

# Using Minnesota and Federal Historic Preservation Laws in Your Development Practice

---

**Steven B. Mayeron**  
Stinson Leonard Street LLP  
Minneapolis

**Matthew B. Seltzer**  
Attorney at Law  
Minneapolis

## Minnesota CLE's Copyright Policy

Minnesota Continuing Legal Education wants practitioners to make the best use of these written materials but must also protect its copyright. If you wish to copy and use our CLE materials, you must first obtain permission from Minnesota CLE. Call us at 800-759-8840 or 651-227-8266 for more information. If you have any questions about our policy or want permission to make copies, do not hesitate to contact Minnesota CLE.

All authorized copies must reflect Minnesota CLE's notice of copyright.

### MINNESOTA CLE is Self-Supporting

A not for profit 501(c)3 corporation, Minnesota CLE is entirely self-supporting. It receives no subsidy from State Bar dues or from any other source. The only source of support is revenue from enrollment fees that registrants pay to attend Minnesota CLE programs and from amounts paid for Minnesota CLE books, supplements and digital products.

---

© Copyright 2017

MINNESOTA CONTINUING LEGAL EDUCATION, INC.

ALL RIGHTS RESERVED

---

Minnesota Continuing Legal Education's publications and programs are intended to provide current and accurate information about the subject matter covered and are designed to help attorneys maintain their professional competence. Publications are distributed and oral programs presented with the understanding that Minnesota CLE does not render any legal, accounting or other professional advice. Attorneys using Minnesota CLE publications or orally conveyed information in dealing with a specific client's or other legal matter should also research original and fully quoted sources of authority.

# Using Minnesota and Federal Historic Preservation

## Laws in Your Development Practice

By

Steven B. Mayeron and Matthew B. Seltzer

### I. Introduction

There are a variety of federal, state, and local laws that protect and provide incentives for the rehabilitation of historic resources.

While these laws may restrict or condition development of a historic property, they may also provide very real and valuable financial benefits for a developer.

This session will provide an overview of some of the major historic preservation laws and potential implications of these laws for real estate development.

The first part of the session will be devoted to a consideration the primary laws for the designation and regulation of historic properties under federal, Minnesota, and local law. The second part of session will review the law of historic rehabilitation tax credits under federal and Minnesota law.

Key takeaways:

- The mere listing of a property on the National Register of Historic Places does not result in regulation of the property.
- Nonetheless, National Register standards and concepts are used for a number of other federal, state, and local programs that can result in regulation of a property or the provision of valuable benefits such as tax federal and state tax credits.
- Relatively modern buildings that do not appear to be “historic” may qualify for listing and subject to regulation or eligible for benefits.
- Any one property may be listed at either the federal, state, or local level, or on multiple levels.
- In Minnesota, the most significant direct regulation of properties occurs at the local level.
- The Minneapolis heritage preservation program is an example of a local program with strong regulatory requirements that may pose a challenge for real estate development.
- The Minnesota Environmental Rights Act (“MERA”) provides broad protection for historic resources, including properties that have not been listed on federal, state, or local registers.
- Suits to prevent the demolition of historic buildings are typically brought under MERA.
- Federal and state tax credits may provide very significant benefits for qualifying rehabilitation projects.

- However, compliance with tax credit requirements can be time consuming and expensive. This often makes tax credits most appropriate for medium and large projects.

## II. Designation of Historic Properties and Regulatory Controls

### A. National Register of Historic Places

#### 1. Overview

Congress created the National Register in the National Historic Preservation Act of 1966, *codified as amended at 54 U.S.C. § 300101 et seq.* The National Register is a listing of properties deemed “significant in American history, architecture, archaeology, and culture.” A variety of properties may be listed on the National Register, including districts, sites, buildings, structures and objects.” 54 U.S.C. § 300308.

The National Park Service administers the National Register at the federal level. However, state and tribal historic preservation offices play a key role recommending properties for inclusion on the National Register and the operation of the program.

Since the inception of the National Register program in Minnesota, the State Historic Preservation Office (“SHPO”) has been housed in the Minnesota Historical Society. As a result of legislation passed in 2017, SHPO will move to the Minnesota Department of Administration effective March 1, 2018. *See* 2017 Minn. Laws, First Spec. Sess., ch. 4, art. 2, §§ 29-31.

According to the National Park Service, there are 92,375 total listings on the National Register. *See* National Park Service, “National Register of Historic Places, <https://www.nps.gov/nr/>. There are more than 1,500 listed properties in Minnesota. Minnesota Historical Society, <http://www.mnhs.org/nrhp>.

Private property may not be listed on the National Register over the objection of the property owner or the majority of the owners in the case of a district. 54 U.S.C. § 302105(b0)

Properties must usually be at least fifty years old to be listed on the National Register, but there are exceptions to this requirement that may result in particularly significant buildings that are less than 50 years old being listed.

