Federal Tax Incentives for Historic Preservation: A Strategy for Conservation and Investment

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FEDERAL TAX INCENTIVES FOR HISTORIC PRESERVATION: A STRATEGY FOR CONSERVATION AND INVESTMENT

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INTRODUCTION

In a recent address on the economy, President Reagan declared that "the taxing power . . . must not be used to regulate the economy or bring about social change." This proposition represents a radical departure from familiar economic practice and, to anyone concerned with the preservation of America's cultural and architectural heritage, the policy underlying the President's statement may prove disastrous. Preservationists and community development strategists alike should realize that if the federal government does not use its taxing power to encourage preservation, the nation stands to lose a large part of its historic property and hence a large part of its existing re-usable commercial and housing stock.

The federal tax policy embodied in the Tax Reform Act of 1976 (TRA), together with the preservation policy embodied in the Na-

3. The scope of this article is limited to the use of the federal taxing power to encourage historic preservation. Because the federal government has no power to tax real property, U.S. CONST. art. 1, § 2, cl. 3, it must rely on its income taxing power, U.S. CONST., amend. XVI, to achieve this goal. See Powers, Tax Incentives for Historic Preservation: A Survey, Case Studies and Analysis, 12 URB. LAW. 103, 116 (1980). For a discussion of state efforts to encourage historic preservation, see Brenneman, Historic Preservation Restrictions: A Sampling of State Statutes, 8 CONN. L. REV. 231, 233-43 (1976).
tional Historic Preservation Act of 1966 (NHPA),\(^5\) represented a strong progressive federal program to utilize the taxing power to achieve important conservation and preservation goals. This program has been severely weakened, however, by the passage of the Reagan administration's tax package, the Economic Recovery Tax Act of 1981 (ERTA),\(^6\) which significantly alters the tax treatment of historic preservation activity.\(^7\)

The TRA provided tax incentives to stimulate private investment for neighborhood conservation and urban regeneration of historically significant property. These incentives included tax benefits for donating either a whole or partial interest in historically important property to a charitable organization dedicated exclusively to preservation,\(^8\) rapid amortization or accelerated depreciation for the rehabilitation of certified historic structures greater than that allowable for noncertified structures,\(^9\) and the denial of deductions for demolition expenses and any remaining undepreciated basis in the structure.\(^10\) The law also denied accelerated depreciation on any replacement structure where a certified historic structure had been either demolished or substantially altered.\(^11\)

The ERTA repealed this last disincentive.\(^12\) Moreover, the ERTA repealed the rapid amortization election and the election for accelerated depreciation for certified historic structures.\(^13\) While preservationists strive to protect historically significant structures, owners and developers struggle to overcome the economic hardships of maintaining and rehabilitating our built heritage. To assist in this struggle, the ERTA offers only a twenty-five percent investment tax credit for the rehabilitation of a certified historic structure.\(^14\) To be eligible for this tax credit, the owner must subject the property to the restrictions and limitations on use required by listing in the Na-

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7. See id. § 212(d), 95 Stat. 239 (repealing certain provisions of Internal Revenue Code relating to historic preservation).
13. Id. (repealing I.R.C. §§ 191, 167(o) (1976)).
HISTORIC PRESERVATION

The historic preservation movement has grown in scope since 1966, when the National Register of Historic Places was created.

Since the tax credit is only five percent more than that for the rehabilitation of a forty year old non-certified building, it is likely that many investors will choose to ignore it. Unless the added expense of preservation can be made at least reasonable, if not profitable, by the use of federal tax incentives similar to those available under the TRA, the private sector may be forced to abandon history and opt for the practicality of the bulldozer and the wrecking ball used so frequently prior to the NHPA and the TRA.

This note advocates the increased use of federal tax incentives to encourage preservation of America’s architectural heritage. Federal historic preservation policy, as embodied in early legislation and the NHPA, is examined first. This is followed by an extensive analysis of the TRA. The operation of the historic preservation provisions of this Act, now largely repealed by the ERTA, are explained to show the quality of the incentives under this law, to provide a basis for criticism and analysis of historic preservation tax incentives, and to suggest a contrast to the approach available under the ERTA. After a brief look at the NHPA Amendments of 1980, the note examines and criticizes how the ERTA, despite the provision for an increased investment tax credit, undermines the broad preservation and conservation policies underlying the NHPA. The note concludes with a plea for the restoration of strong federal tax incentives for historic preservation.

HISTORIC PRESERVATION: THE BEGINNING

The historic preservation movement has grown in scope since

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15. The National Register was created by the National Historic Preservation Act of 1966, 16 U.S.C. § 470a (1976).
the early isolated efforts to save national shrines. It is difficult to find a town or city in the United States today that does not have some kind of significant preservation activity. This breadth of activity evolves out of the view that the spirit of a nation is rooted in its history, and that communities have special irreplaceable values that must be preserved in order to provide a sense of place and continuity in people's lives. In this sense, preservation is a potential catalyst to retaining an aesthetic quality in the urban environment where people live and work. If this traditional view completely preoccupied the preservationist movement, however, its relevance in today's economy would be severely limited. For preservation today is equally important as a conservation movement designed to meet the needs of developing communities by rehabilitating our built historic environment for immediate appreciation and use.


19. Over 100 years ago, George Washington's home was offered to Virginia and the federal government. Both refused to accept it. Ann Pamela Cummington, recognizing the need to preserve it for future generations, formed the Mount Vernon Ladies' Association to save it. Today, millions of Americans continue to enjoy visits to the home which is still owned by the "Ladies." Government participation in historic preservation activities was noticeably absent for over 100 years after the founding of the nation. But as early as 1906, the Antiquities Act was passed. Ch. 3060, § 2, 34 Stat. 225 (1906) (codified at 16 U.S.C. § 431 (1976)). The Act authorized the President to set aside historic landmarks, located on lands controlled by the United States, as national monuments. 16 U.S.C. § 431 (1976). Congress later created the National Park Service. Act of Aug. 25, 1916, ch. 408, § 1, 39 Stat. 535 (current version at 16 U.S.C. § 1 (1976)). Thus, the federal government began its programs to protect and preserve historic and prehistoric sites. H.R. REP. No. 1457, 96th Cong., 2d Sess. 18-19 (1980) [hereinafter cited as HOUSE REPORT], reprinted in 1980 U.S. CODE CONG. & AD. NEWS 6378, 6380-81.

21. Id.
23. Id.
Between 1935 and 1966, the federal program for preservation was accomplished through the Historic Sites, Buildings, and Antiquities Act of 1935.\textsuperscript{25} The Act declared, for the first time, a national policy of historic preservation.\textsuperscript{26} Although the scope of the act was limited, it gave the Secretary of the Interior authority to survey and identify historic buildings and sites of national significance which were within the historical or archeological units of the National Park Service or which had been declared eligible for designation as a National Landmark.\textsuperscript{27} In order to "facilitate public participation in the preservation of sites, buildings, and objects of national significance or interest,"\textsuperscript{28} Congress chartered the National Trust for Historic Preservation in 1949.\textsuperscript{29} Through the National Trust, federal funds became available for preservation.\textsuperscript{30}

The 1935 Act and the National Trust, however, failed to stop the accelerated loss of the historic built environment, especially in areas of urban renewal and road construction which dominated the post World War Two landscape in the 1950's. This was a period of rapid urban growth and urban expansion when there was a general disregard for historic preservation.\textsuperscript{31} The major burden of rehabilitation of historic buildings, which was often slow and expensive, was borne by private agencies and individuals and their initiative to preserve may have been dampened accordingly.\textsuperscript{32} For at least a decade, federal efforts toward historic preservation were weak in the face of a swift and powerful wrecking ball.\textsuperscript{33}

In an effort "to forestall the wholesale demolition of historic properties and neighborhoods,"\textsuperscript{34} new and innovative legislation began to emerge.\textsuperscript{35} The Housing and Urban Development Act of 1965,\textsuperscript{36} for example, provided that urban renewal projects include

\begin{itemize}
\item 26. Id. § 461.
\item 27. Id. § 462.
\item 28. Id. § 468.
\item 31. HOUSE REPORT, supra note 19, at 18-19, reprinted in 1980 U.S. CODE CONG. & AD. NEWS, supra note 19, at 6381-82.
\item 32. Id.
\item 33. Id. at 19, reprinted in 1980 U.S. CODE CONG. & AD. NEWS, supra note 19, at 6382.
\item 34. Id.
\item 35. Id.
\item 36. 42 U.S.C. § 1460(c)(6), (9), (10) (1976).
\end{itemize}
the relocation of structures determined to be of historical value by local public agencies, but only if there was a public or nonprofit organization that would undertake the responsibility of renovation and maintenance. The Federal Highway Administration was required, in 1966, to avoid planning and carrying out projects that would harm identified historic resources unless “no feasible and prudent alternative” existed. Despite their limited application, these enactments are concrete examples of the early federal response to the upsurge of public concern about urban historic preservation.

