements.

businesses and small farms.[10] Activities that finance such small businesses and small farms are considered to promote economic development when, for example, they support permanent job creation, retention, or improvement for LMI individuals, in LMI areas, or in areas targeted for redevelopment by federal, state, local, or tribal governments. Community development also includes activities that revitalize or stabilize LMI geographies, designated disaster areas, or designated distressed or underserved non-metropolitan, middle-income geographies.[11]

Banks that finance or invest in HTC projects located within the bank's assessment area(s) may receive CRA consideration, to the extent that the activities meet the definition of community development. In addition, financing or investing in HTC projects located in the broader statewide or regional area that includes the bank's assessment area(s) and that meet the definition of community development may also be eligible for consideration. Examiners consider these activities even if the activities do not benefit the bank's assessment area(s), as long as the bank has been responsive to community development needs and opportunities in its assessment area(s).

What Are the Risks to Banks?

When HTC transactions are established as partnerships or limited liability companies, the structure determines whether the partners or members may receive the tax credits. The IRS issued guidance on HTCs in Revenue Procedure 2014-12, which establishes a safe harbor for investors in HTCs. If HTC transactions are structured in accordance with Revenue Procedure 2014-12, the IRS will respect the allocation of tax credits to the investors. Banks considering an investment in HTCs should become familiar with this IRS procedure because it affects how current HTC transactions are structured to mitigate the potential for HTC disallowance.

In the year a qualified property is "placed in service," the owner of the qualified rehabilitated historic building is eligible to begin receiving the tax credits. The credits are earned ratably over a five-year period, or 20 percent per year.[12]

A participating bank risks the potential recapture of the credit by the IRS if there is a transfer of ownership of the historic property during the five-year period (including a transfer triggered by foreclosure).[13] Banks, as limited partners or members of limited liability companies'

[10] For purposes of the CRA, small businesses or small farms are those that have gross annual revenues of $1 million or less or that meet the size eligibility requirements of the U.S. Small Business Administration's Small Business Development Company or Small Business Investment Company programs.

[11] Refer to 12 CFR 25.12(g)(4) (national banks) and 12 CFR 195.12(g)(4) (FSAs); "Community Reinvestment Act; Interagency Questions and Answers Regarding Community Reinvestment; Guidance," 81 Fed. Reg. 48506 and 48527-28 (Q&A § __.12(g)(4)(i) – (ii)) (July 25, 2016).

[12] The Tax Cuts and Jobs Act includes a transition rule relating to qualified rehabilitation expenditures that allows a taxpayer to use the prior law to claim 100 percent of the tax credits in the year in which the building is placed in service if (1) the taxpayer owned or leased by the taxpayer during the entirety of the period after December 31, 2017; and (2) the 24- or 60-month period selected by the taxpayer begins not later than June 20, 2018. Refer to Pub. L. 115-97, 131 Stat. 2054, 2134-35, Sec. 13402(c)(2).

[13] Other events may also trigger recapture. Refer to IRS Brief, Mark Primoli, "Rehabilitation Tax Credit Recapture."

subsidiaries, must retain ownership of the property for a five-year compliance period following the year the property is placed in service to avoid tax credit recapture. Once the five-year compliance period is over, the IRS cannot recapture the tax credit and a bank is free to exercise its right to divest its interest in the partnership.

In addition to recapture risk, a bank should consider the strategic (tax planning) and compliance risks associated with any tax credit investment and the reputation risks of investing in a high-profile community project that could fail.

Resources

Office of the Comptroller of the Currency

- *Community Developments Insights*, "Historic Tax Credits: Bringing New Life to Older Communities"
- Community Affairs Historic Tax Credit Resource Directory
- OCC Community Affairs Contacts
- Public Welfare Investments Resource Directory (national banks)
- OCC Corporate Decision 99-07 (national banks)
- Federal Savings Association Investment Authorities

HTC Program Information—Other Agencies

- Internal Revenue Service: Revenue Procedure 2014-12
- National Park Service, U.S. Department of the Interior
- National Conference of State Historic Preservation Officers
- National Trust for Historic Preservation
- Historic Tax Credit Coalition