The listing of a property on the National Register does not result in any direct regulation of what the property owner may do with the property. However, as discussed below, listing may have a number of other impacts, including potential eligibility for tax credits and requirements for special review of federal actions affecting the property.

#### 2. Significance

The National Park Service regulations for the National Register, 36 C.F.R. § 60.4, provide the following criteria for significance:

*National Register criteria for evaluation.* The quality of significance in American history, architecture, archeology, engineering, and culture is present in districts, sites, buildings, structures, and objects that possess integrity of location, design, setting, materials, workmanship, feeling, and association and:

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

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

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

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

Additionally, the National Park Service regulations, 36 C.F.R. § 60.4, provide the following considerations for a determination of significance, including the 50 year factor:

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

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

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

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

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

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

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

(g) A property achieving significance within the past 50 years if it is of exceptional importance. This exception is described further in NPS “How To” #2, entitled “How to Evaluate and Nominate Potential National Register Properties That Have Achieved Significance Within the Last 50 Years” which is available from the National Register of Historic Places Division, National Park Service, United States Department of the Interior, Washington, D.C. 20240.

### 3. Integrity

According to the National Park Service, “[i]ntegrity is the ability of a property to convey its significance.” There are seven factors that bear upon the integrity of a property:

#### a. Location

Location is the place where the historic property was constructed or the place where the historic event occurred.... Except in rare cases, the relationship between a property and its historic associations is destroyed if the property is moved....

#### b. Design

Design is the combination of elements that create the form, plan, space, structure, and style of a property. It results from conscious decisions made during the original conception and planning of a property (or its significant alteration) and applies to activities as diverse as community planning, engineering, architecture, and landscape architecture. Design includes such elements as organization of space, proportion, scale, technology, ornamentation, and materials....

#### c. Setting

Setting is the physical environment of a historic property. Whereas location refers to the specific place where a property was built or an event occurred, setting refers to the character of the place in which the property played its historical role. It involves how, not just where, the property is situated and its relationship to surrounding features and open space....

#### d. Materials

Materials are the physical elements that were combined or deposited during a particular period of time and in a particular pattern or configuration to form a historic property.... A property must retain the key exterior materials dating from the period of its historic significance. If the property has been rehabilitated, the historic materials and significant features must have been preserved. The property must also be an actual

historic resource, not a recreation; a recent structure fabricated to look historic is not eligible. Likewise, a property whose historic features and materials have been lost and then reconstructed is usually not eligible....

e. Workmanship

Workmanship is the physical evidence of the crafts of a particular culture or people during any given period in history or prehistory....

f. Feeling

Feeling is a property's expression of the aesthetic or historic sense of a particular period of time. It results from the presence of physical features that, taken together, convey the property's historic character....

g. Association

Association is the direct link between an important historic event or person and a historic property. A property retains association if it is the place where the event or activity occurred and is sufficiently intact to convey that relationship to an observer....

National Park Service, "How to Apply the National Register Criteria for Evaluation," National Register Bulletin (1990, as revised), *available online at* <https://www.nps.gov/nr/publications/bulletins/nrb15/INDEX.htm>.

4. Listing Process

The National Park Service describes the basic steps in the process as follows:

- Nominations can be submitted to your SHPO from property owners, historical societies, preservation organizations, governmental agencies, and other individuals or groups....
- The SHPO notifies affected property owners and local governments and solicits public comment. If the owner (or a majority of owners for a district nomination) objects, the property cannot be listed but may be forwarded to the National Park Service for a Determination of Eligibility (DOE).
- Proposed nominations are reviewed by your state's historic preservation office and the state's National Register Review Board. The length of the state process varies but will take a minimum of 90 days.
- Complete nominations, with certifying recommendations, are submitted by the state to the National Park Service in Washington, D.C. for final review and listing by the Keeper of the National Register of Historic Places. The National Park Service makes a listing decision within 45 days.

\*Note: National Register nominations of Tribal properties start with the Tribal Historic Preservation Officer. National Register nominations of federal properties start with the agency's Federal Preservation Officer.

National Park Service, National Register of Historic Places Program: Fundamentals, [https://www.nps.gov/nr/national\\_register\\_fundamentals.htm](https://www.nps.gov/nr/national_register_fundamentals.htm).

## 5. Consequences of Listing

Listing on the National Register does not directly regulate a property. However, there are a number of consequences that may be of significance to the owner.

Listed properties may be eligible for a 20% federal tax credit and a 20% Minnesota tax credit for qualifying rehabilitation projects (see below).

Under Section 106 of the National Historic Preservation Act, 54 U.S.C. § 306108, federal agencies are required to consider the effects of their actions on properties listed on or eligible for the National Register. This may be particularly significant if the owner of a listed or eligible property seeks a federal permit or financial assistance affecting the project. *See generally* 36 C.F.R. Part 800 (regulations for Section 106 review).

