

Rehabilitation Credit - Qualified Rehabilitation Expenditures (QREs)

In general, only an amount that is properly capitalized in connection with the rehabilitation of a qualified rehabilitated building (QRB) that is certified by the National Park Service as consistent with the historic character of the building or the district in which the property is located will be a qualified rehabilitation expenditure (QRE). See 26 USC 47(c)(1) (defining QRB) and 47(c)(2)(A) (defining QREs). However, not every amount associated with a rehabilitation will be a QRE that is included in the calculation of the rehabilitation credit. See 26 USC 47(c)(2)(B) (describing certain expenditures not included).

The following are important aspects to remember:

1. Rehabilitation includes **renovation, restoration, or reconstruction** of a building, but does not include an enlargement or new construction. IRC § 47(c)(2) and Treas. Reg. § 1.48-12(b)(2)(iv).
2. A QRE must be (i) an amount properly chargeable to capital account (generally meaning used in computing the basis) of depreciable property that is nonresidential real property, residential rental property, real property with a class life of more than 12.5 years, or an addition or improvement to the preceding three types of property, and (ii) incurred in connection with the rehabilitation of a QRB (including its structural components). IRC § 47(c)(2) and Treas. Reg. § 1.48-12(c).
3. Amounts must be for a building and its structural components. Generally, structural components of a building are those components relating to the operation or maintenance of a building. See Treas. Reg. § 1.48-1(e)(1) and (2) for a definition of a building and structural components of a building, respectively.

Expenditures associated with these items are generally eligible if properly includible in computing the basis of the building

- A. Section 47(c)(1)(A) defines a QRB to include the building and its structural components if – (i) the building has been substantially rehabilitated, (ii) the building was placed in service before the beginning of the rehabilitation, (iii) the building is a certified historic structure, and (iv) depreciation (or amortization in lieu of depreciation) is allowable with respect to the building.

Treasury Regulation § 1.48-1(e)(1) generally defines a building to mean any structure or edifice enclosing a space within its walls, and usually covered by a roof, the purposes of which is, for example, to provide shelter or housing, or to provide working, office, parking, display or sales space.

The costs of these structural components may be QREs if the amounts are properly included in the basis of depreciable property that is nonresidential real property, residential rental property, real property which has a class life of more than 12.5 years, or an addition or improvement to the preceding three types of property. Treas. Reg. § 1.48-1(e)(2) defines structural components and includes the following list of examples of structural components:

- Walls
- Partitions
- Floors
- Ceilings
- Permanent coverings of walls, partitions, floors and ceilings, such as paneling or tiles
- Windows and doors
- Components of central air conditioning or heating systems
- Plumbing and plumbing fixtures
- Electrical wiring and lighting fixtures
- Chimneys
- Stairs
- Escalators
- Elevators
- Sprinkler systems
- Fire escapes
- Other components (that is, other parts of the building) relating to the operation or maintenance of the building

B. Treas. Reg. § 1.48-12(c)(2) describes costs that may be QREs if the amounts are properly included in the basis of depreciable property that is nonresidential real property, residential rental property, real property which has a class life of more than 12.5 years, or an addition or improvement to the preceding three types of property, including the following:

- Construction period interest and taxes
- Architect fees
- Engineering fees
- Construction management costs
- Reasonable arm's length developer fees (value added services)
- Other fees paid that would normally be charged to a capital account

C. The following costs are not specifically listed in the Treasury Regulations, but may be QREs if the amounts are properly included in the basis of depreciable property that is nonresidential real property, residential rental property, real property which has a class life of more than 12.5 years, or an addition or improvement to the preceding three types of property:

- Permanently installed operable floodgates
- Permanently attached fastening devices to hold floodgates or to attach flood wrapping systems
- A retaining wall that is part of or connected to the structure of the building
- A seawall that is part of or connected to the structure of the building
- The portion of landscaping designed only to protect the building (i.e., drains and regrading for drainage)
- Elevated structure built to protect utilities (such as a freestanding air conditioning unit on a raised platform adjacent the building)
- Structural reinforcing and improvements to foundation (to withstand hydrostatic and hydrodynamic pressure)
- Applying waterproof coating to the exterior of the foundation walls, whether above or below grade
- Costs associated with excavation and/or sitework necessary to access an exterior foundation or basement walls in order to undertake structural improvements or to apply waterproof coatings
- Permanently installed vents or drains (inside or outside)
- Sump pumps (only if permanently installed and/or if connected to drainage system)
- Materials to fill in the basement (sand, gravel, etc.) and the installation/compacting of the material
- Basement drains
- Moving utilities inside the building
- In a documented floodplain, lifting/elevating at the same site (lifting the building onto a new, taller foundation) with no additional square footage underneath the building (open space (such as a building on posts/pilings) or crawl space below)
- Lifting/elevating a building on an enclosed foundation with occupiable space below the first floor that is used for parking, storage, or other limited uses allowed by a flood ordinance
- New foundation construction including break-away walls, louvers, lattice, or other architectural screenings
- Where a current site is threatened or destroyed moving the Historic Building including
 - Lifting the building on the original site and transporting it to the new site
 - New site preparation
 - New foundation
 - Permits for and relating to (e.g., utility fees for moving traffic light out of the way, etc.) the move
 - Utility connections at the new location.

Expenditures that do not qualify for the rehabilitation tax credit

Not every amount associated with a rehabilitation project will qualify as a QRE to be included in the calculation of the rehabilitation credit. See 26 USC 47(c)(2)(B) (describing certain expenditures not included). In general, only those amounts that are capitalized in connection with the rehabilitation of structural and architectural features of a building that is a certified historic structure will qualify as QREs. See 26 USC 47(c)(2)(A) (defining QREs).

However, the following costs associated with these items are not generally eligible:

- Acquisition costs
- Appliances not either real or residential rental property
- Office Equipment
- Cabinets (unless inherently permanent structure and part of the building)
- Carpeting (if tacked in place and not glued) - Rev. Rul. 67-349; Hospital Corp of America v. Commissioner, 109 T.C. 21 (1997).
- Decks, Porches and Porticos (that were not part of original building)
- Demolition and removal costs (of an existing building on property site)
- Fencing
- Feasibility studies
- Financing fees (such as mortgage related financing not during the construction period)
- Furniture
- Landscaping
- Leasing Expenses
- New construction costs or enlargement costs (increase in total volume from original building)
- Outdoor lighting (remote from building)
- Parking lot
- Paving
- Planters/Pots
- Retaining walls that are not part of a building and its structural components
- Sidewalks
- Signage
- Storm sewer construction costs
- Window treatments
- Display racks and shelves
- Production machinery
- Grocery counters
- Temporary protective measures like sandbags, inflatable dams, etc.
- Levy
- Retaining wall that is not part of or connected to the structure of the building
- Temporary floodgates/flood shields
- Lifting/elevating a building on an enclosed foundation with occupiable space below the first floor that is used as additional living areas (expansion of the building)
- Attachments for pulley or other system to relocate furnishings above flood level

Are solar panels, wind turbines or geothermal systems eligible expenses?

Solar panels, wind turbines, and geothermal systems generally are 5-year property under section 168. See section 168(e)(3)(B)(vi)(I). The costs of solar panels, wind turbines, and geothermal systems described in section 168(e)(3)(B)(vi)(I) are not included in the basis of the building and, therefore, should not qualify for the rehabilitation credit. Additionally, the same property that is used to claim a rehabilitation credit cannot also be used to claim an energy credit under section 48(a)(2)(B).