**The National Historic Preservation Act of 1966**

The NHPA, enacted in 1966, represented a major step forward in historic preservation law. The purpose of the Act was to create a partnership between the federal government, the state, regional or local authority, and the private sector to protect, rehabilitate, restore, and reconstruct “districts, sites, buildings, structures, and objects significant in American history, architecture, archeology, and culture” at every level. In order to preserve “the historical and
cultural foundations of [America] as a living part of our community life," and to "insure future generations a genuine opportunity to appreciate and enjoy the rich heritage of our Nation," Congress found it necessary and appropriate for the Federal Government to accelerate its historic preservation programs and activities, to give maximum encouragement to agencies and individuals undertaking preservation by private means, and to assist State and local governments and the National Trust for Historic Preservation in the United States to expand and accelerate their historic preservation programs and activities.

In the NHPA, Congress created the National Register of Historic Places, established programs of matching grants-in-aid to states and to the National Trust for properties listed in the National Register, and established the Advisory Council on Historic

42. Id. § 470(c) (1976) (amended 1980).
43. Id. § 470(d) (1976) (amended 1980).
44. Id. § 470a(a)(1) (1976).
45. Id. § 470a(a)(2) (1976). The grants program under NHPA is established pursuant to section 470a, id. § 470a (1976), and carried out in accordance with sections 470b to 470h, id. §§ 470b-470h (1976). Funds are available on a fifty percent matching basis for preparation of state preservation surveys and planning, as well as acquisition and development of cultural properties. Although states are the direct recipients of these grants, they may transfer funds to other public and private organizations and individuals as long as the property benefited by the grant is listed in the National Register of Historic Places. In addition, the application must be in accordance with a comprehensive statewide plan approved by and filed with the Secretary pursuant to sections 470b(a)(2) and 470b(a)(3). Id. § 470b(a)(2) & (3) (1976). Further, after completion of the project, the total cost of continued maintenance, repair, and administration of the property must be assumed by the organization in a manner satisfactory to the Secretary. Id. § 470b(a)(5).
46. Id. § 470a(a)(3).
47. The C.F.R. provides the following standard for listing in the National Register: The quality of significance in American history, architecture, archeology, and culture is present in districts, sites, buildings, structures, and objects of State and local importance 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
Preservation to coordinate preservation activities. The Council encourages public and private participation and interest in preservation efforts and provides training and education in historic preservation. The Council also has a duty to advise, report, and recommend to the President and to Congress necessary and appropriate measures to further the purpose of the NHPA, including matters of tax policy. According to the statute, "[t]he Council shall . . . recommend the conduct of studies in such areas as the adequacy of legislative and administrative statutes and regulations pertaining to historic preservation activities of State and local governments and the effects of tax policies at all levels of government on historic preservation." Thus, through recognition of significant property at every level, as well as tax considerations at all levels, it was hoped that a balance could be reached between historic preservation and new construction in light of the needs of America's growing communities.

Historic preservation can be a costly and time consuming process. To meet the application requirements set forth in the NHPA, a property owner may incur expenses for architects, surveyors, and other experts to determine the historic significance of his or her property. This process is expensive and can delay any rehabilitation contemplated by the owner. There is a danger, therefore, that owners might opt for demolition before the property is certified historically significant. Moreover, if the structure is in an historic district, even maintenance might be a hardship. Problems of costly maintenance

may lack individual distinction; or

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

36 C.F.R. § 60.6 (1981).


49. Id. § 470j(a)(1).

50. Id. § 470j(a)(2).

51. Id. § 470j(a)(5).

52. Id. §§ 470j(a)(1), (4); id. § 470j(b).

53. Id. § 470j(a)(3). This directive was expressly recommended to be included as an amendment to the NHPA. See Letter from Wilfred H. Rommel, Assistant Director for Legislative Reference, Executive Office of the President, Bureau of the Budget, to Hon. Wayne N. Aspinall, Chairman, House Committee on Interior and Insular Affairs (July 15, 1966), reprinted in 1966 U.S. CODE CONG. & AD. NEWS 3316, 3317.

54. H.R. REP. No. 1916, 89th Cong., 2d Sess. 6 (1966), reprinted in 1966 U.S. CODE CONG. & AD. NEWS, supra note 53, at 3307, 3309. The major weakness of the NHPA, however, is that it lacks any express provision for federal tax incentives. See infra note 72.

and/or repair, anticipated or already incurred, can cause an agency or institution to refuse to accept property an owner may wish to donate.66

The NHPA also establishes a mandatory review process that federal agencies must follow in the conduct of their operations.67 This necessary, but often time consuming review process can seri-

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66. In a case where interested community members sought to save an historic house from demolition, the bank to whom the property was sold argued that it offered to donate the structure to any organization that would sponsor its relocation for preservation. The bank argued, further, that it offered to contribute the cost and expense of demolition to the relocation enterprise, but that no individual or groups accepted the offer. Edwards v. First Bank of Dundee, 534 F.2d 1242, 1243 (7th Cir. 1976) (dictum).

67. The substance of NHPA's protective provisions is as follows:

The head of any Federal agency having direct or indirect jurisdiction over a proposed Federal or federally assisted undertaking in any State and the head of any Federal department or independent agency having authority to license any undertaking shall, prior to the approval of the expenditure of any Federal funds on the undertaking or prior to the issuance of any license, as the case may be, take into account the effect of the undertaking on any district, site, building, structure, or object that is included . . . in the National Register. The head of any such Federal agency shall afford the Advisory Council on Historic Preservation . . . a reasonable opportunity to comment with regard to such undertaking.


Provisions of the NHPA do not cease to apply simply because an agency has preliminarily approved expenditures for demolition. In WATCH v. Harris, 603 F.2d 310 (2d Cir.), cert. denied, 444 U.S. 995 (1979), the court directed a preliminary injunction to become permanent where a carriage house deemed eligible for the National Register was threatened with destruction by an urban renewal project. Id. at 327. On the other hand, although the statutory language directs federal agencies to comply with 16 U.S.C. § 470f (1976), non-federal bodies have no obligation to take into account the effect of their project upon a National Register property, or to seek Advisory Committee comment upon their project. See Ely v. Velde, 451 F.2d 1130, 1139 (4th Cir. 1971); Miltenberger v. Chesapeake & O. Ry., 450 F.2d 971, 974 (4th Cir. 1971); Fowler, Federal Historic Preservation Law, supra note 18, at 48 n.61.

It is important to note that:

In order for a project to be "federally assisted" within the meaning of the NHPA or a "major Federal action" within the meaning of the NEPA, it must be wholly or partially funded with federal money. It is this money which imparts a federal character to a project and gives rise to the necessity of meeting the statutory requirements of those two acts. Without such federal funds, the project remains local in nature.

ously delay needed development. Federal program coordination requirements for investigation of threats to historic property, the evaluation of historic significance of properties not yet listed in the National Register, and public participation hearings and reports to the Advisory Council are also vital but costly and time consuming procedures. Moreover, the process of determining the eligibility of property for listing in the National Register is lengthy and uncertain. Interpretations of the eligibility criteria established by the Secretary of the Interior to determine historic preservation status vary. In an attempt to provide uniformity the Advisory Council

58. In 1971, when President Nixon signed Executive Order No. 11593, the protective provisions and mandatory review process established by the NHPA to protect historically significant property were reaffirmed. 36 Fed. Reg. 8921 (1971), reprinted in 16 U.S.C. § 470 (1976). The order, entitled “Protection and Enhancement of the Cultural Environment,” directed federal agencies to identify and nominate properties in their ownership or control that might be eligible for National Register listing. Agencies were also directed to maintain National Register property at professionally determined standards and to give early consideration in project planning to property that may be eligible. Id. An Executive Order promulgated by the President pursuant to the authority delegated by Congress has the effect of a statute and is part of the law of the land. See Givens v. Zerbst, 255 U.S. 11, 18 (1920); Farkas v. Texas Instrument, Inc., 375 F.2d 629, 632 (5th Cir. 1967); Farmer v. Philadelphia Elec. Co., 329 F.2d 3, 7 (3rd Cir. 1964). Clearly, the historic component of a property could not be ignored by developers when property was being assessed for sale, demolition, or re-use. WATCH v. Harris, 603 F.2d 310 (2nd Cir.), cert. denied, 444 U.S. 995 (1979). But see Wisconsin Heritages, Inc. v. Harris, 490 F. Supp. 1334, 1341-42 (E. D. Wis. 1978) (finding that provisions of NHPA, Executive Order No. 11593, and Advisory Council regulations did not authorize injunctive relief against contemplated demolition of mansion considered to be of historic significance where Advisory Council was given reasonable opportunity to comment and Department of Housing and Urban Development properly considered alternatives to and environmental impact of demolition). Wisconsin Heritages suggests that the final determination on demolition will often remain with the particular agency involved. In Committee to Save the Fox Bldg. v. Birmingham Branch of the Fed. Reserve Bank, 497 F. Supp. 504, 512 (N.D. Ala. 1980), the court held that the decision to demolish a recognized historic structure rests with the agency, and NHPA does not apply where the structure is not listed with the National Register until one full year after funds for demolition are approved. Thus, listing in the National Register does not create, in and of itself, an obligation for federal agencies to follow Advisory Council guidelines. Id.; see Central Oklahoma Preservation Alliance, Inc. v. Oklahoma City Urban Renewal Auth., 471 F. Supp. 68, 80-81 (W.D. Okla. 1979); Fowler, Federal Historic Preservation Law, supra note 18, at 38-41.