Chapter 138 of Minnesota Statutes requires the state and political subdivisions to consult with the State Historic Preservation Office before carrying out any undertaking or licensing or permitting any undertaking by other parties that will affect listed properties. *See* Minn. Stat. §§ 138.665-.666.

An environmental assessment worksheet (EAW) must be prepared prior to the issuance of a permit “[f]or the destruction, in whole or part, or the moving of a property that is listed on the National Register of Historic Places or State Register of Historic Places.” *See* Minn. R. 4410.4300, subp. 31.

### B. State Register of Historic Places

This is a statutory list of 115 places. *See* Minn. §Stat. 138.663-.664. The listed places range from geographic locations such as the Falls of St. Anthony to individual homes such as May and Ray B. Hinkly House in Rock County. It also includes districts such as the Historic Hill District in St. Paul. The most recent addition was the Zion Lutheran Church and cemetery, rural Shelly; Norman County. *See* Minn. Stat. §138.664, subd. 115.

As is the case with properties on the National Register, the state and political subdivisions are required to consult with the State Historic Preservation Office before carrying out any undertaking or licensing or permitting any undertaking by other parties that will affect listed properties. *See* Minn. Stat. §§ 138.665-.666.

Listing on the State Register alone does not qualify a site for Minnesota historic structure rehabilitation tax credits. The site must be listed on the National Register and eligible for federal credits. *See* Minn. § Stat. 290.0681, subd. 1(d).

C. Local Designation and Regulation

1. Statutory Authority

The Municipal Heritage Preservation statute, Minn. Stat. § 471.193, authorizes cities, counties, and towns to establish heritage preservation commissions and designate “districts, sites, buildings, structures, and objects that are of historical, architectural, archaeological, engineering, or cultural significance” for protection. *See id.*, subd. 3.

Additional authority for local regulation is found in Minn. Stat. § 138.74 which authorizes political subdivisions to adopt regulations governing “construction, alteration, demolition and use” of properties within historic districts designated by the legislature in Minn. Stat. § 138.73.

2. Local Program Example: Minneapolis

a. Overview

Minneapolis regulates alterations to and demolition of designated individual landmarks, historic districts, and interiors under the Heritage Preservation Regulations in Chapter 599 of the Minneapolis Code. The program is administered by the Minneapolis Planning Director and a ten-member appointed Heritage Preservation, with overall supervision and control by the City Council.

The City Council designates property based upon recommendations by the Heritage Preservation Commission. The City Council has designated approximately 150 individual landmarks and twelve historic districts.

The City identifies “Recognition,” “Potential Variances,” “Staff Assistance,” and “Façade Improvement Matching Grants” as the benefits of local preservation. *See* City of Minneapolis, “Benefits of Preservation,” <http://www.ci.minneapolis.mn.us/hpc/BenefitsofPreservation>.

b. Selected Features

1. Significance

The definition of “significance” for purposes of designation overlaps in many respects with the National Register criteria for evaluation of significance described above. However, the Minneapolis definition does not include a minimum age requirement analogous to the generally

applicable 50-year requirement in the federal program. *Compare* Minneapolis Code § 599.110 with 36 C.F.R. § 60.4. *See also* Minneapolis Code § 599.210 (designation criteria).

## 2. Commission Membership

The ten members of the Heritage Preservation Commission must include, if available, at least two registered architects, at least one licensed real estate agent or appraiser, and persons with other specified qualifications. Minneapolis Code §599.120 (c).

## 3. Minor Alteration

A “minor alteration” that does not affect the “integrity” of a designated property requires an administrative “certificate of no change” issued by the Planning Director. *See* Minneapolis Code §§ 599.110, .130. Examples of minor alterations identified by the City include general maintenance, replacement of a standard shingle roof, and changes that reproduce the existing design. Decisions of the Planning Director are appealable to the Heritage Preservation Commission. *See id.* 599.180.

## 4. Alteration

An “alteration” that would make a “material change” to a designated property requires a “certificate of appropriateness” issued by the Heritage Preservation commission after a public hearing. *See* Minneapolis Code §§ 599.110, .120. New construction, additions and large-scale rehabilitations are all examples of alterations identified by the City. In addition to other requirements, all alterations must comply with The Secretary of the Interior’s Standards for the Treatment of Historic Properties. *See* Minneapolis Code § 599.350(a)(4). The City advises that the approval process for an alteration typically takes from six to eight weeks from application to issuance of a building permit. *See* City of Minneapolis, “A Guide to Heritage Preservation in Minneapolis,” available online at: <http://www.ci.minneapolis.mn.us/www/groups/public/@cped/documents/webcontent/wcmsp-194035.pdf>.