60. Id. § 60.6.
61. Id. § 800.13.
62. For the criteria for listing in the National Register, see supra note 47.
63. See supra notes 38, 55, 57. The Massachusetts Supreme Judicial Court held that a state court does not have jurisdiction to review the decision of an historic commission. Springfield Preservation Trust, Inc. v. Springfield Historical Comm'n, 1980 Mass. Adv. Sh. 725, 402 N.E.2d 488 (1980). In Stop H-3 Ass'n v. Coleman, 533 F.2d 434 (9th Cir.), cert. denied, 429 U.S. 999 (1976), the court held that a state or local authority finding cannot vitiate a Secretary of the Interior finding of eligibility for the National Register. Where the court has juris-
now provides supplementary guidance to assist federal agencies, state historic preservation offices, and the general public. Where the property is not yet listed in the National Register, the final decision to save it generally rests with the developer. If the property is to be preserved, however, the developer is obliged to follow proper procedure: a procedure inherently uncertain because professional judgment and interpretation are involved. The resulting delay could negate the project or program entirely. One unfortunate result of the legal process designed to protect historic properties from demolition, therefore, has been to make preservation difficult and expensive. Thus, for preservation to be feasible, financial assistance is essential.

By the mid 1970’s, Congress began to consider historic structures as valuable resources that could be converted, without damage to aesthetic or historic significance, into usable commercial space and housing stock. This attitude is reflected in the Housing and Community Development Act of 1974 where Congress recognized that conservation of existing housing stock through federal assistance

diction, the National Register criteria prevail over a state or local determination that property has only “marginal” significance. Id. at 441. But see Historic Green Springs, Inc. v. Bergland, 497 F. Supp. 839 (E.D. Va. 1980). There the court held that where the Department of the Interior fails to promulgate substantive standards or prepare and publish rules to govern the designation process, the court can set aside the placement of a district on the National Register. Id. at 857.


65. The final decision to demolish a structure of historic significance rests with the developing agency if the property was not listed in the National Register prior to approval of federal funds for its demolition. Committee to Save the Fox Bldg. v. Birmingham Branch of the Fed. Reserve Bank, 497 F. Supp. 504, 512 (N.D. Ala. 1980); see supra note 58.

66. See supra note 64.

67. Among the most important enactments providing financial support for historic preservation was the expansion of the Historic Preservation Fund in 1976. 16 U.S.C. § 470h (1976). The legislation authorized the Fund, in increasing annual amounts, through 1981 ($24,400,000 for fiscal year 1977; $100,000,000 per year for fiscal years 1978 and 1979; and $150,000,000 per year for fiscal years 1980 and 1981). Id. The Historic Preservation Fund now receives its money from revenues derived from offshore oil leasing. See id. (citing 30 U.S.C. § 191; 43 U.S.C. § 1338 (1976)). The purpose of this legislation may have been to expand the preservation grant program begun in 1966 to protect our built heritage from wholesale destruction. See supra notes 45-46 and accompanying text. It may have been enacted, however, as a result of the new attitude toward historic preservation as a conservation measure that evolved during the mid 1970’s. See infra text accompanying notes 68-70.

for rehabilitation would be less costly, especially in transitional areas, than the ultimate cost of neighborhood degeneration or blight.69 A strong federal policy emerges from this Act that harmonizes historic preservation values and community development goals. This policy recognizes that expenditures for preservation can serve important social as well as aesthetic goals and that a large part of the commercial and housing needs of American communities can be met by the practical and efficient conservation of historic property. In order to implement this policy effectively, however, Congress had to provide significant federal tax incentives for historic preservation. With this recognition, Congress passed the Tax Reform Act of 1976.70

Congress believes that the rehabilitation and preservation of historic structures and neighborhoods is an important national goal. Congress believes that the achievement of this goal is largely dependent upon whether private funds can be enlisted in the preservation movement. Tax considerations have an important bearing on whether private interests are willing to maintain and rehabilitate historic structures rather than allow them to deteriorate or replace them with new buildings.71

THE TAX REFORM ACT OF 1976: A STEP FORWARD

Basic Provisions for Historic Preservation

The major weakness of the NHPA was the absence of federal tax incentives for preservation efforts.72 Passage of the TRA, there-
fore, was a major victory for proponents of historic preservation.\textsuperscript{73} Until 1976, the tax code may have actually encouraged the demolition of historic structures by permitting owners and developers to write off demolition expenses\textsuperscript{74} and by providing developers with accelerated depreciation benefits for the new structure built on the site of the destruction.\textsuperscript{75} After 1976, however, an owner who demolished an historic structure that was listed on the National Register could neither deduct the cost of demolition\textsuperscript{76} nor take a depreciation deduction above the straight line method\textsuperscript{77} on the replacement structure.\textsuperscript{78} Hence developers who destroyed landmarks could suffer tax penalties. On the other hand, an owner who chose to preserve an historic structure could obtain various tax benefits that were nonexistent before 1976. Owners of historic structures were encouraged by the TRA to donate their interest, in whole or part, to an appropriate organization and deduct its value,\textsuperscript{79} or to rehabilitate the structure and receive the benefit of either rapid amortization of the rehabilitation expenditure\textsuperscript{80} or accelerated depreciation of the entire structure.\textsuperscript{81}

The TRA amended prior law by redefining conservation and permitting the deduction of donated partial interests in property for the purpose of “the preservation of historically important land areas...
or structures." In addition, the Code permitted the deduction of charitable contributions of partial and remainder interests in property only if the recipient organization accepted the donation exclusively for conservation purposes. Further, deductions for donations of partial interests were no longer limited to perpetual scenic or facade easements. After 1976, the permissible donations of partial interests included the transfer of a lease, option to purchase, or easement of not less than thirty years' duration, if donated to a recognized charitable conservation organization where perpetuation of its historic function was guaranteed. Thus, by relinquishing the right to control and modify a facade or the right to use or exercise a lease or option to a recognized charitable organization dedicated to conservation, an owner could deduct the fair market value of the interest conveyed, reduced by the amount of gain that would be recognized as other than long-term capital gain if the property were sold, subject to a limit on the total amount of all charitable contributions.

85. Id. § 170 (1976) (amended 1980, 1981). Treas. Reg. § 1.170A-1(c)(1) (1975) provides: "If a charitable contribution is made in property other than money, the amount of the contribution is the fair market value of the property at the time of the contribution reduced as provided in section 170(e)(1) and paragraph (a) of § 1.170A-4." Where a charitable deduction for a partial easement has been claimed, a limitation for a partial interest in property does not apply if the easement was acquired by an appropriate agency interested in conservation or preservation of natural beauty. The value is still determined by the price at which the property would change hands between a willing buyer and a willing seller. Thayer v. Commissioner, 36 T.C.M. (CCH) 1504 (1977).

The retention of appointment of specific beneficiaries of a charitable remainder interest, including organizations other than those described in section 170(b)(1)(A) of the Internal Revenue Code, does not defeat the charitable contribution deduction, subject to the limitation of section 170(b)(1)(B). Rev. Rul. 417, 1968-2 C.B. 103. Accordingly, in a recent private ruling (Private Ruling No. 8047090, August 28, 1980) (available March 22, 1981, on LEXIS, Fedtax library, IRS Private Rulings Released to Public) (document not to be used or cited as precedent under section 6110(J)(3) of the Internal Revenue Code), a charitable deduction was allowed for the donation of a partial interest in property certified by the Department of the Interior as an historic structure in the manner and to the extent provided by section 170 of the Internal Revenue Code. See generally Shull, supra note 2, at 410 (discussing tax proposals related to donations of partial interests in real property); Comment, Historic Preservation and the Tax Reform Act of 1976, 11 U.S.F.L. Rev. 453, 479-83 (1977) (discussing tax provisions related to charitable contributions of interests in real property).

86. I.R.C. §§ 170(b), (e) (1976); see Comment, supra note 85, at 482-90.
This deduction for donation of an interest in property differed from other tax incentives for historic preservation because it was neither limited to “certified historic structures” nor did the structure have to be used for commercial purposes. The donation had only to be “historically important,” a term not defined in the statutes, and accepted by a qualified organization. Assuming a qualified organization that would accept the property could be found, the allowable tax deduction would act as an incentive for the donation of various types of easements and structures that might otherwise have been demolished. A facade easement donated to a local organization can enable that organization to preserve the character of a neighborhood and protect the aesthetic value of the structure without impairing the structure’s usefulness. This incentive was particularly advantageous to homeowners who did not contemplate major changes to the exterior of their homes. Because the property was used as the residence of the owner, the structure did not otherwise qualify for the tax incentives for historic preservation property available for commercial and rental residential property. The primary advantage for owners of commercial or rental residential property, when that property was considered “historically important,” was that the structure did not have to be placed in the National Register to qualify for the deduction for the donation of a partial interest or facade. Therefore, an owner could take a tax deduction, preserve the historic character of the structure, and escape any other control, limitation, or requirement for qualification that National Register certification

87. *See supra* text accompanying notes 82-86.
90. *Id.* § 170(h)(3) (1976).
91. Because continued conservation was the purpose, it was an open question whether a qualified organization could be found that would accept charitable donations of historic property other than easements. *See* Edwards v. First Bank of Dundee, 534 F.2d 1242, 1243 (7th Cir. 1976) (dictum); *Comment, supra* note 85, at 483 n.122. Future maintenance costs, which could be high, had to be anticipated and made part of the budget of any recipient organization. This expense could preclude acceptance of the property. 534 F.2d at 1243.
94. *See supra* notes 88-92 and accompanying text.
imposed. 95