## 5. Demolition

For demolition or destruction in whole or in part of a designated property, the Heritage Preservation Commission must find:

- (1) The destruction is necessary to correct an unsafe or dangerous condition on the property; or
- (2) That there are no reasonable alternatives to the destruction. In determining whether reasonable alternatives exist, the commission shall consider, but not be limited to:
  - a. The significance of the property;
  - b. The integrity of the property; and

- c. The economic value or usefulness of the existing structure, including its current use, costs of renovation and feasible alternative uses.

Minneapolis Code § 599.350(b).

#### 6. Interim Protection for Undesignated Historic Resources

The Heritage Preservation Regulations protect undesignated “historic resources” from demolition. A historic resource is a property that may qualify as a landmark or inclusion within a historic district. Minneapolis Code § 599.10. If the Heritage Preservation Commission concurs in the Planning Director’s determination that a property is a historic resource then, subject to certain exceptions, no demolition permit will be issued pending completion of a designation study and a determination that the property does not qualify for designation. *See id.* 599.480(a). If the property is nominated for designation, demolition may be delayed for up to 18 months to allow the designation process to go forward under interim protection features of the ordinance. *See id.* § 599.240(b).

#### 7. Historic Variances

Designated landmarks and properties within historic districts are eligible for historic variances to allow “departure from the literal requirements of any of the applicable zoning regulations.” Minneapolis Code § 599.490. The purpose of these variances is to “encourage the preservation and reuse of landmarks properties in historic districts.” *Id.* Prior to granting a historic variance, the Heritage Preservation Commission must hold a public hearing and find that “the variance is compatible with the preservation of the property and with other properties in the area, and that the variance is necessary to alleviate practical difficulties due to special conditions or circumstances unique to the property and not created by the applicant.” *Id.* §§ 599.10, .20.

### III. Minnesota Environmental Rights Act

The Minnesota Environmental Rights Act, Minn. Stat. ch. 116B (“MERA”) provides a powerful tool for the protection of historic properties. It creates a civil action for the protection of “natural resources,” including “historical resources.” Minnesota actions to prevent the demolition of historic properties are typically based upon MERA.

#### A. Purpose

The purpose of MERA is to create and maintain within the state conditions under which human beings and nature can exist in productive harmony in order that present and future generations may enjoy clean air and water, productive land, and other natural resources with which this state has been endowed.” Minn, Stat. § 116B.01.

#### B. Definitions of “Natural Resources” and “Historical Resources”

Under MERA, “[n]atural resources’ shall include, but not be limited to, all mineral, animal, botanical, air, water, land, timber, soil, quietude, recreational and *historical resources*.” Minn. Stat. § 116B.02, subd. 4 (emphasis added).

MERA does not require a property to be listed on the national, state, or a local register to be a protected historical resource. Nor does prior listing control the question of whether a property is protected by MERA. However, in determining whether a property is a historical resource, Minnesota courts look “principally to the criteria used to determine what buildings are listed on the National Register of Historic Places.” *State by Archabal v. County of Hennepin*, 495 N.W.2d 416, 421 (Minn. 1993) (Minneapolis Armory found to be a MERA historical resource) ; *see also State by Powderly v. Erickson*, 285 N.W.2d 84, 88 (Minn. 1979) (19<sup>th</sup> century Red Wing row houses found to be MERA historical resources).

### C. Civil Action

MERA provides a civil action for any person to sue in the name of the state to protect natural resources, including historical resources, from “pollution, impairment, or destruction.”

Any person residing within the state; the attorney general; any political subdivision of the state; any instrumentality or agency of the state or of a political subdivision thereof; or any partnership, corporation, association, organization, or other entity having shareholders, members, partners or employees residing within the state may maintain a civil action in the district court for declaratory or equitable relief in the name of the state of Minnesota against any person, for the protection of the air, water, land, or other natural resources located within the state, whether publicly or privately owned, from pollution, impairment, or destruction.

Minn. Stat. § 116B.03, subd. 1.

Definition of “Pollution, Impairment, or Destruction” and “Materially Adversely Affects”

“Pollution, impairment, or destruction” is defined as “any conduct by any person which violates, or is likely to violate, any environmental quality standard, limitation, rule, order, license, stipulation agreement... or is likely to occur or any conduct which materially adversely affects or is likely to materially adversely affect the environment.” Minn. Stat. § 116B.02, subd. 5.

“Materially adversely affects ... the environment” is determined by considering the five factors specified by the Minnesota Supreme Court in *Schaller v. County of Blue Earth*, 563 N.W.2d 260 (Minn. 1997):

- (1) The quality and severity of any adverse effects of the proposed action on the natural resources affected;
- (2) Whether the natural resources affected are rare, unique, endangered, or have historical significance;

(3) Whether the proposed action will have long-term adverse effects on natural resources, including whether the affected resources are easily replaceable (for example, by replanting trees or restocking fish);

(4) Whether the proposed action will have significant consequential effects on other natural resources (for example, whether wildlife will be lost if its habitat is impaired or destroyed);

(5) Whether the affected natural resources are significantly increasing or decreasing in number, considering the direct and consequential impact of the proposed action.

The Supreme Court emphasized that “these factors are not exclusive and that each factor need not be met in order to find a materially adverse effect. Rather, the factors are intended as a flexible guideline for consideration as may be appropriate based on the facts of each case.”

#### D. Prima Facie Case and Affirmative Defense

The plaintiff must first make a prima facie showing “that the conduct of the defendant violates or is likely to violate said environmental quality standard, limitation, rule, order, license, stipulation agreement, or permit ... [or] has, or is likely to cause the pollution, impairment, or destruction of the air, water, land or other natural resources located within the state.” Minn. Stat. § 116B.04.

After the plaintiff has made a prima facie case, the burden shifts to the defendant who “may rebut the prima facie showing by the submission of evidence to the contrary.” *Id.*

Alternately or in addition, the defendant may attempt to prove an affirmative defense as follows:

The defendant may also show, by way of an affirmative defense, that there is no feasible and prudent alternative and the conduct at issue is consistent with and reasonably required for promotion of the public health, safety, and welfare in light of *the state’s paramount concern for the protection of its air, water, land and other natural resources from pollution, impairment, or destruction. Economic considerations alone shall not constitute a defense hereunder.*

*Id.* (emphasis added).

As indicated by the italicized language in the foregoing passage, the burden of proof for a defendant seeking to demolish a historical resource is very high:

In deciding whether defendants have established an affirmative defense under MERA, *the trial court is not to engage in wide-ranging balancing of compensable against non-compensable impairments.* Rather, protection of natural resources is to be given

paramount consideration, and those resources should not be polluted or destroyed unless there are truly unusual factors present in the case or the cost of community disruption from the alternatives reaches an extraordinary magnitude.

*State by Archabal v. County of Hennepin*, 495 N.W.2d 416, 422 (Minn. 1993) (quoting *State by Powderly v. Erickson*, 285 N.W.2d 84, 88 (Minn. 1979)).

#### E. Bond

MERA authorizes the court to require the plaintiff to post a \$500 bond for posts and disbursements. Minn. Stat. § 116B.03. Of greater significance is the potential that a court will require a plaintiff to post a large bond as a condition for a temporary injunction to prevent the demolition of a historic building. MERA provides that “[w]hen the court grants temporary equitable relief, it may require the plaintiff to post a bond sufficient to indemnify the defendant for damages suffered because of the temporary relief, if permanent relief is not granted.” Minn. Stat. § 116B.07; *see also* Minn. R. Civ. P. 65.03(a) (“[n]o temporary restraining order or temporary injunction shall be granted except upon the giving of security by the applicant, in such sum as the court deems proper”).

#### IV. Federal and State Tax Credits

##### A. Federal Historic Tax Credits – Overview.

1. 10% Credit For Pre-1936 Building. A tax credit is available in the amount of 10% of the qualified rehabilitation expenditures with respect to any qualified rehabilitated building, other than a certified historic structure. I.R.C. § 47(a). A qualified rehabilitated building must be first placed in service before 1936, and meet certain additional criteria. I.R.C. § 47(c)(1).

2. 20% Credit for Certified Historic Structures. A tax credit is available in the amount of 20% of the qualified rehabilitation expenditures with respect to any certified historic structure. I.R.C. § 47(a).

##### 3. Qualified Rehabilitation Expenditures.

a. In General. Subject to certain exceptions, qualified rehabilitation expenditures are defined as any amount that is properly chargeable to a capital account, for which depreciation is allowable under I.R.C. § 168 and which is, or is added to, non-residential real property, residential rental property, real property with a class life of more than 12.5 years, and in connection with the rehabilitation of a qualified rehabilitated building. I.R.C. § 47(c)(2).

b. Certain Expenditures Disallowed. I.R.C. § 47(c)(2) sets forth certain expenditures that are expressly disallowed. Disallowed expenditures include:

- i. acquisition costs;

- ii. expenditures attributable to enlargement of an existing building;
- iii. rehabilitation costs related to a certified historic structure unless the rehabilitation is a certified rehabilitation (discussed below);
- iv. rehabilitation of a building to be used for tax-exempt use;
- v. expenditures made by a lessee, if the term of the lease remaining on the date the rehabilitation is less than the recovery period determined under I.R.C. § 168(c).

c. QREs Include Hard Costs and Soft Costs. In general, costs incurred to renovate a qualified rehabilitated building or its structural components should be included within the definition of qualified rehabilitation expenditures. “Hard costs” incurred to renovate the structural component of a building including walls, partitions, floors, ceilings, permanent coverings such as paneling or tiling, windows and doors, components of HVAC systems, plumbing and plumbing fixtures, chimneys, stairs escalators, elevators, sprinkling systems, fire escapes, and other components related to the operation or maintenance of the building, will be considered qualified rehabilitation expenditures. Treasury Regulations. 1.48-1(e)(2). “Soft costs” for the project which may be capitalized, including construction period interest, taxes, architect fees, engineering fees, construction management costs, reasonable developer fees, and other soft costs that would normally be capitalized, will also qualify as qualified rehabilitation expenditures. *Id.*

d. Examples of Non-Qualifying Costs. Costs which are not qualified rehabilitation expenditures include:

- Acquisition costs
- Appliances
- Cabinets
- Carpeting (if tacked in place and not glued)
- Decks (not part of original building)
- Demolition costs (removal of a building on property site)
- Enlargement costs (increase in total volume)
- Fencing
- Feasibility studies
- Financing fees
- Furniture
- Landscaping
- Leasing Expenses
- Moving (building) costs (if part of acquisition)
- Outdoor lighting remote from building

- Parking lot
- Paving
- Planters
- Porches and Porticos (not part of original building)
- Retaining walls
- Sidewalks
- Signage
- Storm sewer construction costs
- Window treatments

(See National Park Service, Frequently Asked Questions, Eligible Buildings and Expenses, available online at: <https://www.nps.gov/tps/tax-incentives/before-apply/irs-faq2.htm>)

4. Qualified Rehabilitated Building.

a. General Test. To be eligible for either the 10% tax credit or the 20% tax credit, the qualified rehabilitation expenditures must be made with respect to a qualified rehabilitated building. (See I.R.C. § 47(a) [with respect to the 10% credit] and Treas. Reg. § 1.148-12(c)(5) [with respect to the 20% credit]). A qualified rehabilitated building is any building (and its structural components) (i) that has been substantially rehabilitated, (ii) that was placed in service before the beginning of the rehabilitation, and (iii) for which depreciation is allowable. In addition, the building must either be a “certified historic structure” or meet the following test: (i) at least 50% of the external walls must remain in place as external walls, and (ii) at least 75% of the existing internal structural framework must remain in place. I.R.C. § 47(c)(1)(A). Buildings which are not certified historic structures must have been placed in service before 1936. I.R.C. § 47(c)(1)(B).

b. Substantial Rehabilitation. A building is considered substantially rehabilitated if the qualified rehabilitation expenditures during the 24-month period selected by the taxpayer exceed the greater of: (i) the adjusted basis of the building (and its structural components), or (ii) \$5,000. I.R.C. § 47(c)(1)(C)(i). The 24-month period may be extended to 60 months if the project is expected to be completed in phases set forth in architectural plans completed before the rehabilitation begins. I.R.C. § 47(c)(1)(C)(ii).

5. Certified Historic Structure. A building is a certified historic structure if it is either (a) listed in the National Register or (b) located in a registered historic district and certified as being of historic significance to the district. I.R.C. § 47(c)(3).

B. Timing; Recapture.

1. Timing Considerations for Project.

a. Credit Claimed For Rehabilitation Expenditures Within 24 Month Period. Credit can be claimed with respect to any 24-month period during which

building is substantially rehabilitated. Rehabilitation expenditures within the 24-month period must exceed the greater of the adjusted basis of the building and its structural components or \$5,000. Treasury Regulation § 1.48-12(b)(2).

b. Certain Projects can be Phased over 5 Years. Project can alternatively be phased over a 5 year period, if (i) there is a written set of plans and specifications for the entire project, (ii) the written plans are completed before rehabilitation begins and (iii) project is placed in service. Treasury Regulation § 1.48-12(b).

2. Credit Claimed In Year Project Placed In Service. One hundred percent (100%) of the credit may be claimed during the year the qualified rehabilitation expenditures are placed in service. I.R.C. § 47(b). When property is placed in service is generally determined with respect to depreciation rules which provide generally that a project is placed in service when it is substantially completed and in a state of readiness and availability. Treasury Regulation § 1.167(a)(11)(e)(1)(i). Property will be deemed placed in service when the project is substantially complete and ready for use, regardless of whether the owner actually begins use of the project.

3. Recapture.

a. General Rule. The historic rehabilitation tax credit is recaptured if within five (5) years from the date when any qualified rehabilitation expenditure is placed in service the property is disposed of or otherwise ceases to be investment credit property with respect to the taxpayer claiming the credit. I.R.C. § 50(a)(1). Property would cease to be investment credit property if, among other things, the property is removed from the National Register is determined to no longer contribute to a Registered Historic District. Revocation of status as a historic structure can occur if the building is materially altered such that it loses its historic integrity or character.

b. Amount of Recapture. The amount of credit recaptured decreases by 20% for each full year that elapses after the qualified rehabilitation expenditure is placed in service. I.R.C. § 50(a)(1)(B). Thus, recapture is limited to 80% during the second year after placement in service, 60% during the third year, 40% during the fourth year and 20% during the fifth year.