In lieu of depreciation deductions for the cost of improvements to an historic structure, under the TRA a taxpayer could have elected to amortize any rehabilitation expense 96 for a "certified rehabilitation" of a "certified historic structure." 97 To amortize is to allocate, or charge to expense, the cost of an intangible asset over its estimated useful life. 98 The TRA permitted the use of a rapid amortization period of sixty months on rehabilitation expenses for historic preservation property. 99 A "'certified rehabilitation'" is "any rehabilitation of a certified historic structure which the Secretary of the Interior has certified . . . as being consistent with the historic character of such property or the district in which such property is located." 100 "A 'certified historic structure' is a depreciable building or structure which is either listed in the National Register or located in a registered historic district and certified by the Secretary of the Interior as being of historic significance to the district." 101 It has recently been made clear by the Internal Revenue Service that Depart-
ment of Interior certification will determine the historic character of the rehabilitation and the structure.\(^\text{102}\)

Although few owners or developers would consider preservation solely because of the deduction, such a deduction could be the determinative factor in the decision to preserve through donation or rehabilitation, to sell, or to demolish or abandon.\(^\text{103}\) Under the TRA, if rehabilitation was chosen, the regulations provided that only an owner of a fee simple interest in the certified historic structure and the land on which it was located could have elected rapid amortization of the expenditure.\(^\text{104}\) There were exceptions,\(^\text{105}\) however, including one for certain transferees of historic structures where the transferee acquired ownership before the structure was placed in service,\(^\text{106}\) and directly from the owner who made the expenditure and commenced the rehabilitation activity.\(^\text{107}\) Under the TRA’s election for sixty-month amortization of rehabilitation expenditures of historic structures, a separate amortization period could have been established for each identifiably separate component of the rehabilitation project.\(^\text{108}\) The amortization option was available to joint owners, life tenants, remaindersmen, and certain transferees.\(^\text{109}\) In addition, expenditures for relocating an existing certified historic structure, if approved by the Secretary of the Interior, could have been amortized as an expense.\(^\text{110}\) Modernization costs such as the expenditures for plumbing, electric wiring, heating and air conditioning systems, elevators, escalators, and improvements to comply with local fire and building

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102. See T.D. 7700, 1980-2 C.B. 73. It is notable that the Internal Revenue Service has delegated this authority to another agency. This position was adopted by the Internal Revenue Service because it was believed that this certification would insure a uniform standard of eligibility for benefit, benefit only those structures intended to be protected, and minimize abuse. Id. at 74-75. Yet, despite this quest for uniformity in standards of eligibility, the Code permits special deductions to be taken for the donation of certain property that is not certified, but merely “historically important,” provided that it is donated to a qualified organization for conservation purposes. I.R.C. § 170(b)(4)(A)(iv) (1976); see supra text accompanying notes 82-85. In permitting this double standard to exist, the Internal Revenue Service may have contravened, to some extent, the uniform standard sought through reliance on Department of Interior certification.

103. See Day, supra note 73, at 330.


105. See infra text accompanying note 109.

106. Treas. Reg. § 1.191-1(c)(2)(iii); see supra sources cited note 102.

107. See supra sources cited notes 102, 106.


codes also could have been amortized. These improvements not only benefit the user by producing more desirable facilities in which to live or work, but they often have a centrifugal effect as well, improving the quality of life in whole communities and creating more desirable neighborhoods. Moreover, the original preservation minded owner, developer, or private investor gets a benefit from the increasing value of his property either through higher rents or a higher sales price.

One alternative to rapid amortization for the rehabilitation expenditure of historic preservation property under the TRA was accelerated depreciation. One advantage of accelerated depreciation is that the rehabilitation expenditure is added to the basis in the property and the taxpayer is allowed to accelerate the deduction for depreciation of the entire amount. For the election to be made, the historic structure may be either in commercial or residential use, but cannot be the owner's private residence. Additionally, the expenditure, reduced for amortization or depreciation already allowed or allowable, over a two-year period ending on the last day of any taxable year must exceed the greater of the taxpayer's adjusted basis as of the beginning of the two-year period or $5,000. For tax purposes, rehabilitation expenditures are treated as capital expenditures, added to the basis in the property which is subject to depreciation, and are thereby periodically deducted from the taxpayer's gross income. The rate at which this deduction is taken varies. Under the straight line method of depreciation, the cost or other basis of the property less its estimated salvage value is deductible in equal annual amounts over the period of the estimated useful life of the property. "Under the declining balance method a uniform rate is applied each year to the unrecovered cost or other basis of the prop-

113. See id. at 437.
114. Id. at 445.
116. Id. § 167(j) (1976).
117. See supra text accompanying note 93.
120. See Treas. Reg. § 1.167(a)-1(c)(1) (1956).
121. See id. § 1.167(a)-1(b) (1956).
122. Id. § 1.167(b)-1 (1956).
but this deduction "shall not exceed twice the appropriate straight line rate computed without adjustment for salvage." The declining balance method of depreciation, however, is not available unless the original use of such property commenced with the taxpayer after December 31, 1953. As an incentive to preserve an historically significant property, however, the TRA allowed taxpayers to elect to treat for depreciation purposes “substantially rehabilitated historic property” as if the taxpayers were the original users of the property so that they could use accelerated depreciation methods. If the declining balance method of depreciation was elected, the taxpayer was entitled to use a rate not exceeding 150% of the rate which would have been used had the annual allowance been computed under the straight line method for commercial property, and 200% for used residential rental property. If accelerated depreciation was elected by a taxpayer who rehabilitated a noncertified structure, the special rate allowed could not exceed 150% for property where the original use commenced with the taxpayer, and 125% for used residential rental property where the original use did not commence with the taxpayer.

*The Investment Tax Credit Under the Revenue Act of 1978*

In addition to the accelerated tax benefits provided for historic preservation property by the TRA, the Revenue Act of 1978 provided a ten percent investment tax credit for the rehabilitation of buildings over twenty years old. An investment tax credit differs from other tax incentives offered for the rehabilitation of historic preservation property because it is not a deduction from income taken over a period of years. Rather, it directly reduces the tax liability of the eligible taxpayer in the year of the expenditure.

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123. *Id.* § 1.167(b)-2(a) (1956). Unrecovered cost is the amount of allowable depreciation not yet taken by the taxpayer as a deduction. *Id.*
124. *Id.* § 1.167(b)-2(a) (1956).
125. *Id.* § 1.167(c)-1(a)(2) (1956).
129. Pub. L. No. 95-600, § 315(b), (d), 92 Stat. 2763, 2828-29 (1978) (adding *I.R.C.* § 48(g) (Supp. III 1979)).
130. *I.R.C.* § 48(g) (Supp. III 1979) (amended 1981). Although this benefit was not specific to property listed in the National Register, most historic structures qualified simply by age.
131. *Id.* § 38(a) (1976); *id.* § 46(a) (1976) (amended 1981); see infra text accompanying notes 237-40.
cause the investment tax credit could not be taken in combination with an election for rapid amortization, it provided an additional consideration for the investor in rehabilitation of historic property in deciding whether to elect accelerated depreciation. This election, together with the ten percent investment tax credit, provided a stimulus for preservation over new construction, as well as a tax shelter for the astute investor.

**Historic Preservation Property as a Tax Shelter**

One main element of a tax shelter is the foregiveness of tax liability through deferral. The larger the amount deferred and the longer the postponement, the more advantageous the shelter. When depreciation is accelerated, the size of the untaxed stream of cash that flows to the investor is greatest in the early years of the deduction. The addition of the investment tax credit yields an even greater up front tax benefit. In combination, the immediate tax benefit to the taxpayer who invests in rehabilitation for preservation can be quite substantial. The investment tax credit alone, however, is limited to only a small percentage of the rehabilitation expendi-


134. Comment, supra note 85, at 498. A tax shelter is a means of reducing tax liability by taking large deductions from income that are generated without the corresponding cash expenditures. Comment, supra note 85, at 498. A real estate tax shelter, particularly, is a mode of assembling capital, a simple device to provide part of the money needed “up front” to finance construction or rehabilitation. A. AXELROD, C. BERGER & Q. JOHNSTONE, LAND TRANSFER AND FINANCE 1092 (2nd ed. 1978) [hereinafter cited as A. AXELROD]. This is known as leverage. Id. at 299. Leverage is particularly important to the real estate investment because the taxpayer can depreciate the entire cost of the investment, including the entire amount of any borrowed money. See Crane v. Commissioner, 331 U.S. 1 (1947). Real estate, unlike certain other investments, is not subject to the “at risk” limitation: that is, a limitation of tax deductions to the amount invested by the taxpayer for which he is personally liable. See I.R.C. § 465(c)(3)(D) (1976); Comment, supra note 85, at 500. One incentive to invest in real estate in general and historic preservation property in particular, therefore, is that the dollar amount of non-recourse loans, i.e., loans for which the taxpayer is not personally liable, can be depreciated or leveraged. A. AXELROD, supra, at 307. In return for their investment, investors expect to receive a stream of tax savings, preferably as large and as early a return as they can get. Id. at 1094. Accelerated depreciation is one way to achieve this goal. It provides large deductions in the early years of the investment and thereby defers tax liability, postponing for as long as possible the payment of the tax on that amount until future sale. Id. at 309. This temporary forgiveness amounts to an interest free loan or government subsidy of the venture. Id. at 1093.