c. Changes of Ownership. Sale of all or part of a partner's partnership interest in the property can trigger recapture. Treasury Regulation § 1.47-6(a)(2). If a partner disposes of more than two-thirds of the partner's initial interest, such a disposition is treated as a disposition of the property. If "C" corporation owns the property, transfers of shareholder's interest in the corporation will not trigger recapture. I.R.C. § 50(a)(4)(B). Because the credit is claimed for the year in which the property is placed in service (see above) and because subsequent transfers of ownership could cause recapture, it is critical to establish the desired ownership structure for the property before the rehabilitation project is completed and the property is deemed placed in service.

d. Recapture on Casualty. When the property is completely destroyed within the recapture period, the tax credits will be subject to recapture under I.R.C. § 50(a). The property will cease to be investment credit property. In this case recapture cannot be avoided by rebuilding the property because the rebuilt property would not be investment credit property—property that would qualify for the historic rehabilitation tax credit. If the property is partially destroyed, recapture may be avoided if the property is rebuilt in accordance with the standards required by NPS in connection with the initial rehabilitation (discussed below) and the property is again placed in service within a reasonable time. *Rehabilitation Tax Credit Recapture*, Prepared by Mark Primoli, Internal Revenue Service. [https://www.irs.gov/pub/irs-utl/tax\\_credit\\_recapture\\_brief.pdf](https://www.irs.gov/pub/irs-utl/tax_credit_recapture_brief.pdf).

#### C. Use of the Tax Credit; Impact of Passive Loss Rules.

“Passive Loss” and “At Risk” rules apply to individuals and closely held corporations, but do not apply to widely-held C corporations. These rules make it more difficult for individuals and closely held corporations to make use of the credits.

“Passive Loss” rules which apply to individuals, personal service corporations and estates or trusts, require that, for any of these taxpayers, tax credits derived from passive activity, may only be used to offset tax liability resulting from passive income, unless the taxpayer qualifies for special rules for real estate professionals. See, generally, I.R.C. § 469.

“At risk” rules generally limit tax credits that may be claimed by individuals or closely held corporations to the amount the taxpayer has at risk with respect to the project. This limitation generally does not apply to C corporations. See, generally, I.R.C. § 49.

Because of the impact of the “passive loss” and “at risk” rules, it is much easier for a C corporation, than an individual or closely held corporation, to make use of the federal historic tax credits. Investors in historic tax credit projects very often tend to be large C corporations—often banks.

D. Application Process For Certified Historic Structures. To claim the 20% credit, the taxpayer must complete a 3 part application. (See, generally, I.R.C. § 47(c)(2)(C) and <https://www.nps.gov/tps/tax-incentives/application-process.htm>.) All parts of the application are made to the SHPO (discussed above). After completing its review, the SHPO will forward the application, with the SHPO’s recommendation, to the National Park Service for a final determination.

#### Part 1 – Determination of Significance

For structures that are not listed on the National Register, the taxpayer must request an evaluation of significance to determine that:

- (i) a property located within a registered historic district is of historic significance to the district,

(ii) a property not yet on the National Register appears to meet the National Register criteria, or

(iii) a property located within a potential historic district appears to contribute to the significance of such district.

Note that a determination of significance (Part 1 Application) is not required for properties listed on the National Register.

### Part 2 – Description of the Rehabilitation

The owner must provide detailed descriptions of the proposed rehabilitation, including “before” photos of the site. The NPS will make a determination as to whether the proposed rehabilitation will be consistent with the Secretary of the Interior’s Standards for Rehabilitation, such that the rehabilitation will be considered a “certified rehabilitation.”

### Part 3 – Certification of Completed Work

The final portion of the application requires the taxpayer to provide additional information regarding the completed work, including “after” photos of the work. The NPS will then make a determination as to whether the completed work meets the Secretary of the Interior’s Standards for Rehabilitation.

#### E. Investment Structures.

Historic rehabilitation tax credits can only be claimed by an owner of the property. I.R.C. § 47(a); *see also Historic Boardwalk Hall, LLC v. Commissioner of Internal Revenue*, 694 F.3<sup>rd</sup> 425 (2012). The tax credits may not be sold to an unrelated third party. *Id.* As a result, financing structures have been developed by which a party who can take advantage of the tax credits obtains an ownership interest in the property owner (usually a limited partnership or limited liability company). The investor party makes a capital contribution to the property owner and is allocated the right to claim the tax credits.

#### 1. Historic Boardwalk Case; Rev. Proc. 2014-12.

a. Historic Boardwalk Hall, LLC vs. C.I.R. In *Historic Boardwalk Hall, LLC v. Commissioner of Internal Revenue.*, 694 F.3<sup>rd</sup> 425 (2012), the Third Circuit Court of appeals ruled that an investor to whom tax credits were allocated was not a true partner, and therefore, not an owner of the project and not entitled to claim the historic tax credits.

In 1998, the New Jersey Sports and Exposition Authority (“NJSEA”) undertook renovate the East Hall, an entertainment venue located on the boardwalk in Atlantic City and listed on the National Register of Historic Places. After raising sufficient funds for completion of the project, a consultant proposed the idea of raising additional funds for

the project through the “sale” of historic tax credits to an investor. Sale of the tax credits would generate additional funds sufficient to pay to NJSEA a development fee that would not otherwise have been payable.

NJSEA formed Historic Boardwalk Hall, LLC (“HBH”) and sublet the property to HBH. NJSEA then sold a membership interest in HBH to a subsidiary of Pitney Bowes (“PB”). Under the terms of the operating agreement for HBH, PB would make a capital contribution to HBH, in exchange for which BP would be allocated 99% of the profits and losses of HBH to BP, so that BP could claim substantially all of the tax credits. However, under the agreement, HBH would be distributed only a small portion of the cash flow generated by ownership and operation of the property. After the five-year recapture period expired, NJSEA would purchase BP’s interest pursuant to a pre-arranged purchase option.

To incentivize BP to make the investment, BP was given certain guaranties, including (1) a guaranty of completion of the project, (2) an operating deficit guaranty, (3) a tax indemnity and (4) an environmental indemnity. NJSEA also guaranteed payment to PB of a guaranteed 3% annual preferred return on its investment, which guaranty was secured by a funded guaranteed investment contract with a solvent third party. The timing of the investment to be made by BP was after much of the construction had been completed, and after confirmation that amounts spent would be classified as qualified rehabilitation expenditures, sufficient to generate historic tax credits.

The Third Circuit held that, under these terms, PB was not a bona fide partner, because PB was completely insulated from any risk with respect to its investment. Similarly, PB’s upside potential was also limited to essentially its guaranteed 3% return, plus the amounts it expected to claim in tax credits. PB’s attempt to claim the tax credits was disallowed.

b. Rev. Proc. 2014-12

In the wake of the Historic Boardwalk case, the Treasury Department issued Revenue Procedure 2014-12 establishing a safe harbor for structuring historic tax credit investments. The Revenue Procedure sets forth “safe harbor” guidelines, within which an investor in a historic rehabilitation project will be deemed have sufficient downside risk and upside potential to be characterized as a bona fide partner, entitled to claim the credit. A copy of the Revenue Procedure is available here: [https://www.irs.gov/irb/2014-3\\_IRB#RP-2014-12](https://www.irs.gov/irb/2014-3_IRB#RP-2014-12). Investments made in connection with historic tax credit projects are now structured largely as set forth in the Revenue Procedure.

F. Minnesota State Historic Tax Credits.

1. Availability of Credit. A 20% credit against Minnesota state taxes is available pursuant to Minn. Stat. § 290.0681. Availability of the credit largely follows availability of the federal 20% tax credit. In general, to claim the credit (1) the project must

receive Part 3 certification and (2) the taxpayer must be allowed the federal credit allowed pursuant to I.R.C. §47(a)(2).

2. Grant In Lieu of Credit. In lieu of a tax credit, the taxpayer may instead elect to receive a grant in an amount equal to 90% of the amount of tax credit that would be permitted. Minn. Stat. § 290.0681, Subd. 2(b). This is an important difference from the federal historic tax credit. Project owners electing the grant do not need to obtain investment from a third party which can make use of the tax credits. Instead, the project owner can simply elect to receive the grant.

3. Assignment of Tax Credit Certificate. A tax payer receiving state historic tax credits may assign the certificate to another taxpayer, which is then allowed the credit. The assignee must notify the Minnesota Commissioner of Revenue within 30 days after the date of the assignment. Minn. Stat. § 290.0681, Subd. 4(b). This is another important difference from the federal historic tax credit. The credit may truly be “sold” and claimed by a party who is not an owner of the project.

4. Applications; Allocations. To qualify for a credit or grant under this section, the developer of a project must apply to the State Historic Preservation Office before the rehabilitation begins. The application must indicate if the application is for a credit or a grant in lieu of the credit or a combination of the two and designate the taxpayer qualifying for the credit or the recipient of the grant. Minn. Stat. § 290.0681, Subd. 4. Upon approving the application, the State Historic Preservation Office will issue a certificate confirming the award. *Id.*

5. No Recapture. The Minnesota historic tax credit is not subject to recapture. Minn. Stat. § 290.0681, Subd. 4(d).

## Helpful Websites

National Park Service

<https://www.nps.gov/nr/>

Minnesota Historic Preservation Office

<http://www.mnhs.org/shpo/>

Minneapolis Heritage Preservation

[http://www.ci.minneapolis.mn.us/hpc/hpc\\_index](http://www.ci.minneapolis.mn.us/hpc/hpc_index)

St. Paul Heritage Preservation

<https://www.stpaul.gov/departments/planning-economic-development/heritage-preservation>

Preservation Alliance of Minnesota

<http://www.mnpreservation.org>