135. A. AXELROD, supra note 134, at 299.
ture. Therefore, the investment tax credit, without the allowable accelerated depreciation, has only limited sheltering possibilities. Thus, it was the highly accelerated depreciation election provided by the TRA that made investment in the rehabilitation of historic preservation property a tax shelter; the ten percent investment tax credit merely added to the benefit.

Tax sheltered income, however, does not escape taxation forever. A reckoning occurs when and if the property is sold. Taxable gain may occur even in the absence of a market profit because the taxpayer is required to reduce his cost basis in property by the amount of allowable depreciation. Gain for tax purposes is measured by the difference between the amount realized and the adjusted basis. Therefore, the amount of that gain is increased to the extent that deductions for depreciation have reduced the basis. Accelerated depreciation, under these circumstances, would seem an unwise election for the investor who might contemplate the sale of an historic property within a short time after rehabilitation. Rate conversion, however, may compensate for this because it allows a taxpayer to convert ordinary income into capital gains. This is favorable to the taxpayer who invests in and keeps depreciable property for more than one year because only forty percent of the gain is includable in gross income and subject to tax. Thus, in 1978, an investor could have acquired an historically significant structure in need of rehabilitation at a depressed price because of its condition. After certification, and with an investment of very little of his own money, he could have rehabilitated the structure and elected either rapid amortization or an investment tax credit together with accelerated depreciation. Then, because it was improved, the structure would probably yield a much higher market price upon sale. Further, because the deduction for accelerated depreciation would permit the

137. An investment tax credit is a desirable tax shelter because it is a deferral, or forgiveness, of tax. The investment tax credit has limited use as a tax shelter, however, because the amount forgiven is limited to only a small percentage of a particular expenditure (e.g., ten percent of the expenditure for the rehabilitation of a qualified structure) rather than the larger deferral derived from the deduction for accelerated depreciation of the entire basis in the structure including the whole rehabilitation expenditure.
138. A. AXELROD, supra note 134, at 300.
140. I.R.C. § 1001 (1976); see A. AXELROD, supra note 134, at 300.
142. Id. § 1202 (1976).
taxpayer to postpone annual taxation at ordinary rates on the tax-
sHELTERED income, upon the sale of the property the larger gain
would be taxed at the gentler capital rates Thus, the investor in
an historic preservation property tax shelter could have enjoyed the
benefit of lower taxes and the use of the tax money saved while pre-
serving and revitalizing the structure for the enjoyment and use of
the entire community.

The Effect of Recapture and Minimum Tax

Tax incentives for the rehabilitation of historic preservation
property present a desirable tax shelter in favor of the investor. This
type of investment receives preferential tax treatment and is
sought after because it can reduce tax liability substantially. The tax
benefits under the TRA for such an investment were somewhat lim-
ited, however, through the interplay of recapture and minimum
taxes. Whether a taxpayer elected rapid amortization, or accelerated
depreciation and the ten percent investment tax credit, the recapture
provisions of the tax code were triggered by sale of the property.
Recapture is the recovery of any amount of amortization or depre-
ciation that exceeds straight line depreciation upon the sale of prop-
erty prior to the end of the functional period for depreciation: that is,
its useful life. Recapture applies to the portion of the taxpayer’s
basis in property which has been adjusted to reflect deductions due
to rehabilitation expenses, or that portion of depreciation taken
above straight line. Any amount recaptured becomes ordinary in-
come to the taxpayer to the extent of the gain on sale and is taxed
accordingly. Conversely, because the ceiling on recapture is the
gain on sale, if there is a loss on sale, there is no recapture. If the
property is held less than one year, a recovery of the full amount
allowable for rapid amortization, accelerated depreciation, or the in-
vestment tax credit will be recaptured as ordinary income.

143. Id. § 1222(3) (1976). This discussion presumes that the investor holds the property
for more than one year.
144. Id. § 1202 (1976); see A. AXELROD, supra note 134, at 300.
146. Id. § 47(a)(1) (1976); id. §§ 1245(a), 1250 (1976) (amended 1981); see infra note
154.
152. Id. § 1221 (1976) (amended 1981); id. § 1222 (1976).
cause taxpayers usually seek to minimize the gain on sale that will be characterized as ordinary income, an owner who is considering the rehabilitation of historic property will consider the disadvantages of recapture in relation to the intended term of ownership.

Over the last few years there has been much concern about high income individuals who are able to eliminate or substantially reduce their tax liability through the use of various tax preferences. One such tax preference is a deduction for accelerated depreciation in excess of straight line. Another tax preference item is capital gain because it is sheltered from full taxation by reason of deduction or special tax rate. In addition to any other tax imposed by the Code, Congress imposed a minimum tax “with respect to the income of every person, a tax equal to 15 percent of the amount by which the sum of the items of tax preference exceeds the greater of—(1) $10,000, or (2) the regular tax deduction for the taxable year.” There is also an Alternative Minimum Tax which is applied to taxable income increased by the amount of capital gain and adjusted itemized deductions. Unfortunately, there is no exception to these add-on taxes for owners of historic property who rehabilitated that property and elected either rapid amortization or accelerated depreciation, both of which were tax preference items under the TRA. Nor is there an exception from Alternative Minimum Tax for the amount of capital gain derived from the sale of a rehabilitated historic structure. Thus, while tax preferences reduce tax liability and function as incentives to preserve historically significant property, the minimum taxes restore a percentage of the taxpayer’s liability each year. Consideration of the effect of recapture and minimum

153. Capital gains treatment under I.R.C. § 1202 (1976) is preferred because only forty percent of the net capital long term gain is taxable.

154. An item of tax preference represents income that is not subject to current taxation because it is temporarily deferred.


156. Id. § 57(a)(9) (1976); Treas. Reg. 1.57-1(b) (1978).


159. Id. § 55(b)(1).

160. See supra note 102. Amortization of deductions under the Internal Revenue Code, I.R.C. § 191 (1976) (repealed 1981), was an item of tax preference for the purpose of the minimum tax to the extent that the deductions exceeded the amount that could have been claimed under straight line depreciation using the actual useful life of the property. Id. § 57(a)(2) (1976) (amended 1981); Treas. Reg. § 1.191-1(a) (1980). If there was no tax benefit to the taxpayer, however, the tax benefit rule, id. § 58(h) (1976), applied and no minimum tax was imposed.
taxes, as well as maximum tax,\(^1\) could make straight-line depreciation preferable to either rapid amortization or accelerated depreciation because it is not subject to recapture or tax preference treatment.\(^2\) Thus, the tax incentives for the rehabilitation of historic preservation property must be accelerated, or at least maintained, if these incentives are to succeed in their purpose.

**Demolition of Historic Properties Under the TRA**

Prior to 1976, an historic preservation property designated for demolition was given no special consideration, except where its historical significance had to be considered because the project was federally funded.\(^3\) An owner could demolish the structure without fear of any tax penalties or loss of tax benefits incorporated into the Code to encourage new construction.\(^4\) After the TRA, however, an owner who wanted to demolish a certified historic structure or a structure within an historic district without incurring tax penalties had to establish certification of nonsignificance.\(^5\) There was a presumption that every structure that was certified or located within a registered historic district was, in fact, significant.\(^6\) If the Secretary of the Interior made a finding of nonsignificance, however, the owner would no longer be subject to any tax penalty associated with the demolition of an historic structure.\(^7\) On the other hand, if certification of nonsignificance was not granted, the owner was denied any deduction for the expense of demolition.\(^8\) An owner who demolished a

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161. Beginning with the 1982 tax year, the maximum tax rate on all income is fifty percent. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 101(a), 95 Stat. 176 (amending I.R.C. § 1). Prior to the 1982 tax year, however, the maximum tax of fifty percent applied only to income from personal services. I.R.C. § 1348 (1976) (repealed 1981). This included earned income from salary, wages, fees, and certain pension and annuity income. Id. § 1348(b)(1) (1976) (repealed 1981). Maximum tax sheltered personal service income only if that income, by itself, was taxable at rates exceeding fifty percent. The sum of a taxpayer's tax preference items, other than the capital gains deduction, therefore, reduced, dollar for dollar, the amount of total income eligible for maximum tax. Thus, for the taxpayer in the above fifty percent bracket, either the election for rapid amortization or accelerated depreciation (both tax preference items) could have reduced the benefit of the maximum tax. This undesirable consequence of the maximum tax could have reduced the value of the tax incentives for historic preservation.

162. See Day, supra Note 73, at 329-34 & 333 n.147.


166. Id.

167. Id.

168. Id.
certified historic structure had to capitalize the cost just as with any other nondeductible item. Capitalization of the cost of demolition meant that the expense was chargeable to the land on which the structure was located. It thereby increased the owner's basis in land which might reduce any gain (or increase any loss) upon future sale of the property. In effect, therefore, a benefit still accrued to the owner who demolished a certified historic structure. This deferred benefit merely reduced the hardship of the tax penalty to some extent. It did not eliminate its effect as a disincentive to demolition of certified historic structures. Moreover, after the passage of the TRA, if an owner demolished a certified historic structure, and then built a new structure on the site of the destruction, he was barred from taking any more than straight line depreciation on the replacement structure. The loss of the use of accelerated depreciation for the replacement structure was financially significant and may have dissuaded many owners from demolishing certified historic structures.

The TRA: Effect, Proposals, and Criticisms

The tax incentives for historic preservation and the tax disincentives to demolition established by the TRA accelerated and expanded historic preservation activities in the private sector considerably. Within the first two-and-one-half years of operation of the tax incentives for rehabilitation of historic structures, the Department of the Interior approved restoration projects in forty-one states, representing a private investment of more than $400 million. State participation in historic preservation has been varied and responsive to individual needs. At the same time, state programs have been a testament to the preservation movement. Nearly every state has granted power to local governments to preserve historic resources through zoning and the establishment of historic districts. A small but growing number of states require conservation of historic resources to be provided for in comprehensive local land-use plans.

171. Day, supra note 73, at 337.
172. Comment, supra note 112, at 437 & n.15.
174. Id.
175. Id.
176. Id.
177. Id. at 591.
Conservation of historic property has even been included as a goal in some state constitutions. This partnership between the federal government and the states has generated about 20,000 new listings in the National Register that are potentially eligible for federal tax incentives. Thus, the effects of the TRA are only beginning to be felt. In a recent study, completed for Congress by the Heritage Conservation and Recreation Service (HCRS), it was reported that ninety-three percent of those responding to a questionnaire about tax law and tax treatment of historic property believed that federal tax incentives and disincentives bring about an "increased awareness and interest in the preservation of existing building stock." It is hoped that this trend will continue.

A host of proposals for increased tax incentives have been made at various times, primarily in the context of housing rehabilitation, that also may be useful in the preservation effort. These include an investment tax credit for the purchase of an historic structure, "deferred taxation of the gain generated by a sale of restored property to the extent that proceeds are used to purchase or restore other similar property," greater use of component depreciation—that is, depreciation applied separately to the various parts of

178. Id. at 592. Mantell points out that state constitutions have provisions for historic preservation that fall into three basic categories:
—Declarations of a right to a decent environment with a corresponding duty to conserve and maintain the environment (Illinois, Massachusetts, Pennsylvania, Rhode Island, Texas);
—Statements that the development and preservation of a decent environment is a public policy (Alaska, Florida, Georgia, Louisiana, Massachusetts, New York, North Carolina, and Virginia);
—Financial sections, such as tax exemptions, to promote a decent environment (Georgia, New York, Virginia).


181. The passage of the Economic Recovery Tax Act of 1981 together with the "written consent" provision required by the National Historic Preservation Act Amendments of 1980 for listing in the National Register may have endangered this trend. See infra text accompanying notes 213-55.

182. Comment, supra note 85, at 508 n.226 (citing Caplin, Preservation and Taxation, Preservation News, May 1976, at 9, col. 1 (published by the National Trust for Historic Preservation)).

183. Shull, supra note 2, at 411.

184. Comment, supra note 85, at 508 n.226 (quoting Caplin, supra note 182, at 9, col. 1).
a building such as the shell, wiring and plumbing, heating and air conditioning, and roofing and fixtures, an income tax imposed if certain levels of maintenance are not maintained or the structure is destroyed, "[d]isallowance of depreciation deduction to the extent that some portion of the amount deductible is not spent on maintenance," and "[a] special maintenance deduction for . . . repairs that would normally be considered capital improvements." The desired changes most frequently cited, however, are proposals to reduce recapture and to extend a tax credit for rehabilitation to resident-owners of historically significant homes.

One criticism of the use of tax incentives for historic preservation is that the individuals who benefit most tend to be those in the high tax brackets. It is true that in a graduated tax system, those in higher income tax brackets reap proportionately greater benefits from a tax deduction than those in lower brackets. To this extent, tax incentives for historic preservation can be viewed as a tax shelter or a tax subsidy for high income taxpayers. The benefit to the investor who is in a high income bracket, however, is not necessarily a detriment to low income residents in the affected urban area. Preferential tax treatment for historic preservation investment may actually encourage private owners and developers to adapt and restore

185. Carlin & Engelberg, The American Phoenix—New Incentives for Old Buildings, 7 J. REAL EST. TAX’N 241, 256 (1980). There are advantages that may result from the use of component depreciation. Since straight line depreciation is used with respect to each component, there is no recapture of excess depreciation upon sale or disposition of the building nor is there any minimum tax consequence because no tax preference items are generated. The greatest advantage of component depreciation is that a shorter overall useful life may result for separate components of a building than if one composite life was claimed for the entire building. See id. at 256-57. This was eliminated under the Accelerated Cost Recovery System (ACRS) of the Economic Recovery Tax Act wherein composite depreciation is required for the entire structure. But see I.R.C. § 168(f)(1)(c) (West Supp. 1981) (where taxpayer makes substantial improvements to qualified structure, improvement treated as separate structure rather than as one or more components).

186. Powers, supra note 3, at 133.

187. Comment, supra note 85, at 509 n.226 (quoting Caplin, supra note 182, at 9, col. 1).

188. Id. at 508 n.226 (quoting Caplin, supra note 182, at 9, col. 1). But see Jones v. Comm’r, 242 F.2d 616 (5th Cir. 1957) (tax court failed to distinguish between deductible repair and capital expenditures).

189. Oldham, supra note 180, at 72; see also HOUSE REPORT, supra note 19, at 24, reprinted in 1980 U.S. CODE CONG. & AD. NEWS, supra note 19, at 6387 (denial of federal tax benefits for residential historic properties not used in commerce noted as severe limitation to preservation and rehabilitation efforts).

190. Powers, supra note 3, at 132.

191. Comment, supra note 85, at 500-05, 515.
deteriorating structures that might otherwise be totally lost. Therefore, while some low income residents of neighborhoods eligible for historic preservation benefits may necessarily be displaced, others would be benefited by better housing and improved environments. Moreover, despite any estimated loss of tax revenue resulting from deductions by investors in high tax brackets, the increased conservation activity ultimately creates a net increase in the total tax revenue.\footnote{192} This increase in revenue is in part generated by the tax yield from the upgraded buildings and in part by the employment and sales that occur in the process.

Tax incentives that encourage large investments in rehabilitation of historic structures sometimes result in making districts fashionable, expensive, and outside the reach of the poor.\footnote{193} When rehabilitation results in higher rents, many relatively poor persons may be displaced.\footnote{194} Accordingly, it would seem that tax incentives for historic preservation are themselves regressive and contrary to sound social policy. Specific tax incentives provided by the TRA,\footnote{195} however, have resulted in the creation of almost 4,000 low and moderate income rental housing units.\footnote{196} Further, designated urban historic districts are often in areas that are transitional or have already become slums. Such properties are often easy to purchase individually because they are inexpensive. Low acquisition costs, however, all too often indicate that extensive rehabilitation is necessary to preserve the structure. An individual owner might find the cost of such rehabilitation too high to sustain without at least the benefit of substantial tax deductions.\footnote{197} Private investment, therefore, must be encouraged if urban redevelopment of declining neighborhoods is to be an ongoing process and if historic structures are to be preserved as

\footnote{193. Powers, supra note 3, at 132.}
\footnote{194. Comment, supra note 85, at 513 n.241; see Newsom, Blacks and Historic Preservation, 36 Law & Contemp. Prob. 423, 423 (1971).}
\footnote{195. I.R.C. § 167(k) (1976). This allows the taxpayer to elect to compute the depreciation deduction attributable to rehabilitation expenditures incurred with respect to low-income rental housing under the straight line method using a useful life of 60 months and no salvage value.}
\footnote{196. Jandl, supra note 179, in Historic Preservation Law, supra note 173, at 727. Statistics on proposed and completed work certified or pending certification show that 3,713 low and moderate income units were created through HCRS programs involving the TRA as of August 16, 1980. Id.}
part of a neighborhood stabilization strategy. The preservation of one such structure, by one individual who is willing to make a large investment in a decaying but historically significant structure, may change the attitude of other owners and buyers toward investing in that area. It may also increase the confidence of lending institutions to support projects in what otherwise would be a high-risk area. \textsuperscript{198} Thus, if the tax incentives for the preservation of historic property are what make rehabilitation of those structures economically feasible for private investors, then the federal taxing power must continue to be used to encourage historic preservation. Any benefit to the private investor would indirectly aid the conservation of existing commercial and housing stock and assist in the regeneration of urban communities.

Since 1976, tax incentives for historic preservation have caused a “profusion of preservation organizations in towns and cities of all sizes. . . . [C]urrent estimates are that over 2 million Americans are supporting preservation interests through organizational memberships.” \textsuperscript{199} An increasing number of individual citizens have invested money and personal effort in the preservation and rehabilitation of deteriorated properties in marginal areas of towns and cities, as well as areas that were once considered blighted and undesirable. “There are about 20,000 listings in the National Register now and 10 percent of these are historic districts. It is estimated that 700,000 to 1 million buildings are included in the National Register listings.” \textsuperscript{200} Yet, only eighteen percent of the over fifteen hundred projects in forty-six states that were reviewed by HCRS, as of November, 1979, \textsuperscript{201} involved any federal subsidies other than accelerated tax benefits.\textsuperscript{202} Thus, in over eighty percent of the projects where no other federal assistance was involved, the owners or developers have deemed it worthwhile to pursue the tax incentives provided by the TRA.\textsuperscript{203} This indicates both the broad applicability of the tax write-

\textsuperscript{198} Comment, supra note 85, at 512 n.238 (“Through the practice of redlining, banks have sometimes refused to give loans to owners of property in ‘high risk’ neighborhoods, regardless of the credit characteristics of the individual owners.”). \textit{See generally} Galbreath, \textit{Conservation: The New Word for Old Neighborhoods}, 8 CONST. L. REV. 312, 313 (1976).


\textsuperscript{200} Oldham, supra note 179, \textit{reprinted in} JandI, supra note 179, in \textit{HISTORIC PRESERVATION LAW, supra note 173, at 733.}

\textsuperscript{201} Oldham, supra note 179, \textit{reprinted in} Jandl, supra note 179, in \textit{HISTORIC PRESERVATION LAW, supra note 173, at 732.}

\textsuperscript{202} \textit{Id.}

\textsuperscript{203} \textit{Id.}
offs and the fact that planners are intrigued by the uses and other benefits this strategy may permit. "New uses for these structures vary widely, but fully 60 percent of these projects involve housing units. Eighty percent of the total number of units are new ones and 25 percent of them are for low- and moderate-income occupants."204

Prior to this increase in interest, however, historic preservation was often resisted. It is estimated that between 1933 and 1970, over one-half the landmarks listed in the Historic Building Survey were demolished.205 Many individuals and programs were hampered by the severe limitation of available grants, and the inability to obtain loans for both acquisition and improvement, or repair and maintenance. Without tax incentives historic buildings were threatened and often destroyed where there was a "low-density use in . . . location[s] which demand[ed] a higher-density use."206 All too often sound buildings, often landmarks, were demolished in order to reduce the expense of maintenance and taxes.207 Even today, when the available tax incentives are not great enough to make preservation of historic structures economically feasible, buildings are destroyed and the sites are land banked as parking lots208 to be used for new construction when the opportunity is ripe.209 Historic preservation legislation beginning in 1966 may have been effective in encouraging, advising, and guiding the preservation effort;210 but without the aid of tax incentives to encourage the private sector to invest in historic property, the NHPA remains severely limited.211

THE NHPA AMENDMENTS OF 1980

Today, historic preservation is a conservation effort. It incorporates many important national priorities including

the need to conserve energy resources, to fight inflation, to revi-
ize our cities and to provide more opportunities for local employment. Recent studies have shown that historic preservation contributes to greater housing supply, increased tax revenues, new business starts, growth in retail sales, expanded tourism and convention activity, and increased public and private investments.

Throughout the country, adaptive use of historic structures and rehabilitation of historic districts have proved to be not just a source of local pride but a means of helping local economies and saving energy.

Historic preservation does not inhibit appropriate development. It is, rather, a partner, one that has proven its effectiveness. The time is now to build on its successes, to learn from its experience.

The NHPA Amendments of 1980 provide an important link between historic preservation policies and national community development goals. The amendments attempt to provide definition and guidance for the national preservation programs begun under the NHPA. They reauthorize the Historic Preservation Fund through 1987 at $150 million annually, expand the role of local governments in the certification process of the program, and revise the structure of the Advisory Council.

Perhaps the most controversial provision, however, is the new requirement for owner notification and concurrence before a property may be included in the National Register or designated as National Historic Landmarks. Unless the nomination of a non-federal property is accompanied by a statement in writing from the nominating authority that the owner consents to the inclusion, the Secretary may not include the property in the National Register. This provision was not meant to affect local laws or discourage certification of historic property. Rather, it was meant as a protective...

212. HOUSE REPORT, supra note 19, at 21, reprinted in 1980 U.S. CODE CONG. & AD. NEWS, supra note 19, at 6384; see Fowler, supra note 20, at 3.
216. Id. § 101(a)(6), 94 Stat. 2989. The requirement of consent seems illogical because an owner's attitude has nothing to do with the historic character of the property. Yet, federal tax incentives and disincentives depend upon listing in the National Register. See supra notes 44, 57 and accompanying text. An owner's decision to consent, therefore, may be based on a tax strategy. The written consent requirement, however, may be a legislative response to involuntary preservation. Or it may be a legislative response to any claim to compensation for "taking." See generally Day, supra note 73, at 315-28 (discussing "taking" issue).
control in the face of state and local zoning powers.\textsuperscript{217}

Contrary to legislative expectations, however, the written consent requirement of the 1980 Amendments may have a negative effect on historic preservation. The National Register, intended as a planning tool to help identify property that may receive federal assistance, does not by itself restrict what a private owner can do with property. Other federal, state, and local laws that may be restrictive, however, are triggered automatically by National Register listing.\textsuperscript{218} Therefore, the written consent requirement may serve to protect private property owners from federal, state, and local restrictions only if consent is withheld. The owner who withholds consent, however, is also ineligible for the tax incentives provided for certified historic structures. The property owner who seeks to avoid regulation by withholding consent, but who might otherwise have invested in rehabilitation, may find the cost of rehabilitation too high without federal tax incentives. He or she may demolish the structure and take accelerated depreciation on the replacement structure, as well as a deduction for the cost of the demolition, without incurring any penalty. In short, the written consent provision of the 1980 Amendments to the NHPA may inadvertently controvert the purpose of the tax incentives and disincentives provided by the TRA, and thereby operate to encourage demolition.

Despite this possibility, Congress claims that many incentives\textsuperscript{219} make it "doubtful that in the future many owners would object to having their properties included on the National Register."\textsuperscript{220} This optimistic speculation ignores the impact that even one owner may have on historic preservation. In 1980, for example, the House appropriations bill that included the allocation of money to HCRS for preservation stipulated that none of that money could be used to cre-


\textsuperscript{219} As an incentive for property to be listed in the National Register, the NHPA Amendments of 1980 promise to increase federal grants and insured loans. But, these may be deferred for budgetary reasons. [1980] 8 Hous. & Dev. Rep. (BNA) No. 30, at 611, 615 (Dec. 22, 1980).

ate landmarks of industrial buildings without owner consent. This was the result of one owner's desire not to be listed. Historic significance alone, regardless of the owner's wishes, should be the criterion for listing in the National Register if the National Register is to continue to be useful for preservation. The goals of the NHPA should not be limited by one individual attempting to maximize profits at the expense of the entire community. Because written consent is now required for listing in the National Register, however, federal tax incentives for historic preservation have become more important than ever.

THE ECONOMIC RECOVERY TAX ACT OF 1981: A STEP BACK

The Economic Recovery Tax Act of 1981 (ERTA) significantly revised the tax incentives for historic preservation first enacted in the TRA. The new law provides a twenty-five percent investment tax credit for the rehabilitation expense of structures, industrial, commercial, or residential rental, that are certified as historic by the Secretary of the Interior. This can be combined with a fifteen year accelerated cost-recovery period for depreciation of the structure. For certified historic structures, the basis in the structure will not be reduced by the amount of the investment tax credit. When combined with the twenty-five percent investment tax credit, depreciation on the structure is limited to straight line. To qualify for the increased investment tax credit the rehabilitation must be substantial and the expenditure must occur after Decem-

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221. Oldham, supra note 180, at 72.
222. Id.
223. Id. at 73.
230. Id. § 48(g)(5)(A) (West Supp. 1981). Such a reduction is made, however, for other property. Id. The Accelerated Cost Recovery System (ACRS) replaces the class life (ADR) system of depreciation for property placed in service after 1980. Under ACRS, the cost of eligible historic preservation property is recovered over a fifteen year statutory recovery period (previously called useful life for depreciation purposes). Id. § 168(c)(2)(D) (West Supp. 1981).
232. A building has been substantially rehabilitated if the expenditures during the 24 month period ending on the last day of the taxable year exceed the greater of either the ad-
ber 31, 1981.233

The effect of the ERTA on existing tax incentives for preservation, and disincentives for demolition, is even more significant. The five-year rapid amortization provision,234 the accelerated depreciation provision,235 and the denial of accelerated depreciation for any replacement structure on the site of a demolished historic structure, have all been repealed.236 In fact, every major tax reform provided by the TRA to encourage historic preservation has been repealed by the ERTA. Just when historic preservation seems to depend most on a tax strategy for survival, the ERTA has limited the federal tax incentives for preservation to an increased investment tax credit, with its inherent limitations, and has repealed, without replacement, the major disincentive to demolition.

An investment tax credit differs from other tax incentives for historic preservation because it directly reduces the tax liability of the eligible taxpayer.237 If the owner of preservation property elects this benefit, he reduces the amount of money he pays the federal government in taxes at the end of the tax year in which the expense occurs by subtracting twenty-five percent of the rehabilitation expense from the net tax liability.238 Of course, if the credit is greater than the amount owed, the benefit can be spread over more than one year.239 Some investors prefer an investment tax credit because it reduces their tax liability dollar for dollar in the first year of the

233. A combination of the old and the new tax laws results where the expenditures occur both before and after the effective date of the ERTA. The increased investment tax credit applies only to rehabilitation expenditures incurred after December 31, 1981 in tax years ending after that date. Where expenditures are incurred before and after December 31, 1981, the pre-December 31, 1981 expenses can qualify for either the ten percent investment tax credit for the expenses of rehabilitating an over twenty year old building, id. § 46(a)(2)(A) (1976) (amended 1981), or the five year rapid amortization election for the rehabilitation of a certified historic structure. Id. § 191 (1976) (repealed 1981). Expenditures that occur after December 31, 1981 can qualify for the 25 percent investment tax credit for the rehabilitation of certified historic structures. Id. § 48(g)(2)(A) (West Supp. 1981).
235. Id. (repealing I.R.C. § 167(o)).
236. Id. (repealing I.R.C. § 167(n)).
237. See supra note 131.
238. See id.
expense, while other tax incentives, such as an election for rapid amortization, and even accelerated depreciation, are deductions from gross income that reduce only the net taxable income over a period of years.\textsuperscript{240}

Investment tax credits, however, are not always the panacea that they seem. While the ERTA attracts the investor to a more immediate benefit than those provided for in the TRA, in actuality the benefit is a kind of loan conditioned upon retention of the property. To qualify for this special benefit, the historic preservation property must be held for five years in order for the taxpayer to keep the full amount of his benefit.\textsuperscript{241} If the property is held for less than one year, the credit taken is added back onto tax liability.\textsuperscript{242} If the property is held for more than one, but less than five years, the investment tax credit is recaptured by the I.R.S. on a sliding scale depending upon how long the taxpayer actually holds the property.\textsuperscript{243}

The advantage of the investment tax credit may lose some of its impetus when viewed in light of the five-year holding period required for maximum benefit. For example, assume $A$ has a $10,000 rehabilitation expenditure on a certified historic structure and that she is in the fifty percent tax bracket. Under the ERTA, if $A$ elects to take a twenty-five percent investment tax credit, she simply deducts $2,500 from her tax liability at the end of the tax year in which the expense occurs. Prior to the ERTA, however, $A$ might have elected rapid amortization. The same $10,000 expenditure (under the TRA) would have been amortized over five years, creating a $2,000 deduction from gross income each year. $A$'s tax savings would have been $1,000 per year for five years for a total of $5,000. Although $A$'s benefit in the first year would have been only $1,000, in order to keep the full $2,500 benefit that the twenty-five percent investment tax credit would yield, $A$ would have to hold the property for the full five years. At the end of five years, the investment tax credit would amount to only one-half the tax benefit $A$ would have accrued taking rapid amortization under the TRA. Yet, some investors prefer the

\textsuperscript{240} See supra text accompanying notes 99 & 115.
\textsuperscript{242} Id.
\textsuperscript{243} If the property is disposed of within one full year after being placed in service, the recapture percentage is 100%; between one and two years, the recapture percentage is 80%; between two and three years, the recapture percentage is 60%; between three and four years, the recapture percentage is 40%; between four and five years, the recapture percentage is 20%; after five years there is no recapture. Id. § 47(a)(5) (West Supp. 1981).
smaller, but more immediate return provided by an investment tax credit to the larger return that rapid amortization would produce. It can provide the investor with both ready cash to finance new investments and a hedge against inflation. If the rate of inflation is curbed or reversed, however, and tomorrow's dollar emerges stronger, then the $5,000 total benefit over five years that A could have elected under the TRA might have been worth much more than twice the maximum benefit of the investment tax credit under the ERTA. Thus, the repeal of rapid amortization and its replacement with an increased investment tax credit by the ERTA could work to reduce the incentive to invest in historic preservation property. Under these circumstances, the ERTA may halt, or even reverse, the trend to encourage private investment in historic preservation property.

A decision to rehabilitate a certified historic structure may depend upon a variety of economic circumstances. These circumstances include such variables as the cost of the rehabilitation, the amount of time over which a deduction or credit can be taken and when that period begins, the length of time ownership is intended, the size of the basis in the property that is affected, the location of the building and its potential income, as well as the nature and amount of the taxpayer's other income, including any other investment tax credits the taxpayer may have, and the effect of recapture and minimum taxes. Generally, however, when a taxpayer has owned a structure for many years, his adjusted basis is likely to be quite low because of depreciation already taken and a low purchase price. Prior to the ERTA, this taxpayer probably would have elected rapid amortization of the expenditure over a five-year period. Similarly, a taxpayer with a high basis in his property and a large rehabilitation expenditure probably would have elected accelerated depreciation together with the ten percent investment tax credit because the net benefit over the same time period probably would have been greater. The accelerated depreciation allowance for the rehabilitation of a certified historic structure, however, under the ERTA is equal to, but no greater than, the depreciation allowable for noncertified structures. Further, accelerated depreciation is no longer available if the increased investment tax credit is elected.

The ERTA does make available, however, an increased investment tax credit for the rehabilitation of noncertified structures:

244. See supra text accompanying notes 147-62.
fifteen percent for buildings over thirty years old,247 and twenty percent for buildings over forty years old.248 Most historically significant structures, because of their age, would qualify for the twenty percent investment tax credit. All other benefits being equal, the ERTA provides a viable alternative to owners or developers who want to avoid listing in the National Register. In addition, there is also a ceiling on the amount of investment tax credit that can be taken by a taxpayer in any one year.249 Although the benefit of an investment tax credit may be carried forward,250 this defeats, to a considerable extent, the primary benefit of the investment tax credit: immediacy. Thus, unless an investor finds that the increased investment tax credit adequately compensates him for the expense of rehabilitating and maintaining a certified historic structure according to Department of Interior standards, he may either withhold consent to listing, or not rehabilitate at all.

One preservationist has said that with the increased investment tax credit historic preservation should become the “‘biggest game in town.’”251 Another has claimed that the ERTA “should provide a major impetus to capital investment in historic buildings and spur revitalization of historic neighborhoods.”252 These expectations, however, may be even more optimistic than Congress’ optimistic assumption that if given the choice, people would surely consent to listing in the National Register.253 For despite the increased investment tax credit, conservation efforts are expected to be opposed by developers, particularly in high density residential communities and thriving commercial areas.254 As a result of the changes brought about by the ERTA, historic preservation may be more vulnerable to private interests and expediency than ever before. Although certain state and local programs for historic preservation may provide partial compensation for the regressive federal tax changes, these programs are inconsistent and vary from one locality to the next.255 It is questionable, therefore, whether the new federalism can adequately

248. Id.
250. Id. § 46(b) (West Supp. 1981).
252. Id. at 19.
253. See supra text accompanying notes 219-20.
254. Holubowich, supra note 251, at 20.
255. See supra note 173 and accompanying text.
compensate for the loss of the tax incentives for historic preservation and the disincentive to demolition that was available under the TRA.

CONCLUSION

Historic preservation is not stasis. Rather, it is a dynamic conservation movement compelling our attention as a vital recycling strategy. It depends for success on the adaptive re-use of the nation's built environment. In a competitive market of housing and community development, federal tax incentives are vital to the economic feasibility of investment in the rehabilitation of historic preservation property. In the process of revitalizing structures and neighborhoods of historic significance, Americans have discovered that preservation is not incompatible with meeting current needs for employment, economic growth, and housing. Even tax revenues have grown because of the increased activity and the revitalization in otherwise marginal areas. If the federal government does not use its taxing power to encourage the private sector to invest in historic preservation, the nation may lose a large part of its valuable commercial and housing stock.

Through the enactment of a series of tax incentives and disincentives beginning in 1976, Congress clearly expressed its favor of the conservation and rehabilitation of existing historic structures. While this attitude was first expressed by the passage of the National Historic Preservation Act of 1966, it was the Tax Reform Act of 1976 that first provided tax incentives for the rehabilitation of certified historic structures. Rapid amortization of the expenditure, or in the alternative accelerated depreciation, up to 200 percent for rental residential structures, was allowable for the rehabilitation of historic preservation property. At the same time, the TRA provided tax penalties to discourage demolition of historic structures that could be revitalized and adopted for our immediate appreciation and use. By 1978, the Revenue Act had made a ten percent investment tax credit available to those who elected accelerated depreciation on a qualified rehabilitation. In addition, in order to encourage taxpayers who could not individually maintain certain historic buildings, the Code allowed a deduction for the donation of a whole or partial interest in an historically important property to an organization dedicated to conservation.

The passage of the Economic Recovery Tax Act of 1981, however, endangers historic preservation because investors who might otherwise have invested in the rehabilitation of historic structures
may no longer find it economically feasible to do so. Although the increased investment tax credit offered for the rehabilitation of a certified historic structure is attractive, the investment tax credits and the accelerated depreciation benefits that can accrue to owners of property not burdened by listing in the National Register may be equally, or even more, attractive. Moreover, the ERTA repeals both the major tax incentives for preservation and the major tax disincentive for demolition. In doing so, the ERTA may have restored to the owner of historic property already listed in the National Register the pre-TRA incentive to demolish rather than rehabilitate. While demolition may be economically progressive from the perspective of investors and developers, as evidenced by the wholesale destruction of historic property prior to the NHPA, it is certainly retrogressive from the point of view of the proponents of historic preservation. To insure the choice of investment in historic preservation property, more, not less, federal tax incentives should be provided.

_Miriam Joels Silver_